Independent auditor's report
on the consolidated financial information of
PJSC Sovcombank
and its subsidiaries
for the year ended 31 December 2017

April 2018

Independent auditor's report
on the consolidated financial statements of
PJSC Sovcombank

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Independent auditor's report

To the Sole Shareholders and Supervisory Board

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of PJSC Sovcombank (the Bank) and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for 2017, and notes to the consolidated financial statements and 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 31 December 2017, its consolidated financial performance and its consolidated cash flows for 2017 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 consolidated financial statements in the Russian Federation, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. 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 Consolidated 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 consolidated 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 our audit addressed the matter
Allowance for impairment of loans to customers	
The appropriateness of allowance for impairment of loans to customers is a key area of judgment for the Group's management. The identification of impairment and the determination of the recoverable amount involve a high level of subjectivity, the use of assumptions and analysis of various factors, including the analysis of the customer's financial position and expected future cash flows. The Group's management approach to assessing and managing credit risk is described in Note "Risk management" to the consolidated financial statements. The use of various models and assumptions may significantly affect the estimates of the allowances for impairment of loans to customers. Due to the significance of the loans to customers and the subjectivity of judgment, the estimation of the allowance for impairment was a key audit matter.	We focused on identification of impairment signs, which may be different for different types of products and customers. We analyzed the loan loss allowance assessment methodology on the basis of the collective impairment assessment. We also paid attention to significant individually impaired loans, as well as loans mostly exposed to the risk of individual impairment. Our audit procedures included testing of controls over the process of creating an allowance for loans to customers, review of the methodology, testing of input data, analysis of assumptions used by the Group to perform collective assessment for impairment, and the assessment of adequacy of allowances for individually impaired loans. In the course of our audit procedures, we analyzed the consistency of the management assumptions used to assess the economic factors and statistical information on losses incurred and amounts recovered and their compliance with the generally accepted practices, our professional judgment and information available in the market. We analyzed data disclosed in Notes "Loans to customers" and "Risk management" to the consolidated financial statement.
Fair value of financial assets not quoted in active markets	
The Group invests in various types of financial assets recognized in the consolidated statement of financial position at fair value as at the reporting date. The significant part of financial assets recognized at fair value are not quoted in an active market and are classified within Level 2 and Level 3 of the fair value hierarchy. Methods and unobservable inputs used in the fair value measurement of unquoted and illiquid investments may be of a subjective nature and based on various price driver assumptions. Various methods and assumptions may significantly affect the fair value measurement. Due to significance of judgment and the potential effect on the consolidated financial statements, we considered the fair value measurement of financial assets not quoted in active markets to be one of the key audit matters.	Our audit procedures included testing of controls over the process of the fair value measurement of assets by the Group's management. Audit procedures included restatement and analysis of assumptions used to verify fair value of assets on a selective basis. We analyzed information disclosed in Notes "Financial instruments at fair value through profit or loss" and "Fair value of financial instruments" to the consolidated financial statements.

Other information included in the 2017 Annual report of PJSC Sovcombank

Other information consists of the information included in the Annual report of PJSC Sovcombank for 2017, other than the consolidated financial statements and our auditor's report thereon. Management is responsible for other information.

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

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

Responsibilities of management and the Supervisory Board for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these 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.

Supervisory Board is responsible for overseeing the Group's financial reporting process.

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

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

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

- Identify and assess the risks of material misstatement of the 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our 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 Supervisory Board 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 Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and have communicated with it 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 Supervisory Board, 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.

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

Management of the Bank is responsible for the compliance by the banking group, where the Bank is the parent credit institution (hereinafter, the "Banking Group") with the mandatory prudential ratios established by the Central Bank of the Russian Federation (hereinafter, the "Bank of Russia") and for the conformity of internal control and organization of the risk management systems of the Banking Group with the requirements set forth by the Bank of Russia in respect of such systems.

In accordance with the requirements of Article 42 of Federal Law No. 395-1 of the Russian Federation *Concerning Banks and Banking Activities* of 2 December 1990 (hereinafter, the "Federal Law"), during the audit of the Group's consolidated financial statements for the year ended 31 December 2017, we determined:

1) Whether the Banking Group complied as at 1 January 2018 with the obligatory ratios established by the Bank of Russia.
2) Whether internal control and organization of the risk management systems of the Banking Group conformed to the requirements set forth by the Bank of Russia for such systems in respect of the following:
   - subordination of the risk management departments;
   - the existence of methodologies, approved by the Bank's respective authorized bodies, for detecting and managing risks that are significant to the Bank and for performing stress-testing; the existence of a reporting system at the Bank pertaining to its significant risks and capital;
   - consistency in applying and assessing the effectiveness of methodologies for managing risks that are significant to the Bank;
   - oversight performed by the Supervisory Council and executive management of the Bank in respect of the Bank's compliance with risk limits and capital adequacy requirements set forth in the Bank's internal documents, and effectiveness and consistency of the application of the Bank's risk management procedures.

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

The findings from our work are provided below.

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

We found that the values of the obligatory ratios of the Banking Group as at 1 January 2018 were within the limits established by the Bank of Russia.

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

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

- We found that in accordance with the legal acts and recommendations issued by the Bank of Russia, as at 31 December 2017, the Bank's internal audit function was subordinated and accountable to the Supervisory Board and the Bank's risk management departments were not subordinated and accountable to the departments that take relevant risks.

- We found that the Bank's internal documents effective as at 31 December 2017 that establish the methodologies for detecting and managing credit, market, operational and liquidity risks, that are significant to the Banking Group, and stress-testing have been approved by the Bank's authorized bodies in accordance with the legal acts and recommendations issued by the Bank of Russia. We also found that, as at 31 December 2017, the Bank had a reporting system pertaining to credit, market, operational and liquidity risks that were significant to the Banking Group and pertaining to its capital.

- We found that the frequency and consistency of reports prepared by the Bank's risk management departments and internal audit division during the year ended 31 December 2017 with regard to the management of credit, market, operational and liquidity risks of the Banking Group complied with the Bank's internal documents, and that those reports included observations made by the Bank's risk management departments and internal audit division in respect of the effectiveness of relevant risk management methodologies as well as recommendations on their improvement.

- We found that, as at 31 December 2017, the authority of the Supervisory Board and executive management bodies of the Bank included control over compliance of the Banking Group with internally established risk limits and capital adequacy requirements. For the purpose of control over the effectiveness and consistency of the risk management procedures applied by the Bank during the year ended 31 December 2017, the Supervisory Board and executive management bodies of the Bank regularly reviewed the reports prepared by the Bank's risk management departments and internal audit division, and the measures suggested to address the findings.

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

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

G.A. Shinin
Partner
Ernst & Young LLC

3 April 2018

Details of the audited entity

Name: PJSC Sovcombank
Record made in the State Register of Legal Entities on 1 September 2014, State Registration Number 1144400000425.
Address: Russia 156000, Kostroma, prospect Tekstilshchikov, 46.

Details of the auditor

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

Consolidated statement of comprehensive income
for the year ended 31 December 2017

	Notes	2017 RUB MM	2016 RUB MM
Interest income	6	68,723	63,477
Interest expense	6	(34,482)	(34,831)
Obligatory deposit insurance		(1,263)	(901)
Net interest income		**32,978**	**27,745**
Allowance for loan impairment	11	(4,438)	(4,687)
Net interest income after allowance for loan impairment		**28,540**	**23,058**
Fee and commission income	7	20,282	13,921
Fee and commission expense	8	(2,232)	(1,146)
Net fee and commission income		**18,050**	**12,775**
Net gain on financial instruments at fair value through profit or loss		11,567	16,039
Net gain on available-for-sale assets		1,067	–
Net foreign exchange gain	9	2,670	466
Other impairment, provisions and expenses attributable to non-controlling interests	14	(2,718)	(1,362)
Share of profit in car leasing joint venture		126	145
Other operating income	10	1,725	5,140
Operating income		**61,027**	**56,261**
Revaluation of buildings and investment property		(78)	6
Personnel expenses	12	(13,397)	(7,955)
Other general and administrative expenses	13	(10,893)	(6,662)
Profit before income tax expense		**36,659**	**41,650**
Income tax expense	15	(7,088)	(8,043)
Profit for the year		**29,571**	**33,607**
Profit for the year attributable to:			
- shareholders of the Bank		29,571	33,558
- non-controlling interests		–	49
Other comprehensive income			
Other comprehensive income to be reclassified subsequently to profit or loss when specific conditions are met			
Revaluation reserve for available-for-sale investment securities, net of tax		(782)	1,588
Other comprehensive income not to be reclassified subsequently to profit or loss			
Revaluation of buildings, net of tax		33	63
Other comprehensive income, net of tax		**(749)**	**1,651**
Total comprehensive income		**28,822**	**35,258**
Comprehensive income attributable to:			
- shareholders of the Bank		28,822	35,209
- non-controlling interests		–	49

Approved: 3 April 2018

Mr. Dmitry Gusev
Chairman of the Management Board

Mr. Dmitry Baryshnikov
Financial Director

Mr. Andrei Osnos
Managing Director

The consolidated statement of comprehensive income is to be read in conjunction with note 1 to 44, and forming an integral part of, the consolidated financial statements.

Consolidated statement of financial position

as at 31 December 2017

	Notes	2017 RUB MM	2016 RUB MM
Assets			
Cash and cash equivalents	16	39,962	21,465
Mandatory cash balances with the CBR		2,975	3,017
Placements with banks	17	9,338	384
Financial instruments at fair value through profit or loss:			
- held by the Group	18	140,043	91,592
- pledged under sale and repurchase agreements	27	209,098	193,626
Available-for-sale investment securities	20	3,935	7,086
Loans to customers:			
- held by the Group	19	262,729	211,931
- pledged under sale and repurchase agreements	27	3,516	26,489
Investments in associates	43	8,224	802
Investments in car leasing joint venture		506	456
Assets held for sale		425	134
Investment property	22	58	288
Property and equipment and intangible assets	23	4,942	4,963
Goodwill	41	728	728
Deferred tax asset	32	459	496
Other assets	24	2,561	1,872
Total assets		**689,499**	**565,329**
Liabilities			
Due to the CBR	26	–	42,618
Due to banks	27	194,135	145,196
Due to customers	25	358,914	276,467
Debt securities issued	28	15,744	8,774
Other borrowed funds	29	15,381	15,691
Deferred tax liability	32	5,244	4,861
Subordinated debt	30	6,799	1,484
Non-controlling interests		–	525
Other liabilities	31	7,864	5,797
Total liabilities		**604,081**	**501,413**
Equity			
Share capital	33	1,716	1,716
Other capital contributions		2,852	2,382
Revaluation reserve for available-for-sale investment securities		806	1,588
Perpetual subordinated debt		–	5,770
Revaluation reserve for buildings		122	89
Retained earnings		78,302	52,249
Total equity attributable to shareholders of the Bank		**83,798**	**63,794**
Non-controlling interests		1,620	122
Total equity		**85,418**	**63,916**
Total equity and liabilities		**689,499**	**565,329**

Approved: 3 April 2018

Mr. Dmitry Gusev
Chairman of the Management Board

Mr. Dmitry Baryshnikov
Financial Director

Mr. Andrei Osnos
Managing Director

The consolidated statement of financial position is to be read in conjunction with note 1 to 44, and forming an integral part of, the consolidated financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2017

	Notes	2017 RUB MM	2016 RUB MM
Cash flows from operating activities			
Interest received		67,437	62,983
Interest paid		(27,397)	(27,129)
Fees and commissions received		20,798	14,414
Fees and commissions paid		(2,112)	(1,084)
Net realized gain on financial instruments at fair value through profit or loss		(1,649)	6,331
Net realized foreign exchange gain		(1,635)	10,506
Other operating income received		1,540	722
Personnel and other general administrative expenses paid		(22,814)	(14,544)
Cash flows from operating activities		**34,168**	**52,199**
(Increase) decrease in operating assets			
Mandatory cash balances with the CBR		42	(1,420)
Placements with banks and the CBR		(9,545)	8,304
Financial instruments at fair value through profit or loss		(47,335)	(50,114)
Loans to customers		(34,769)	(10,434)
Other assets		(850)	177
Increase (decrease) in operating liabilities			
Due to customers		79,945	52,659
Due to the CBR and other banks		5,686	(87,333)
Promissory notes issued		(258)	(636)
Other liabilities		(767)	(84)
Net cash flows from operating activities before income tax		**26,317**	**(36,682)**
Income tax paid		(6,453)	(6,197)
Cash flows from operating activities		**19,864**	**(42,879)**
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash received	39, 43	(755)	14,505
Acquisition of associates	43	(1,637)	–
Acquisition of property and equipment and intangible assets		(710)	(583)
Proceeds from disposal of property and equipment and intangible assets		20	4
Proceeds from disposal of investment property		72	–
Acquisition of available-for-sale financial assets		(2,802)	(2,150)
Cash flows from investing activities		**(5,812)**	**11,776**
Cash flows from financing activities			
Contributions from shareholders		470	–
Proceeds from bonds issued		10,367	8,188
Redemption of bonds issued		(3,032)	(2,035)
Subordinated debt received		1,302	2,000
Subordinated debt repaid		(1,470)	(1,952)
Distributions to shareholders		(3,592)	(4,613)
Cash flows from financing activities		**4,045**	**1,588**
Net increase (decrease) in cash and cash equivalents		**18,097**	**(29,515)**
Effect of exchange rate changes on cash and cash equivalents		400	(1,548)
Cash and cash equivalents at the beginning of the year		21,465	52,528
Cash and cash equivalents at the end of the year	16	**39,962**	**21,465**

The consolidated statement of cash flows is to be read in conjunction with note 1 to 44, and forming an integral part of, the consolidated financial statements.

Consolidated statement of changes in equity
for the year ended 31 December 2017

	Share capital RUB MM	*Treasury shares RUB MM*	*Other capital contributions RUB MM*	*Revaluation reserve for property RUB MM*	*Revaluation reserve for available-for-sale assets RUB MM*	*Perpetual subordinated debt RUB MM*	*Retained earnings (accumulated losses) RUB MM*	*Total equity attributable to shareholders of the Bank RUB MM*	*Non-controlling interests*	*Total capital*
As at 1 January 2016	**1,906**	**(190)**	**2,382**	**26**	**–**	**–**	**22,980**	**27,104**	**217**	**27,321**
Net profit for the period	–	–	–	–	–	–	33,558	**33,558**	49	**33,607**
Other comprehensive income for the period	–	–	–	63	1,588	–	–	**1,651**	–	**1,651**
Total comprehensive income	**–**	**–**	**–**	**63**	**1,588**	**–**	**33,558**	**35,209**	**49**	**35,258**
Perpetual subordinated debt received	–	–	–	–	–	6,109	–	**6,109**	–	**6,109**
Foreign currency translation reserve for perpetual subordinated debt	–	–	–	–	–	(339)	339	**–**	–	**–**
Payments on perpetual subordinated loans (Note 33)	–	–	–	–	–	–	(258)	**(258)**	–	**(258)**
Tax effect recognized in respect of perpetual subordinated debt	–	–	–	–	–	–	(15)	**(15)**	–	**(15)**
Dividends paid (Note 33)	–	–	–	–	–	–	(4,355)	**(4,355)**	(144)	**(4,499)**
Net result from treasury shares operations (Note 33)	(190)	190	–	–	–	–	–	**–**	–	**–**
As at 31 December 2016	**1,716**	**–**	**2,382**	**89**	**1,588**	**5,770**	**52,249**	**63,794**	**122**	**63,916**
As at 1 January 2017	**1,716**	**–**	**2,382**	**89**	**1,588**	**5,770**	**52,249**	**63,794**	**122**	**63,916**
Net profit for the period	–	–	–	–	–	–	29,571	**29,571**	–	**29,571**
Other comprehensive income for the period	–	–	–	33	(782)	–	–	**(749)**	–	**(749)**
Total comprehensive income	**–**	**–**	**–**	**33**	**(782)**	**–**	**29,571**	**28,822**	**–**	**28,822**
Perpetual subordinated debt received	–	–	–	–	–	(5,770)	(7)	**(5,777)**	–	**(5,777)**
Payments on perpetual subordinated loans (Note 33)	–	–	–	–	–	–	(458)	**(458)**	–	**(458)**
Dividends paid (Note 33)	–	–	–	–	–	–	(3,053)	**(3,053)**	–	**(3,053)**
Contributions from participants (Note 33)	–	–	470	–	–	–	–	**470**	–	**470**
Non-controlling interests (Note 43)	–	–	–	–	–	–	–	**–**	1,498	**1,498**
As at 31 December 2017	**1,716**	**–**	**2,852**	**122**	**806**	**–**	**78,302**	**83,798**	**1,620**	**85,418**

The consolidated statement of changes in equity is to be read in conjunction with notes 1 to 44, and forming an integral part of, the consolidated financial statements.

1. Background

Principal activities

These consolidated financial statements include the financial statements of Public join-stock company Sovcombank (the “Bank” or “Sovcombank”) and its subsidiaries (together referred to as the “Group” or “Sovcombank Group”). list of principal consolidated subsidiaries included in these consolidated financial statements of Sovcombank Group is disclosed in Note 43.

Sovcombank, the parent company of the Group, was originally established in the city of Kostroma as a limited liability company in 1990. In September 2014, the Bank changed its legal form from limited liability company to open joint-stock company. In December 2014, the Bank changed its legal form from open joint-stock company to public joint-stock company pursuant to regulatory changes in Russia. These reorganizations, first into the open joint-stock company and then into the public joint-stock company, had no effect on the principal activities of the Bank or its shareholder structure.

The Bank’s registered legal address is 46, prospect Tekstilshchikov, Kostroma, 156000, Russia, and it operates under general banking license No. 963 issued by the Central Bank of the Russian Federation (the “CBR”). The Bank also holds licenses of a professional participant of the securities market to engage in brokerage, dealer and depositary activity issued by the Federal Securities Market Commission (the “FSMC”) on 27 January 2009. Since 15 September 2005, the Bank is a member of the deposit insurance system managed by State Corporation Deposit Insurance Agency (the “DIA”).

The Group’s principal business activity is retail and corporate banking as well as investment banking services. This includes deposit taking and issuing commercial loans denominated in Russian rubles and foreign currencies; providing financial services, including investment banking services; transactions with securities and derivative financial instruments. The Group includes a major digital trading platform which enables access to public procurement for 353 thousand companies, represented mostly by small and medium businesses. The Group operates primarily in the Russian Federation.

The Bank operates 2,418 offices, including 2,087 mini-offices located in 1,031 cities and towns across 74 constituent entities of the Russian Federation (as at 31 December 2016: 2,111 offices, including 1,758 mini-offices located in 971 cities and towns across 74 constituent entities of the Russian Federation).

The Bank’s customers may withdraw and deposit cash through 4,119 ATMs and cash-in terminals (as at 31 December 2016: 3,420 ATMs and cash-in terminals).

The Group serves 3.2 million individuals: 2.7 million borrowers, 0.5 million depositors, and 170 thousand corporate customers.

The Bank had 11,480 employees (as at 31 December 2016: 8,703 employees).

Shareholders

	Ownership, % 31 December 2017	*Ownership, % 31 December 2016*
Sovco Capital Partners N.V.	100.00%	100.00%

As at 31 December 2017 and 31 December 2016, the Group was not under control of any single beneficiary owner (Note 33).

Sovco Capital Partners N.V., a legal entity incorporated in the Netherlands, is the legal successor of Sovco Capital Partners B.V. since 30 August 2016. Sovco Capital Partners B.V., was the shareholder of the Group since 2003. A group of Russian businessmen, including the key members of Sovcombank management and the Supervisory Board of the Bank, collectively own Sovco Capital Partners N.V., but company is not controlled by any ultimate owner.

Sovco Capital Partners N.V. is a tax resident of the Russian Federation since 1 January 2016.

The Bank’s Supervisory Board comprises seven persons, including the Bank’s five major ultimate owners (individuals who indirectly own the Bank and have a significant effect on the Bank’s decision-making processes), one member of the Bank’s Management Board and one independent director. Mikhail Kuchment is the Chairman of the Bank’s Supervisory Board.

The Bank is regulated and supervised by the Bank of Russia, a sole regulator of banking and insurance activities, as well as financial markets in the Russian Federation.

1. Background (continued)

Operating environment

The Group operates predominantly in the Russian Federation. In 2017, Russian economy continued to recover after the crisis. The economy adapted to a drop in world prices of energy products and raw materials, as well as to international sectoral sanctions imposed on Russia by several countries. According to the Federal State Statistics Service, GDP in 2017 increased by 1.5% as compared to 2016 (2016: GDP decreased by 0.2% as compared to 2015).

The adaptation of the economy to the new economic environment was accompanied by recovery of oil prices and stabilization of RUB/USD exchange rate: the average price for Urals oil in 2017 increased to USD 53 per barrel as compared to USD 42 per barrel in 2016, and the average RUB exchange rate in Q4 2017 (RUB 59.1 per USD 1) changed insignificantly as compared to Q1 2017 (RUB 58.7 per USD 1).

The Russian banking sector profit decreased to RUB 790 billion in 2017, according to the CBR, as compared to 930 billion in 2016. The Russian banking sector profit decrease in 2017 as compared to 2016 was due to one time recognition of negative financial performance of several major Russian banking groups, which undergo financial rehabilitation.

In 2017, foreign rating agencies improved their outlook on sovereign credit ratings of the Russian Federation:

- Moody's: up to "stable"
- Standard & Poor's: up to "positive";
- Fitch Ratings: up to "positive".

In February 2018, Standard & Poor's upgraded the sovereign credit rating of the Russian Federation from speculative BB+ to investment BBB- with a "stable" outlook.

Five credit rating agencies assess the Group's creditworthiness:

- Fitch Ratings: BB- with a "positive" outlook (the credit rating was confirmed and the outlook upgraded to "positive" in March 2018);
- Moody's: Ba3 with a "stable" outlook (the credit rating upgraded to Ba3 in July 2017 and confirmed in March 2018);
- Standard & Poor's: BB- with a "stable" outlook (the credit rating upgraded to BB- in November 2017 and confirmed in March 2018);
- ACRA: A(RU) with a "stable" outlook (the credit rating upgraded to A(RU) in September 2017 and confirmed in March 2018);
- Expert RA: ruA- with a "stable" outlook (the credit rating assigned for the first time in July 2017).

2. Basis of preparation

General

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

The Bank and its subsidiaries maintain accounting records and prepare financial statements in accordance with Russian accounting and banking legislation and related instructions ("Russian Accounting Standards", or "RAS"). The consolidated financial statements are based on those RAS accounting records and financial statements, as adjusted and reclassified in order to comply with IFRS.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the summary of significant accounting policies below. For example, trading and available-for-sale investment securities, derivative financial instruments, investment property, and buildings are measured at fair value.

The consolidated financial statements are presented in millions of Russian rubles ("RUB MM"), unless otherwise indicated.

3. Significant accounting policies

Changes in accounting policies

The Group adopted certain amendments to the IFRS standards, which apply from 1 January 2017. The Group did not adopt early any standards, interpretations or amendments that are issued by the International Accounting Standards Board but are not yet effective. The nature and impact of each amendment are described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Group has provided the information for both the current and the comparative period in Note 40.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealized Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealized losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Application of the amendments has no effect on the Group's financial position and performance as the Group has no deductible temporary differences or assets that are in the scope of the amendments.

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the Scope of Disclosure Requirements

The amendments clarify that certain disclosure requirements in IFRS 12 apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified as held for sale or included in a disposal group. These amendments did not affect the Group's financial position or performance.

Basis of consolidation

Subsidiaries, which are the entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date, on which control is transferred to the Group, and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealized gains on transactions between group companies are eliminated in full; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

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

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

Business combinations

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

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

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

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

3. Significant accounting policies (continued)

Business combinations (continued)

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

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Acquisition of subsidiaries from parties under common control

Acquisitions of subsidiaries from parties under common control are accounted for using the pooling of interests method.

The assets and liabilities of the subsidiary transferred under common control are recorded in these consolidated financial statements at the carrying amounts of the transferring entity (the "Predecessor") at the date of the transfer. Related goodwill inherent in the predecessor's original acquisition is also recorded in these consolidated financial statements. Any difference between the total book value of net assets, including the Predecessor's goodwill, and the consideration paid is accounted for in these consolidated financial statements as an adjustment to the net assets attributable to shareholders.

These consolidated financial statements, including corresponding figures, are presented as if the subsidiary had been acquired by the Group on the date it was originally acquired by the Predecessor.

Investments in associates and joint ventures

Associates are entities, in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control.

Jointly controlled entities are joint ventures that involve the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity. A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

Investments in associates and joint ventures are accounted for under the equity method and are initially recognized at cost, including goodwill. Goodwill arising as a result of an investment in associates or joint ventures is not tested for impairment separately. Subsequent changes in the carrying amount reflect the post-acquisition changes in the Group's share of net assets of the associate or joint venture. The Group's share of its associates' or joint ventures' profits or losses is recognized in the consolidated statement of profit or loss, and its share of movements in reserves is recognized in other comprehensive income.

If an acquisition is achieved in stages, initial cost of investments in associates includes fair value of investments recorded in lines "Investment securities available for sale" or "Financial instruments at fair value through profit or loss" at the moment of acquisition of significant influence.

If the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognize further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Cash and cash equivalents

The Group classifies cash, nostro accounts with the CBR and other banks, due from other banks and other credit institutions with an original maturity less than 90 days as Cash and cash equivalents. The minimum mandatory reserve deposit with the CBR is not considered to be a cash equivalent due to restrictions on its use by the Group.

3. Significant accounting policies (continued)

Financial instruments

Classification

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

- Acquired or incurred principally to sell or repurchase in the near term;
- Part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking;
- Derivative financial instruments (except for derivative financial instruments that are designated and effective hedging instruments); or
- Upon initial recognition, designated at fair value through profit or loss.

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

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

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

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

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

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity, other than those that:

- The Group upon initial recognition designates as at fair value through profit or loss;
- The Group designates as available-for-sale; or
- Meet the definition of loans and receivables.

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

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

Recognition

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

3. Significant accounting policies (continued)

Financial instruments (continued)

Measurement

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

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

- Loans and receivables which are measured at amortized cost using the effective interest method;
- Held-to-maturity investments which are measured at amortized cost using the effective interest method; and
- Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, which are measured at cost.

All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortized cost. Amortized cost is calculated using the effective interest method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortized based on the yield to maturity using the effective interest rate method.

Where a valuation based on observable market data indicates a fair value gain or loss on initial recognition of an asset or liability, the gain or loss is recognized immediately in profit or loss. Where an initial gain or loss is not based entirely on observable market data, it is deferred and recognized over the life of the asset or liability on an appropriate basis, or when prices become observable, or on disposal of the financial asset or liability.

Fair value measurement principles

The fair value of financial instruments is based on their quoted market price in active markets at the reporting date without any deduction for transaction costs. Active market means a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Where a quoted market price is not available, fair value is determined using valuation techniques with a maximum use of market inputs. Such valuation techniques include reference to recent arm's length market transactions, current market prices of substantially similar instruments, discounted cash flow and option pricing models and other techniques commonly used by market participants to price the instrument.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-based rate at the reporting date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market-based measures at the reporting date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Group would receive or pay to terminate the contract at the reporting date taking into account current market conditions and the current creditworthiness of the counterparties and own credit risk.

Gains and losses on subsequent measurement

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

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

For financial assets and liabilities carried at amortized cost, a gain or loss is recognized in profit or loss when the financial asset or liability is derecognized or impaired, or through the amortization process.

Derecognition

A financial asset is derecognized when the rights to receive cash flows from the financial asset have expired or when the Group has transferred substantially all the risks and rewards of ownership of the financial asset. Any rights and obligations created or retained in the transfer are recognized separately as assets or liabilities. A financial liability is derecognized when it is extinguished.

3. Significant accounting policies (continued)

Financial instruments (continued)

The Group also derecognizes certain assets when it writes off balances pertaining to the assets deemed to be uncollectible.

Sale and repurchase and reverse repurchase agreements

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

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

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

Derivative financial instruments

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

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

Offsetting

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

Property and equipment and intangible assets

Owned assets

Items of property, equipment and intangible assets are carried at cost, less accumulated depreciation and accumulated impairment losses, except for buildings that are recorded at revalued amounts, as described below.

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

Leased assets

Lease under which the Group assumes substantially all risks and rewards of ownership are classified as finance leases. Property and equipment acquired by way of finance lease is stated at the amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

Revaluation

Buildings of the Group are measured at revalued amounts. The frequency of revaluation depends upon the movements in the fair values of the buildings being revalued. A revaluation increase on a building is recognized directly in other comprehensive income (in equity) except to the extent that it reverses a previous revaluation decrease recognized in profit or loss, in which case it is recognized in profit or loss. A revaluation decrease on a building is recognized in profit or loss except to the extent that it reverses a previous revaluation increase recognized as other comprehensive income directly in equity, in which case it is recognized directly in other comprehensive income (in equity).

3. Significant accounting policies (continued)

Property and equipment and intangible assets (continued)

Depreciation

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

Buildings	20-50 years
Computers and ATMs	2-5 years
Motor vehicles	3-5 years
Furniture and equipment	3-7 years
Intangible assets	Over 1 year and not later than 10 years

Intangible assets

Intangible assets that are acquired by the Group are stated at cost less accumulated amortization and impairment losses.

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

Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in normal course of business, or for the use in production or supply of goods or services or for administrative purposes. Investment property is measured at fair value with any change recognized in profit or loss.

When the use of an investment property changes so that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

Goodwill

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

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

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

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

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

Repossessed assets

The assets repossessed by the Group following litigation to recover amounts due under loans and held for sale in the near term to cover losses arising from lending activities are classified as inventories in accordance with IAS 2. In accordance with IAS 2, the Group measures these assets at the lower of cost and net realizable value.

3. Significant accounting policies (continued)

Leases

i. Finance – Group as lessee

The Group recognizes finance leases as assets and liabilities in the consolidated statement of financial position at the date of commencement of the lease term at amounts equal to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments, the discount factor used is the interest rate implicit in the lease, when it is practicable to determine; otherwise, the Group's incremental borrowing rate is used. Initial direct costs are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The costs identified as directly attributable to activities performed by the lessee under the finance lease agreement, are included as part of the amount recognized as an asset under the lease.

ii. Finance – Group as lessor

The Group recognizes lease receivables at value equal to the net investments in the lease, starting from the date of commencement of the lease term. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding. Initial direct costs are included in the initial measurement of the lease receivables.

iii. Operating – Group as lessee

Leases of assets, under which the risks and rewards of ownership are effectively retained by the lessor, are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included in other operating expenses.

iv. Operating – Group as lessor

The Group presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset. Lease income from operating leases is recognized in the consolidated profit or loss on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is recognized as a reduction of lease income over the lease term on a straight-line basis.

Promissory notes

Promissory notes purchased are included in trading securities, or in due from credit institutions or in loans to customers, depending on their substance and are accounted for in accordance with the accounting policies for these categories of assets.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include current accounts and deposits from customers, deposits and balanced from banks, promissory notes, subordinated debt. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated profit or loss when the borrowings are derecognized as well as through the amortization process.

Impairment

Financial assets carried at amortized cost

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

Objective evidence that financial assets are impaired can include a default or delinquency by a borrower, a breach of loan covenants or conditions, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, a deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in a borrower group's finances or economic conditions that correlate with defaults in the borrower group.

3. Significant accounting policies (continued)

Impairment (continued)

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

To evaluate the impairment on collective basis, financial assets are grouped on the basis of the Group's internal credit rating system that mainly considers credit risk characteristics such as asset type, industry, collateral type and past-due status.

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

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

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

When a loan is uncollectable it is written off against the related allowance for loan impairment. The Group writes off a loan balance (and any related allowances for losses from the loan impairment) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is recovered later, the recovery is credited to the consolidated statement of profit or loss.

Financial assets carried at cost

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

All impairment losses in respect of these investments are recognized in profit or loss and cannot be reversed.

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Group immediately recognizes the difference between the transaction price and fair value (a 'Day 1' profit) in the consolidated statement of profit or loss. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated profit or loss when the inputs become observable, or when the instrument is derecognized.

Available-for-sale assets

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

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

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

3. Significant accounting policies (continued)

Impairment (continued)

Non-financial assets

Other non-financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of goodwill is estimated at each reporting date. The recoverable amount of non-financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those of from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

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

Renegotiated loans

In certain circumstances, the Group renegotiates the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. This may involve extending the payment arrangements and the agreement of new loan conditions.

The accounting treatment of such restructuring is as follows:

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

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

Provisions

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

Credit-related commitments

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

Financial guarantees are contracts that require the 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.

A financial guarantee liability is recognized initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognized less cumulative amortization or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit-related commitments are recognized when losses are considered probable and can be measured reliably.

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

Financial guarantee liabilities and allowance for other credit related commitments are included in other liabilities.

3. Significant accounting policies (continued)

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional capital.

Treasury shares

Where the Bank purchases the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are canceled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost.

Dividends

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

Taxation

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

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

Deferred tax is provided using the balance sheet liability method for temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for taxation. The following temporary differences are not provided for: goodwill not deductible for tax, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and temporary differences related to investments in subsidiaries, associates and joint ventures where the parent is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the reporting date.

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

Russia also has various operating taxes that are applied to the Group's activities. These taxes are included as a part of other operating expenses.

Recognition of income and expenses

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

Interest and similar income and expense

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

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

3. Significant accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

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

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

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

Fee income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party − such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses − are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance indicator are recognized once the corresponding criteria have been met.

Dividend income

Revenue is recognized when the Group’s right to receive the payment is established.

Foreign currency translation

The consolidated financial statements are presented in Russian rubles, which is the Bank’s functional and presentation currency. Each entity in the Group determines its own functional currency, and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the consolidated statement of profit or loss as gains less losses from foreign currencies. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as of the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the dates when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the Central Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official CBR exchange rates at 31 December 2017 and 31 December 2016 were RUB 57.6002 and RUB 60.6569 to USD 1, respectively.

As at the reporting date, the assets and liabilities of the entities whose functional currency is different from the presentation currency of the Group are translated into Russian rubles at the rate of exchange ruling at the reporting date and their statements of profit or loss are translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken to other comprehensive income. On disposal of a subsidiary or an associate whose functional currency is different from the presentation currency of the Group, the deferred cumulative amount recognized in other comprehensive income relating to that particular entity is recognized in profit or loss. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at the closing rate.

Segment reporting

The Group determines operating segments based on its organizational structure. Operational segments are based on the aggregated management accounts provided to the Supervisory Board. The Group’s segment reporting is based on the following operating segments: Retail banking, Corporate and investment banking.

As assets and liabilities of the Group are primarily concentrated in the Russian Federation and the largest proportion of its revenues and financial result is received from the operations within the territory of the Russian Federation, the Group does not use the geographical segmentation of its business.

3. Significant accounting policies (continued)

Standards issued but not yet effective

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

IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement*. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required but restating comparative information is not compulsory.

In the course of adoption of IFRS 9, the Group engaged external advisors and analyzed the effect this standard would have on the financial statements, interaction processes, evaluated whether new input parameters as well as methods to obtain and review them would be necessary, developed internal procedures and regulations, prepared software and automation techniques. The Group is at the final stage of reviewing the calculation of the effect of adoption of IFRS 9, however no final estimate of this effect is yet available.

(a) Classification and measurement

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

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

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realized and unrealized gains and losses, except for dividend income, are recognized in other comprehensive income with no subsequent reclassification to profit and loss.

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

(b) Impairment

IFRS 9 requires the Group to record an allowance for expected credit losses (ECL) on all of its debt financial assets at amortized cost or FVOCI, as well as loan commitments and financial guarantees. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance is based on the ECL over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired, the allowance is based on the change in the lifetime ECL.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and amended in April 2016. The new standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application will be required for annual periods beginning on or after 1 January 2018. The Group plans to adopt the new standard using the modified retrospective method by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018, without restating comparative information.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. Interest and fee income integral to financial instruments and leases will fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (IFRS 9 and IFRS 16 *Leases*). As a result, the majority of the Group's income will not be impacted by the adoption of this standard.

The Group currently does not expect a material effect from adoption of IFRS 15.

3. Significant accounting policies (continued)

Standards issued but not yet effective (continued)

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

The amendments address the conflict between in IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognized in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business is recognized only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group does not expect a material effect from adoption of these amendments.

IFRS 2 Classification and Measurement of Share-based Payment Transactions − Amendments to IFRS 2

The IASB issued amendments to IFRS 2 *Share-based Payment* that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled. On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. The Group does not expect a material effect from adoption of these amendments.

IFRS 16 Leases

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

Lessees will be also 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). The lessee will generally recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principles as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. In 2018, the Group will continue to assess the potential effect of IFRS 16 on its consolidated financial statements.

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts*, a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life and non-life insurance, direct insurance and re-insurance) regardless of the type of entities that issues them, as well as to certain guarantees and financial instruments with discretionary participation features.

A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects.

3. Significant accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 17 is effective for reporting periods beginning on or after 1 January 2021, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Group will assess the potential effect of IFRS 17 on its consolidated financial statements, including treatment of non-financial guarantees issued by the Group.

Transfers of Investment Property − Amendments to IAS 40

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if it is possible without the use of hindsight. Effective for annual periods beginning on or after 1 January 2018. The Group does not expect a material effect from adoption of these amendments.

Annual improvements 2014-2016 cycle (issued in December 2016)

These improvements include:

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

The amendments clarify:

- An entity that is a venture capital organization, or other similar entity may decide to measure investments in associates and joint ventures at fair value through profit or loss. This election is made separately for each investment at initial recognition.
- If an entity, that is not itself an investment entity, has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognized; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.

The amendments should be applied retrospectively and are effective from 1 January 2018. The Group does not expect a material effect from the application of these amendments.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts − Amendments to IFRS 4

The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing IFRS 17 *Insurance Contracts*, which replaces IFRS 4. The amendments introduce two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach. The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated on transition to IFRS 9. The entity restates comparative information reflecting the overlay approach if, and only if, the entity restates comparative information when applying IFRS 9. These amendments are not applicable to the Group.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the advance consideration. The Interpretation is effective for annual periods beginning on or after 1 January 2018. Since the Group's current practice is in line with the Interpretation, the Group does not expect any effect on its consolidated financial statements.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

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

3. Significant accounting policies (continued)

Standards issued but not yet effective (continued)

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The Interpretation also addresses the assumptions an entity makes about the examination of tax treatments by taxation authorities, as well as how it considers changes in facts and circumstances.

The Interpretation is effective for annual reporting periods beginning on or after 1 January 2019. The Group will apply interpretation from its effective date. Since the Group operates in a complex tax environment, applying the Interpretation may affect its consolidated financial statements and the required disclosures. In addition, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

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

These improvements are effective for annual reporting periods beginning on or after 1 January 2019 and include:

IFRS 3 Business Combinations and IFRS 11 Joint Arrangements – previously held interest in a joint operation

These amendments clarify whether the previously held interest in a joint operation (that is a business as defined in IFRS 3) should be remeasured to fair value, when:

- A party to a joint operation obtains control over the joint operation (IFRS 3);
- A party that participates in (but does not have joint control over a joint operation) obtains joint control over the joint operation (IFRS 11).

The Group does not expect any effect on its consolidated financial statements.

IAS 12 Income Taxes – income tax consequences of payments on financial instruments classified as equity

These amendments clarify that an entity must recognize all income tax consequences of dividends in profit or loss, other comprehensive income or equity, depending on where the entity recognized the originating transaction or event that generated the distributable profits giving rise to the dividend. Earlier application is permitted and must be disclosed. The amendments must first be applied to income tax consequences of dividends recognized on or after the beginning of the earliest comparative period. Since the Group's current practice is in line with the amendments, the Group does not expect any effect on its consolidated financial statements.

IAS 23 Borrowing Costs – borrowing costs eligible for capitalization

These amendments clarify that, when a qualifying asset is ready for its intended use or sale, and some of the specific borrowing related to that qualifying asset remains outstanding at that point, that borrowing is to be included in the funds that an entity borrows generally. Earlier application is permitted and must be disclosed. The Group does not expect any effect on its consolidated financial statements.

4. Significant accounting judgments and estimates

Judgments

In the process of applying the Group's accounting policies, Management makes the following judgments, apart from those involving estimates, which have the most significant effect on the amounts recognized in the consolidated financial statements.

Estimation uncertainty

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

Fair value of financial instruments (Note 18)

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

4. Significant accounting judgments and estimates (continued)

Judgments (continued)

Allowance for loan impairment (Note 19)

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

Goodwill impairment

The Group determines whether goodwill is impaired on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and to choose a suitable discount rate in order to calculate the present value of those cash flows. As of 31 December 2017 and 31 December 2016, the carrying amount of goodwill was RUB 728 MM. More details are provided in Note 41.

Revaluation of buildings and investment property

Following initial recognition at cost, buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluation is performed annually, on the basis of reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category, in order to avoid significant differences between fair value of the revalued asset an its carrying amount.

Deferred tax

When determining the amount of deferred tax assets which may be recognized in the financial statements, the Group's management assesses the probability that the deferred tax asset will be used. The use of the deferred tax asset depends on taxable profit obtained in periods when timing differences may be used against it. When conducting such an assessment, management takes into account the regulatory restriction on utilization of deferred tax assets, future expected taxable profit, as well as tax planning strategies.

Based on the historical data on income tax amounts, as well as future expected taxable profit in periods when timing differences may be used against it, the Group's management considers it possible to use the deferred tax asset recognized in the Bank's financial statements.

5. Segment information

The Group has two operating segments:

- **Retail banking services ("Retail"):** providing mass market financial services to low- and middle-income retail customers residing primarily in small towns. These services include issuance of mortgage, car and consumer loans, placement of term deposits and insurance products provided by third-party companies.
- **Corporate and investment business ("CIB"):** extending loans (both in form of bonds and loans) and providing investment banking services to the major Russian corporations, state-owned companies and constituent entities of the Russian Federation. CIB services also include enabling small and medium businesses, individual entrepreneurs access to public procurement through the Group's digital platform for electronic procurement auctions and online bank guarantees.

5. Segment reporting (continued)

Management monitors the operating results of the segments separately to make management decisions. In 2017, the Group changed its approach to segment reporting. Comparative data was adjusted retrospectively for comparability.

	2017			
	Retail *RUB MM*	***CIB*** *RUB MM*	***Adjustments and eliminations*** *RUB MM*	***Total*** *RUB MM*
Revenue				
Interest income	26,512	42,211	–	**68,723**
Fee and commission income	16,004	4,278	–	**20,282**
Net gain on financial instruments at fair value through profit or loss	–	11,567	–	**11,567**
Net foreign exchange gain and net gain on currency derivatives	–	2,670	–	**2,670**
Net gains on available-for-sale assets	–	1,067	–	**1,067**
Other operating income	48	1,803	–	**1,851**
Inter-segment revenue	14,884	–	(14,884)	**–**
Total revenue	**57,448**	**63,596**	**(14,884)**	**106,160**
Interest expense	(21,514)	(12,968)	–	**(34,482)**
Obligatory deposit insurance	(1,221)	(42)	–	**(1,263)**
Fee and commission expense	(1,636)	(596)	–	**(2,232)**
Allowance for loan impairment	(3,808)	(630)	–	**(4,438)**
Depreciation	(530)	(353)	–	**(883)**
Other impairment and provisions	(102)	(2,616)	–	**(2,718)**
Payroll, including bonuses	(9,646)	(3,751)	–	**(13,397)**
Other expenses	(8,909)	(1,179)	–	**(10,088)**
Inter-segment expenses	–	(14,884)	14,884	**–**
Segment results	**10,082**	**26,577**	**–**	**36,659**
Income tax expense				**(7,088)**
Profit for the period				**29,571**

	2016 (restated)			
	Retail *RUB MM*	***CIB*** *RUB MM*	***Adjustments and eliminations*** *RUB MM*	***Total*** *RUB MM*
Revenue				
Interest income	19,638	43,839	–	**63,477**
Fee and commission income	11,161	2,760	–	**13,921**
Net gain on financial instruments at fair value through profit or loss	–	16,039	–	**16,039**
Net foreign exchange gain and net gain on currency derivatives	–	466	–	**466**
Other operating income	95	5,196	–	**5,291**
Inter-segment revenue*	16,487	–	(16,487)	**–**
Total revenue	**47,381**	**68,300**	**(16,487)**	**99,194**
Interest expense	(20,207)	(14,624)	–	**(34,831)**
Obligatory deposit insurance*	(888)	(13)	–	**(901)**
Fee and commission expense	(456)	(690)	–	**(1,146)**
Allowance for loan impairment	(3,646)	(1,041)	–	**(4,687)**
Depreciation	(508)	(8)	–	**(516)**
Other impairment and provisions	–	(1,362)	–	**(1,362)**
Payroll, including bonuses	(5,865)	(2,090)	–	**(7,955)**
Other expenses	(6,053)	(93)	–	**(6,146)**
Inter-segment expenses*	–	(16,487)	16,487	**–**
Segment results	**9,758**	**31,892**	**–**	**41,650**
Income tax expense				**(8,043)**
Profit for the period				**33,607**

* In 2016, the lines “Inter-segment revenue”, “Obligatory deposit insurance” and “Inter-segment expenses” were presented separately out of “Interest income”, “Other expenses” and “Interest expenses” for comparability.

5. Segment reporting (continued)

Inter-segment transactions represent funding raised in the Retail segment as term retail deposits and subsequently provided to CIB. The decrease in inter-segment expenses from RUB 16,487 MM in 2016 to RUB 14,884 MM in 2017 was due to lower market rates on term deposits in 2017.

The increase in “Payroll, including bonuses” in Retail segment from RUB 5,865 MM in 2016 to RUB 9,646 MM in 2017 was mainly due to hiring, training and remuneration expenses related to the increase in the number of employees from 8,703 as at 31 December 2016 to 11,480 as at 31 December 2017. The expansion of the retail banking network, diversification of the Bank’s business, including the employment of car loan professionals from JSC Metcombank and mortgage professionals from JSC Nordea Bank Russia, were the key drivers behind the increase in the headcount.

The increase in “Other expenses” in Retail segment from RUB 6,053 MM in 2016 to RUB 8,909 MM in 2017 was mainly due to the expansion of Bank’s retail network from 2,211 branches and mini-offices as at 31 December 2016 to 2,418 branches and mini-offices as at 31 December 2017, upgrade of the Bank’s IT infrastructure, as well as due to the advertising expenses of RUB 997 MM in connection with the launch of a new product, “Halva” installment card, in March 2017.

Income from sales of insurance products related to mortgage loans and car loans explains to a large extent the increase in “Fee and commission income” in Retail segment from RUB 11,161 MM in 2016 to RUB 16,004 MM in 2017 (Note 7).

The increase in “Fee and commission expense” in Retail segment from RUB 456 MM in 2016 to RUB 1,636 MM in 2017 was mainly due to agency services provided by auto dealers to sell certain financial products (Note 8).

The increase in “Fee and commission income” in CIB segment from RUB 2,760 MM in 2016 to RUB 4,278 MM in 2017 was due to the increase in the volume of bank guarantees issued to enable public procurement for micro- and small companies via Sovcombank’s proprietary digital platform (Note 7).

Allowance for loan impairment in Retail segment changed insignificantly from RUB 3,646 MM in 2016 to RUB 3,808 MM in 2017, in spite of significant increase in assets of the segment from RUB 96,680 MM as at 31 December 2016 to RUB 156,503 MM as at 31 December 2017, because the increase in the segment assets was mainly driven by an increase in volume of low-risk loans secured by real estate and vehicles.

The following table presents assets and liabilities of the Group’s operating segments:

	31 December 2017		
	Retail banking RUB MM	***CIB RUB MM***	***Total RUB MM***
Segment assets	156,503	532,996	**689,499**
Segment liabilities	288,271	315,810	**604,081**

	31 December 2016		
	Retail banking RUB MM	***CIB RUB MM***	***Total RUB MM***
Segment assets	96,680	468,649	**565,329**
Segment liabilities	236,991	264,422	**501,413**

6. Net interest income

	2017 RUB MM	2016 RUB MM
Interest income		
Loans to individuals	26,630	19,792
Loans to corporate customers	15,532	14,937
Placements with banks and financial institutions	3,678	6,132
	45,840	**40,861**
Financial instruments at fair value through profit or loss	22,883	22,616
	68,723	**63,477**
Interest expense		
Due to customers	(23,952)	(21,984)
Due to banks	(7,116)	(9,377)
Other borrowed funds*	(2,280)	(2,295)
Promissory notes and bonds issued	(1,033)	(608)
Subordinated debt	(101)	(567)
	(34,482)	**(34,831)**
Obligatory deposit insurance	(1,263)	(901)
Net interest income	**32,978**	**27,745**

* Interest expense on "Other borrowed funds" presented separately in 2016 for comparability.

Interest income from placements with banks and financial institutions mainly relates to the net income from foreign currency swaps entered into through the Moscow Exchange in order to benefit from cheaper financing at interest rates in foreign currencies.

Interest expense on "Other borrowed funds" mainly relates to the interest expense on the loan provided by State Corporation "Deposit Insurance Agency" for the financial rehabilitation of "Express-Volga Bank" JSC ("EVB") in September 2015.

7. Fee and commission income

	2017 RUB MM	2016 RUB MM
Financial and insurance protection program membership	9,944	6,768
Plastic card operations	4,513	3,868
Bank guarantees	2,876	1,260
Settlement operations	965	562
Arranging and underwriting bond issuances	487	536
Agent fee for selling insurance products	434	234
Access to electronic trading platform	340	–
Lending operations	297	124
Agent fees from pension funds	223	254
Cash operations	91	76
Currency control fees	24	26
Other	88	213
	20,282	**13,921**

Income from provision of access to electronic trading platform mainly includes commissions received by the Group from micro- and small businesses for access to public procurement auctions through Sovombank's proprietary digital platform.

8. Fee and commission expense

	2017 RUB MM	2016 RUB MM
Agent services	(1,497)	(292)
Credit cards	(344)	(457)
Depositary services	(165)	(169)
Settlement operations	(72)	(123)
Interest expense on subordinated loan issued by the DIA	(64)	(63)
Other	(90)	(42)
	(2,232)	**(1,146)**

Agent services mainly include agency fees for selling mainly insurance products provided by third parties. The increase in expenses for agent services in 2017 was mainly driven by an increase in related sales volume.

Interest expense on the subordinated loan issued by the DIA relates to the subordinated loan of RUB 6,273 MM received by Sovcombank from the State Corporation Deposit Insurance Agency (the "DIA") (Note 30). Since this subordinated loan is an off-balance sheet item, the related interest expense cannot be recognized in interest expense according to IFRS.

9. Net foreign exchange gain/(loss)

	2017 RUB MM	2016 RUB MM
Dealing	(1,797)	11,134
Net gains on currency derivative financial instruments*	5,868	963
Translation differences	(1,401)	(11,631)
	2,670	**466**

* Since 1 January 2017, the Group separates "Net gains on currency derivative financial instruments" from "Dealing" for clarity. The comparative data for 2016 was reclassified to ensure its comparability with the data for 2017.

Dealing represents a gain or a loss on foreign currency contracts entered into by the Group through the Moscow Exchange in order to hedge long or short foreign currency positions to comply with the regulatory requirements.

Net gains on currency derivative financial instruments represent a gain or a loss from long-term swap contracts entered into by the Group in order to hedge long or short foreign currency positions to comply with the regulatory requirements.

Translation differences represents a gain or a loss on the revaluation of net assets and liabilities denominated in foreign currencies.

10. Other operating income

	2017 RUB MM	2016 RUB MM
Gain from asset restructuring	1,089	–
Disposal of foreclosed assets	176	128
Revaluation of investments in associates	106	–
Income from operating sublease	29	14
Penalties	6	95
Disposal of property and equipment	2	54
Gain from business combinations	–	4,627
Other	317	222
	1,725	**5,140**

Gain from asset restructuring represents cash received by the Group for a conversion of bonds issued by a Russian bank undergoing a financial rehabilitation into subordinated debt with the same nominal value maturing in 2030.

Revaluation of investments in associates represents revaluation of investments in Rosevrobank JSC (hereinafter, the "Rosevrobank") made by the Group in December 2017.

Gain from business combinations represents a gain from the Group's participation in the financial rehabilitation of "Express-Volga Bank" JSC and a bargain purchase gain from acquiring "Garanti Bank – Moscow" JSC in 2016.

11. Allowance for loan impairment

	2017 RUB MM	2016 RUB MM
Allowance for loans to individuals (Note 19)	(3,662)	(3,677)
Allowance for loans to corporate customers (Note 19)	(776)	(1,010)
	(4,438)	**(4,687)**

12. Personnel expenses

	2017 RUB MM	2016 RUB MM
Payroll, including bonuses	(10,762)	(6,384)
Payroll-related taxes	(2,635)	(1,571)
	(13,397)	**(7,955)**

In 2017, the increase in payroll, including bonuses was mainly due to an increase in headcount in the Retail segment (Note 5) and growth of bonuses for achieving key performance indicators.

13. Other general and administrative expenses

	2017 RUB MM	2016 RUB MM
Advertising and marketing	(2,354)	(969)
Renting premises	(2,009)	(1,492)
Professional and cash collection services	(1,229)	(854)
Inventory	(1,039)	(517)
Depreciation and amortization (Note 23)	(883)	(516)
IT support	(742)	(362)
Maintenance of property and equipment	(638)	(476)
Transport and business travel expenses	(571)	(309)
Telecommunication services and postal expenses	(534)	(441)
Taxes other than income tax	(229)	(123)
Security	(202)	(175)
Property insurance	(138)	(51)
Other	(325)	(377)
	(10,893)	**(6,662)**

In 2017, other general and administrative expenses exceeded those of 2016 mainly due to the acquisition of Metcombank JSC in Q4 2016, the expansion of the retail network, the increase in the headcount, launch of new products and upgrade of the Bank's IT infrastructure.

The increase in advertising and marketing expenses from RUB 969 MM in 2016 to RUB 2,354 MM in 2017 was due to the expansion of bank's retail network, moving marketing to the national from the regional level, as well as in connection with marketing expenses of RUB 997 MM related to "Halva" installment card.

Expenses for renting premises increased to RUB 2,009 MM in 2017 from RUB 1,492 MM in 2016 due to the expansion of the bank's retail network from 2,211 branches and mini-offices as at 31 December 2016 to 2,418 branches and mini-offices as at 31 December 2017.

In 2017, expenses for professional and cash collection services increased to RUB 1,229 MM as compared to RUB 854 MM in 2016 due to the expansion of the bank's retail network and significant expansion of the retail and SME business, in particular, increasing number of clients, development of new Retail segments, e.g., car and mortgage lending.

Inventory expenses include costs to acquire computers and office equipment, furniture, consumables and other inventories with the value of RUB 100 thousand or less each. The increase in these expenses in 2017 was due to the expansion of the bank's retail network, upgrade of the Group's IT infrastructure, as well as investments in development of digital platform of Sovcombank, which enables access to public and municipal procurement for 353 thousand companies, mostly micro- and small businesses.

14. Other impairment, provisions and expenses attributable to non-controlling interests

	2017 RUB MM	*2016 RUB MM*
Contingencies (Note 21)	137	(508)
Expenses related to non-controlling interest	(1,095)	−
Litigations (Note 21)	(934)	(210)
Goodwill impairment (Note 41)	(250)	(229)
Foreclosed assets	(30)	(23)
Impairment of investments in associates	−	(325)
Other assets (Note 24)	(546)	(67)
	(2,718)	**(1,362)**

Provision for contingencies is mainly associated with credit risk related to performance and tender bank guarantees mainly for micro- and small businesses selling goods and services through Group's digital platform to the public institutions. These bank guarantees recorded as off-balance sheet liabilities of RUB 84,844 MM (as at 31 December 2016: RUB 58,926 MM) (Note 34).

Expenses related to non-controlling interest represent an adjustment for income attributable to non-controlling shareholders of Sovremenny Kommerchesky Innovatsionny Bank LLC that are consolidated on line-by-line basis in the statement of comprehensive income. In 2016, these expenses were recorded as a part of non-controlling interests (Note 43).

The increase in provisions for litigations relates mainly to a provision of RUB 755 MM in respect of a litigation commenced by the creditors of OJSC Probusinessbank against the bankruptsy administrator of Probusinessbank with regard to several transactions predating the declaration of Probusinessbank bankrupt by the Arbitration court (Note 35). The provision covers the entire amount of possible cash outflow from the Group into Probusinessbank's insolvency estate in respect of this litigation, and does not intlusde a possible return of funds from the insolvency estate as the Bank is a creditor of Probusinessbank too.

15. Income tax expense

	2017 RUB MM	*2016 RUB MM*
Current income tax	(6,354)	(6,409)
Origination of temporary differences (Note 32)	(734)	(1,634)
	(7,088)	**(8,043)**

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

	2017 RUB MM	*2016 RUB MM*
Revaluation reserve for available-for-sale investment securities	195	(397)
Revaluation of buildings	(8)	(16)
Income tax charged to other comprehensive income (Note 32)	**187**	**(413)**

Russian legal entities file individual corporate income tax declarations. The income tax rate for legal entities (including banks) was 20% for 2017 and 2016. In 2017 and 2016, the income tax rate on interest (coupon) income from state and mortgage-backed bonds was 15%, while the income tax rate on interest (coupon) income from municipal bonds 9%. Dividends are taxed at the corporate income tax rate of 9%, which may be reduced to 0% subject to certain criteria.

Reconciliation of effective income tax rate

	2017 RUB MM	*2016 RUB MM*
Profit before tax	**36,659**	**41,650**
Income tax (expense)/benefit at the applicable tax rate	**(7,332)**	**(8,330)**
Tax exempt income	−	31
Effect of non-deductible expenses	(463)	(160)
Effect of income on state securities taxed at different rates	425	248
Other	282	168
	(7,088)	**(8,043)**

16. Cash and cash equivalents

	2017 RUB MM	*2016 RUB MM*
Due from the CBR	24,695	6,787
Nostro accounts with Russian banks and other financial institutions	8,207	9,023
Cash on hand	5,988	5,458
Short-term deposits with OECD banks maturing in less than 90 days	921	–
Short-term deposits and reverse repurchase transactions with Russian banks maturing in less than 90 days	135	8
Nostro accounts with OECD banks	16	189
	39,962	**21,465**

The increase in due from the CBR from RUB 6,787 MM as at 31 December 2016 to RUB 24,695 MM as at 31 December 2017 was mainly due to the placement of funds for averaging mandatory cash balances with the CBR and to the growth in the Group's liabilities.

Cash on hand relates mainly to cash in ATMs and self-service terminals of the Group.

17. Placements with banks

	2017 RUB MM	*2016 RUB MM*
Term deposits with banks	9,307	321
Bonds of Russian banks held by the Group	32	64
Total placements with banks	**9,339**	**385**
Less allowance for impairment	(1)	(1)
Placements with banks, net	**9,338**	**384**

In 2017, term deposits with banks of RUB 7,168 MM mainly included balances with three banks, including a major state-owned Russian bank and an international bank with a credit rating of A1/A+/A (Moody's/S&P/Fitch).

18. Financial instruments at fair value through profit or loss

	2017 RUB MM	*2016 RUB MM*
Held by the Group		
Corporate bonds and Eurobonds	59,467	51,685
Bonds of state-owned companies	43,269	28,368
Government and municipal bonds	27,863	7,111
Derivative financial instruments	9,240	3,610
Corporate shares	204	818
Total financial instruments at fair value through profit or loss held by the Group	**140,043**	**91,592**
Pledged under sale and repurchase agreements		
Corporate bonds and Eurobonds	106,363	96,536
Bonds of state-owned companies	69,301	50,128
Government and municipal bonds	33,434	46,962
Total financial instruments at fair value through profit or loss pledged under sale and repurchase agreements	**209,098**	**193,626**
Total financial instruments at fair value through profit or loss	**349,141**	**285,218**

18. Financial assets at fair value through profit or loss (continued)

Securities at fair value through profit or loss

The breakdown of securities at fair value through profit or loss by industry as at 31 December 2016 and 31 December 2016 is presented in the table below:

	2017		*2016*	
	Amount, RUB MM	***%***	***Amount, RUB MM***	***%***
Government and municipal institutions	61,297	18.0%	54,073	19.2%
Russian banks, including state-owned banks	59,944	17.6%	55,223	19.6%
Transport and infrastructure	46,464	13.7%	27,079	9.6%
Metallurgy	39,157	11.5%	33,190	11.8%
Petrochemicals	26,005	7.7%	32,923	11.7%
Leasing	20,739	6.1%	13,133	4.7%
Mining	16,031	4.7%	13,616	4.8%
Diversified holdings and other financial institutions	15,926	4.7%	9,654	3.4%
Manufacturing	15,503	4.6%	7,151	2.5%
Construction and development	9,242	2.7%	4,936	1.8%
Telecommunication	8,660	2.6%	13,451	4.8%
Services	6,838	2.0%	8,800	3.1%
Chemical industry	5,893	1.7%	6,931	2.5%
Trade	4,041	1.2%	1,196	0.4%
Agriculture and food processing	3,784	1.1%	−	0.0%
Other	377	0.1%	252	0.1%
	339,901	**100.00%**	**281,608**	**100.00%**

The breakdown of securities at fair value through profit or loss by long-term issuer credit rating assigned by international rating agencies (S&P, Fitch or Moody's) is presented in the table below.

	2017 RUB MM	***2016 RUB MM***
Securities at fair value through profit or loss		
Issuers with credit rating from BBB+ to BBB-	85,953	83,919
Issuers with credit rating from BB+ to BB-	184,003	179,677
Issuers with credit rating from B+ to B-	51,533	11,954
Unrated issuers	18,412	6,058
Total securities at fair value through profit or loss	**339,901**	**281,608**

The Group invested in bonds of 17 issuers unrated by international rating agencies (as at 31 December 2016: 9 issuers). 13 issuers were state-owned companies and companies owned by the Ministry of Finance of the Russian Federation and Ministries of Finance of the constituent entities of the Russian Federation (as at 31 December 2016: 2 issuers). The market value of these bonds is RUB 16,231 MM (as at 31 December 2016: RUB 8,360 MM).

The increase in unrated corporate bonds was mainly due to a gradual transition of the largest Russian companies and regional and municipal authorities to ratings assigned by Russian credit rating agencies Analytical Credit Rating Agency (ACRA) and Rating Agency Expert RA, as well as expiration of the credit rating agreements with international rating agencies.

Maturities of securities were within the following range: January 2018 − August 2049 (as at 31 December 2016: January 2017 − June 2043), the coupon rates were from 3.72% to 11.0% for USD-denominated debt securities, 7.49% for GBP-denominated debt securities, and from 6.29% to 17.0% for RUB-denominated debt securities (as at 31 December 2016: from 3.72% to 11.0% for USD-denominated debt securities, 3.37% for EUR-denominated debt securities, 7.49% for GBP-denominated debt securities, and from 6.2% to 15.0% for RUB-denominated debt securities).

The share of the largest issuer (a state-owned financial institution) in the aggregate portfolio of securities at fair value through profit or loss was 6.21% (as at 31 December 2016: 7.73%). The maturities of bonds of this issuer were within the following range: from March 2018 to September 2032 (as at 31 December 2016: from February 2017 to September 2032), and the coupon rates were from 4.5% to 9.75% (as at 31 December 2016: from 4.22% to 13.25%).

Eurobonds are treated as investments in unconsolidated structured companies as required by IFRS 12. The maximum credit risk equals to the carrying amount of corporate Eurobonds.

18. Financial assets at fair value through profit or loss (continued)

Derivative financial instruments

Majoirty of Group's funding is in Russian rubl and has a floating or quasi-floating nature while majority of Group's assets are denominated in USD and Russian rubl and bear typically fixed interest rates. The Group manages interest and currency risks by entering into derivative financial instruments (swaps)for trading purposes.

In November 2016, in order to convert floating interest rate to fixed interest rate, the Bank entered into three interest rate swap transactions with two international banks (with credit ratings of A1/A+/A and A3/A-/A+ of Moody's/ S&P/ Fitch Ratings) and with a major Russian state-owned bank for a total amount of underlying asset of USD 1.1 BN. These swaps mature in November 2023.

In July 2017, in order to convert floating interest rate to fixed interest rate, the Bank entered into five currency interest rate swap transactions with two major Russian banks for a total amount of underlying asset of USD 1.17 BN. The maturity dates of these swaps range from January 2018 to May 2018.

In September 2017, in order to convert floating interest rate to fixed interest rate, the Bank entered into four interest rate swap transactions with two foreign banks (with credit ratings of A1/A+/A и A3/A-/A+ of Moody's/ S&P/ Fitch Ratings) for a total amount of underlying asset of USD 590 MM. The maturity date under two of those transactions for a total of USD 500 MM is September 2022; the maturity dates under the other two transactions for USD 50 MM and USD 40 MM are September 2027 and September 2032.

In November and December 2017, the Bank entered into five credit default swap transactions with a foreign bank (with credit ratings of A1/A+/A of Moody's/ S&P/ Fitch Ratings) for a total amount of underlying asset of USD 270 MM.

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities in the financial statements, and their underlying amounts:

	2017			*2016*		
	Notional amount RUB MM	*Fair value Asset RUB MM*	*Fair value Liability RUB MM*	*Notional amount RUB MM*	*Fair value Asset RUB MM*	*Fair value Liability RUB MM*
Interest rate swaps – international banks	68,544	2,056	–	36,394	1,436	–
Interest rate swaps – contracts with Russian banks	28,800	1,241	–	30,328	1,192	–
Currency interest rate swaps – contracts with Russian banks	67,392	5,943	–	3,033	982	–
Credit default swaps – contracts with international banks	15,552	–	317	–	–	–
Total derivative assets/liabilities	**180,288**	**9,240**	**317**	**69,755**	**3,610**	**–**

The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year-end and are not indicative of the credit risk.

19. Loans to customers

	2017 RUB MM	*2016 RUB MM*
Loans to individuals		
Car loans	56,706	21,475
Consumer loans	47,653	54,613
Mortgages	30,228	3,528
Credit cards	9,222	6,719
Total loans to individuals	**143,809**	**86,335**
Loans to corporate customers		
Loans to corporate customers	83,262	46,158
Loans to constituent entities and municipalities of the Russian Federation	24,887	70,057
Corporate bonds	10,551	10,386
Bonds of state-owned companies	5,933	26,587
Government and municipal bonds	4,298	2,212
Loans to small businesses and other loans to customers	2,530	4,412
Total loans to corporate customers	**131,461**	**159,812**
Total loans to customers	**275,270**	**246,147**
Less: allowance for loan impairment	(9,025)	(7,727)
Loans to customers, net	**266,245**	**238,420**

19. Loans to customers (continued)

As at 31 December 2017, the Group reclassified loans secured by cars as follows:

	Portfolio, prior to reclassification RUB MM	*Reclassification amount RUB MM*	*As reclassified RUB MM*
Car loans	52,464	4,242	56,706
Consumer loans	51,895	(4,242)	47,653

In October 2016, the Bank acquired Metcombank JSC that specialized in car loans (Note 43). The increase in the car loan portfolio to RUB 56,706 MM as at 31 December 2017 as compared to RUB 21,475 MM as at 31 December 2016 relates to the expertise in car loans acquired by the Bank as a part of the transaction.

The increase in the mortgage portfolio to RUB 30,228 MM as at 31 December 2017 as compared to RUB 3,528 MM as at 31 December 2016 was due to the purchase of mortgage loans portfolio of RUB 16 BN from JSC Nordea Bank in January 2017 and the employment of mortgage professionals from JSC Nordea Bank.

The increase in the corporate loan portfolio to RUB 83,262 MM as at 31 December 2017 as compared to RUB 46,158 MM as at 31 December 2016 was due to loans provided to large corporates, the majority stake in which is held by the Russian Federation.

The decrease in loans to constituent entities and municipalities of the Russian Federation from RUB 70,057 MM as at 31 December 2016 to RUB 24,887 MM as at 31 December 2017 was due to less commercially attractive market interest rates in this segment in 2017 and partial expiration of this portfolio as a result.

Corporate bonds are bonds of state-owned companies, government and municipal bonds and corporate bonds reclassified to loans to corporate customers due to loss of an active market for these bonds and the intention of the Group to hold these bonds to maturity due to low credit risk of the bond issuers. Bonds of RUB 3,516 MM were pledged under repurchase agreements with other banks (as at 31 December 2016: bonds of RUB 19,688 MM were pledged under repurchase agreements with the CBR and bonds of RUB 6,801 MM were pledged under repurchase agreements with other banks) (Note 27).

As at 31 December 2017, the carrying amount of loans issued to the Group's ten largest borrowers is RUB 61,485 MM, which represented 22.3% of the total loan portfolio or 8.9% of the Group's total assets. As at 31 December 2016, the carrying amount of loans issued to the Group's ten largest borrowers was RUB 39,383 MM, which represented 16.0% of the total loan portfolio or 7.0% of the Group's total assets. As at 31 December 2017, the Group created an allowance for impairment of RUB 399 MM for loans issued to the ten largest borrowers (as at 31 December 2016: RUB 266 MM).

Industry analysis of loans to corporate customers and corporate bonds

Loans to corporate customers were issued to the companies and corporate bonds were issued by Russian issuers operating in the following industries:

	31 December 2017 RUB MM	*31 December 2016 RUB MM*
Diversified holdings and other financial institutions	37,500	3,387
Leasing	14,387	8,749
Transport and infrastructure	8,505	6,201
Commercial real estate	7,328	5,378
Petrochemicals	6,446	4,800
Construction	5,728	3,865
Energy	5,222	6,286
Services	2,706	1,953
Telecommunication	2,069	1,300
Manufacturing	853	4,265
Metallurgy	576	6,066
Chemical industry	143	–
Trade	8	–
Agriculture and food processing	–	1,829
Other	2,342	2,465
	93,813	**56,544**

19. Loans to customers (continued)

Industry analysis of loans to corporate customers and corporate bonds (continued)

The group of “Diversified holdings and other financial institutions” includes seven companies (as at 31 December 2016: four companies). The carrying amount of loans issued to the borrowers with the majority stake held by the Russian Federation was RUB 25,124 MM (as at 31 December 2016: a loan issued to the largest borrower of this group was RUB 976 MM).

The group of “Leasing” includes four companies (as at 31 December 2016: two companies). The carrying amount of loans issued to the borrowers with the majority stake held by the Russian Federation was RUB 9,793 MM (as at 31 December 2016: RUB 2,814 MM). Borrowers of this group also include LLC Sollers-Finance, a Group’s related party (a car leasing joint venture established by the Group and LLC Sollers, a major Russian car manufacturer); a loan of RUB 502 MM was issued to this related party (as at 31 December 2016: RUB 1,829 MM).

The group of “Transport and infrastructure” includes four companies (as at 31 December 2016: two companies). The carrying amount of loans issued to borrowers with the majority stake held by the Russian Federation was RUB 4,650 MM (as at 31 December 2016: RUB 2,800 MM).

The group of “Commercial real estate” includes 12 companies (as at 31 December 2016: eight companies). All loans issued to this group of borrowers are secured by leased out commercial real estate located for the most part in the center of Moscow. The loan-to-value ratio of the loans in this group does not exceed 60%. The carrying amount of loans issued to the largest group of related with each other borrowers was RUB 5,834 MM (as at 31 December 2016: RUB 3,378 MM). This largest group of related with each other borrowers has 11 years of credit history with the Bank with no loan restructuring or overdue payments.

The group “Petrochemicals” includes two companies (as at 31 December 2016: one company). The carrying amount of loans issued to the borrowers with the majority stake held by the Russian Federation was RUB 6,446 MM (as at 31 December 2016: RUB 4,800 MM).

The group “Construction” includes four companies (as at 31 December 2016: one company) engaged in construction of low-cost residential real estate in Moscow and Moscow region. The carrying amount of a loan issued to the largest borrower was RUB 4,032 MM (as at 31 December 2016: RUB 2,200 MM).

Allowance for impairment of loans to customers

Changes in the allowance for loan impairment for the years ended 31 December 2017 and 2016 are as follows:

	Loans to corporate customers, government, municipal and corporate bonds	*Loans to small businesses and other loans to customers*	*Consumer loans*	*Credit cards*	*Loans to constituent entities and municipalities of the Russian Federation*	*Mortgages*	*Car loans*	*Total*
As at 1 January 2017	**(1,143)**	**(189)**	**(4,848)**	**(829)**	**(361)**	**(357)**	**–**	**(7,727)**
Reversal/(charge) for the year	(623)	(389)	(1,178)	(926)	236	(586)	(972)	**(4,438)**
Reversal of amounts previously written off	–	–	(1,479)	(278)	–	(60)	–	**(1,817)**
Loans written off as uncollectible	253	348	3,141	952	–	303	(40)	**4,957**
As at 31 December 2017	**(1,513)**	**(230)**	**(4,364)**	**(1,081)**	**(125)**	**(700)**	**(1,012)**	**(9,025)**
Individual impairment	(698)	–	–	–	–	–	–	**(698)**
Collective impairment	(815)	(230)	(4,364)	(1,081)	(125)	(700)	(1,012)	**(8,327)**
	(1,513)	**(230)**	**(4,364)**	**(1,081)**	**(125)**	**(700)**	**(1,012)**	**(9,025)**
Total amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**3,010**	**–**	**–**	**–**	**–**	**–**	**–**	**3,010**

19. Loans to customers (continued)

Allowance for impairment of loans to customers (continued)

	Loans to corporate customers, government and municipal bonds, corporate bonds and bonds of state-owned companies	*Loans to small businesses and other loans to customers*	*Consumer loans*	*Credit cards*	*Loans to constituent entities and municipalities of the Russian Federation*	*Mortgages*	*Car loans*	*Total*
As at 1 January 2016	**(496)**	**(60)**	**(7,680)**	**(1,147)**	**(239)**	**(307)**	**–**	**(9,929)**
Reversal/(charge) for the year	(801)	(87)	(2,889)	(721)	(122)	(136)	69	**(4,687)**
Reversal of amounts previously written off	–	(42)	–	–	–	–	(69)	**(111)**
Loans written off as uncollectible	154	–	5,721	1,039	–	86	–	**7,000**
As at 31 December 2016	**(1,143)**	**(189)**	**(4,848)**	**(829)**	**(361)**	**(357)**	**–**	**(7,727)**
Individual impairment	(209)	–	–	–	–	–	–	**(209)**
Collective impairment	(934)	(189)	(4,848)	(829)	(361)	(357)	–	**(7,518)**
	(1,143)	**(189)**	**(4,848)**	**(829)**	**(361)**	**(357)**	**–**	**(7,727)**
Total amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**1,043**	**–**	**–**	**–**	**–**	**–**	**–**	**1,043**

In 2017, interest income accrued on individually impaired loans was RUB 90 MM (in 2016: RUB 30 MM).

Analysis of collateral

The breakdown of loans to customers (net of impairment) by type of collateral is presented in the table below:

	Loans to corporate customers, government and municipal bonds, corporate bonds and bonds of state-owned companies	*Loans to small businesses and other loans to customers*	*Consumer loans*	*Credit cards*	*Loans to constituent entities and municipalities of the Russian Federation*	*Mortgages*	*Car loans*	*Total*
Real estate	6,790	596	–	–	–	29,528	–	**36,914**
Motor vehicles	496	125	–	–	–	–	55,694	**56,315**
Goods and materials	2,423	28	–	–	–	–	–	**2,451**
Securities and equity investments	7,657	113	–	–	–	–	–	**7,770**
Other collateral	1,168	–	–	–	–	–	–	**1,168**
No collateral	83,999	1,437	43,289	8,141	24,761	–	–	**161,627**
Total loans to customers	**102,533**	**2,299**	**43,289**	**8,141**	**24,761**	**29,528**	**55,694**	**266,245**

The breakdown of loans to customers (net of impairment) by type of collateral as at 31 December 2016 is presented in the table below:

	Loans to corporate customers, government and municipal bonds, corporate bonds and bonds of state-owned companies	*Loans to small businesses and other loans to customers*	*Consumer loans*	*Credit cards*	*Loans to constituent entities and municipalities of the Russian Federation*	*Mortgages*	*Car loans*	*Total*
Real estate	5,689	1,381	406	–	–	3,168	12	**10,656**
Motor vehicles	1,722	321	4,265	–	–	–	21,158	**27,466**
Goods and materials	2,403	141	526	–	–	–	–	**3,070**
Securities and equity investments	2,720	182	–	–	–	–	–	**2,902**
Other collateral	980	899	3	–	–	–	31	**1,913**
No collateral	70,686	1,299	44,565	5,890	69,696	3	274	**192,413**
Total loans to customers	**84,200**	**4,223**	**49,765**	**5,890**	**69,696**	**3,171**	**21,475**	**238,420**

19. Loans to customers (continued)

Analysis of collateral (continued)

As at 31 December 2017 and 2016, the loans secured by "Other collateral" were mainly secured by guarantees issued by third parties.

The values shown in the tables above represent the loan carrying amount (net of impairment) and do not necessarily represent the fair value of the collateral.

The breakdown of loans to corporate customers by long-term credit rating assigned by international rating agencies (S&P, Fitch or Moody's) is presented in the table below. If a customer does not have its own credit rating, the breakdown is made with the credit rating of the parent company of such customer.

	31 December 2017 RUB MM	*31 December 2016 RUB MM*
Loans to corporate customers		
Customers with credit rating from BBB+ to BBB-	8,417	11,250
Customers with credit rating from BB+ to BB-	43,991	11,403
Customers with credit rating from B+ to B-	4,602	6,829
Unrated customers	26,252	16,676
Total loans to corporate customers	**83,262**	**46,158**

The increase in loans issued to customers with credit rating from BB+ to BB- was mainly due to the increase in loans issued to borrowers with the majority stake held by the Russian Federation.

The increase in loans issued to customers not rated by international rating agencies was mainly due to the increase in loans issued to customers operating in petrochemicals and commercial real estate (see industry analysis of loans to corporate customers and corporate bonds above), gradual transition to national credit ratings assigned by two Russian credit rating agencies (Analytical Credit Rating Agency (ACRA) and Rating Agency Expert RA) by the largest Russian companies and regional and municipal authorities, as well as expiration of the agreements with the largest international credit rating agencies.

The breakdown of corporate bonds by long-term issuer credit rating assigned by international credit rating agencies (S&P, Fitch or Moody's) is presented in the table below.

	31 December 2017 RUB MM	*31 December 2016 RUB MM*
Corporate bonds		
Issuers with credit rating from BBB+ to BBB-	–	558
Issuers with credit rating from BB+ to BB-	4,092	5,366
Issuers with credit rating from B+ to B-	2,427	1,829
Unrated issuers	4,032	2,633
Total corporate bonds	**10,551**	**10,386**

The increase in loans issued to unrated corporate customers and in unrated corporate bonds portfolio was mainly due to a gradual transition of the largest Russian companies and regional and municipal authorities to national credit ratings assigned by Russian credit rating agencies (Analytical Credit Rating Agency (ACRA) and Rating Agency Expert RA), as well as expiration of the agreements with the largest international credit rating agencies.

20. Available-for-sale investment securities

As at 31 December 2017 and 31 December 2016, the Group's investments classified as available for sale consisted of equity instruments of Russian credit institutions, as well as Russian and foreign companies:

	31 December 2017 RUB MM	*31 December 2016 RUB MM*	*Ownership interest as at 31 December 2017, %*	*Ownership interest as at 31 December 2016, %*
Credit institutions	3,074	4,888	15.54%	19.54%
Companies				
Investments in shares	111	1,111	3.70% to 6.79%	3.70% to 10.00%
Investments in shares as part of mezzanine lending	750	1,087	4.41% to 25.00%	5.00% to 24.70%
Total	**3,935**	**7,086**		

Investments in credit institutions represent investments in the shares in Rosevrobank JSB and in the shares in REG Holding Limited, which owns 64.7% shares of Rosevrobank JSB (as at 31 December 2016: 73.8%).

In 2017, after closure of a number of transactions to acquire shares in Rosevrobank JSB, the Group's direct shareholding in Rosevrobank JSB increased to 24.3%. The investment in Rosevrobank JSB with the carrying amount of RUB 7,445 MM was recognized in investments in associates because the Group exercises significant influence over Rosevrobank JSB (Note 43).

On transfer of investment in Rosevrobank JSB from available-for-sale investment securities to investments in associates, the Group reclassified a revaluation of RUB 1,767 MM previously recognized in equity as revaluation reserve for available-for-sale investment securities (net of taxes of RUB (353) MM) to net gain on available-for-sale assets in the consolidated statement of profit or loss.

Investments in shares as part of mezzanine lending relate to financing provided to Russian companies with a simultaneous purchase by the Group of a non-controlling interest in the borrower as a loan origination fee.

21. Movements in other impairment and provisions

Movements in provisions for other assets, legal claims and contingencies were as follows:

	Other assets (Note 24)	*Provision for litigations (Note 31)*	*Provisions for contingencies (Note 34)*	*Total*
As at 31 December 2015	**65**	**23**	**202**	**290**
Charge (Note 14)	67	210	508	**785**
Write-off	(30)	–	–	**(30)**
Redemption of obligations	–	(99)	–	**(99)**
As at 31 December 2016	**102**	**134**	**710**	**946**
Charge (Note 14)	546	934	(137)	**1,343**
Write-off	(106)	–	–	**(106)**
Redemption of obligations	–	(25)	–	**(25)**
As at 31 December 2017	**542**	**1,043**	**573**	**2,158**

22. Investment property

The Group owns a number of real estate properties. The Group occupies some of these properties and rents out the excess space. Real estate occupied by the Group is part of property and equipment and intangible assets (Note 23) and the remaining (rented out) real estate is classified as investment property.

22. Investment property (continued)

Management determines the fair value of investment property based on annual independent appraisals.

	2017 RUB MM	2016 RUB MM
Fair value at the beginning of the year	288	77
Transfer from/to property and equipment (Note 23)	339	(6)
Transfer to assets held for sale	(425)	–
Disposal	(65)	–
Business combination	–	218
Revaluation	(79)	(1)
Fair value at the end of the year	**58**	**288**

As at 31 December 2016, an investment property of RUB 218 MM included in "Business combination" represented office premises in Moscow International Business Center "Moscow City". The Group received this property as a result of acquisition of Garanti Bank-Moscow JSC in October 2016.

23. Property and equipment and intangible assets

	Land and buildings RUB MM	Leasehold improve-ments RUB MM	Computers RUB MM	ATMs RUB MM	Motor vehicles RUB MM	Furniture and equipment RUB MM	Construc-tion in progress RUB MM	Intangible assets RUB MM	Total RUB MM
Cost/revalued amount									
As at 1 January 2017	**1,092**	**28**	**209**	**1,030**	**134**	**392**	**–**	**3,682**	**6,567**
Effect of business combination	–	–	–	–	–	–	–	514	**514**
Additions	19	–	125	237	44	66	30	189	**710**
Disposals	(16)	(9)	(17)	(6)	(13)	(39)	–	(224)	**(324)**
Transfer to investment property (Note 22)	(339)	–	–	–	–	–	–	–	**(339)**
Revaluation	46	–	–	–	–	–	–	–	**46**
Elimination of accumulated depreciation on revalued assets	(84)	–	–	–	–	–	–	–	**(84)**
As at 31 December 2017	**718**	**19**	**317**	**1,261**	**165**	**419**	**30**	**4,161**	**7,090**
Amortization and impairment									
As at 1 January 2017	**–**	**(4)**	**(80)**	**(639)**	**(31)**	**(225)**	**–**	**(625)**	**(1,604)**
Amortization charge	(87)	(8)	(80)	(133)	(31)	(66)	–	(478)	**(883)**
Disposals	3	–	10	8	6	11	–	217	**255**
Elimination of accumulated depreciation on revalued assets	84	–	–	–	–	–	–	–	**84**
Impairment	–	–	–	–	–	–	–	–	**–**
As at 31 December 2017	**–**	**(12)**	**(150)**	**(764)**	**(56)**	**(280)**	**–**	**(886)**	**(2,148)**
Carrying amount at 31 December 2017	**718**	**7**	**167**	**497**	**109**	**139**	**30**	**3,275**	**4,942**
Carrying amount at 31 December 2016	**1,092**	**24**	**129**	**391**	**103**	**167**	**–**	**3,057**	**4,963**

	Land and buildings RUB MM	Leasehold improve-ments RUB MM	Computers RUB MM	ATMs RUB MM	Motor vehicles RUB MM	Furniture and equipment RUB MM	Intangible assets RUB MM	Total RUB MM
Cost/revalued amount								
As at 1 January 2016	**553**	**7**	**381**	**853**	**77**	**392**	**1,869**	**4,132**
Effect of business combination	519	21	55	–	7	35	1,699	**2,336**
Deconsolidation	–	–	–	–	–	–	–	**–**
Additions	16	–	37	289	68	48	125	**583**
Disposals	(5)	–	(264)	(112)	(18)	(83)	(11)	**(493)**
Transfer from investment property (Note 22)	6	–	–	–	–	–	–	**6**
Revaluation	14	–	–	–	–	–	–	**14**
Elimination of accumulated depreciation on revalued assets	(11)	–	–	–	–	–	–	**(11)**
As at 31 December 2016	**1,092**	**28**	**209**	**1,030**	**134**	**392**	**3,682**	**6,567**
Amortization and impairment								
As at 1 January 2016	**–**	**(2)**	**(248)**	**(654)**	**(28)**	**(240)**	**(334)**	**(1,506)**
Amortization charge	(11)	(2)	(37)	(94)	(17)	(61)	(294)	**(516)**
Deconsolidation	–	–	–	–	–	–	–	**–**
Disposals	–	–	205	109	14	76	3	**407**
Elimination of accumulated depreciation on revalued assets	11	–	–	–	–	–	–	**11**
Impairment	–	–	–	–	–	–	–	**–**
As at 31 December 2016	**–**	**(4)**	**(80)**	**(639)**	**(31)**	**(225)**	**(625)**	**(1,604)**
Carrying amount at 31 December 2016	**1,092**	**24**	**129**	**391**	**103**	**167**	**3,057**	**4,963**
Carrying amount at 31 December 2015	**553**	**5**	**133**	**199**	**49**	**152**	**1,535**	**2,626**

23. Property and equipment and intangible assets (continued)

Revalued assets

The Group recognized:

- A positive revaluation of RUB 1 MM in profit or loss (at at 31 December 2016: a positive revaluation of RUB 9 MM);
- A positive revaluation of RUB 45 MM in other comprehensive income and revaluation reserve (as at 31 December 2016: a positive revaluation of RUB 5 MM).

Had land and buildings not been revalued, their carrying amount would have been RUB 711 MM (as at 31 December 2016: RUB 1,131 MM).

24. Other assets

	2017 RUB MM	*2016 RUB MM*
Advances to suppliers	1,239	622
Current income tax assets	1,153	1,081
Prepaid taxes other than VAT and income tax	216	44
Claims for the delivery of cash and securities	204	129
Foreclosed assets	194	34
Receivables from cash settlement services	56	16
VAT receivable from leasing operations	26	10
Settlements with personnel	1	32
Other	14	6
	3,103	**1,974**
Provision for impairment of advances to suppliers (Note 21)	(542)	(102)
	2,561	**1,872**

Claims for the delivery of cash and securities relate to securitiens sold, but not yet paid for by counterparties.

Foreclosed assets comprise assets initially pledged by borrowers as a security mainly for car and mortgage loans and subsequently repossessed by the Bank. The growth of this line item in 2017 was mainly due to an increase in volume of secured retail lending.

Receivables from cash settlement services comprise receivables from the Bank's customers, mainly from micro- and small businesses, for cash settlement services. The growth of this line item in 2017 is the result of the growth in the volume of services provided.

25. Due to customers

	2017 RUB MM	*2016 RUB MM*
Individuals		
Term deposits	281,762	229,574
Current accounts and demand deposits	20,879	7,045
Legal entities		
Term deposits	28,155	17,111
Current accounts and demand deposits	28,118	22,638
Amounts payable under repurchase agreements	–	99
	358,914	**276,467**

As at 31 December 2017 and 2016, the ten largest customers of the Bank placed the total of RUB 30,497 MM and RUB 17,997 MM on current accounts and term deposits, or 8.5% and 6.5% of total due to customers.

As at 31 December 2017 and 2016, the Group did not have customers whose current accounts and term deposits exceeded 10% of total due to customers.

According to Russian legislation, the Group must repay term deposits placed by an individual upon demand of the client. If a term deposit is repaid prior to its contractual maturity upon a demand of a client, the interest rate of the term deposit is reduced to the interest rate on current accounts retrospectively, unless a different interest rate is specified in the agreement.

26. Due to the CBR

	2017 RUB MM	*2016 RUB MM*
Sale and repurchase agreements	–	42,292
Loans secured by assets	–	326
	–	**42,618**

In 2017, the Group closed all sale and repurchase deals with the CBR because interest rates of sale and repurchase deals with the CBR were higher than those with other financial institutions.

27. Due to banks

	2017 RUB MM	*2016 RUB MM*
Sale and repurchase agreements with other banks	180,056	141,654
Deposits	11,822	1,835
Loro accounts	2,257	1,707
	194,135	**145,196**

The Group had three counterparties whose balance exceeded 10% of total due to banks (as at 31 December 2016: four counterparties). Respective liabilities were RUB 146,287 MM or 75.4% of total due to banks (as at 31 December 2016: RUB 135,752 MM or 93.5% of total due to banks).

As at 31 December 2017 and 31 December 2016, the Group pledged the following securities as collateral for sale and repurchase agreements with the CBR and other banks:

	31 December 2017		*31 December 2016*	
	Sale and repurchase agreements with the CBR RUB MM	*Sale and repurchase agreements with other banks RUB MM*	*Sale and repurchase agreements with the CBR RUB MM*	*Sale and repurchase agreements with other banks RUB MM*
Financial instruments pledged under sale and repurchase agreements				
Corporate bonds and Eurobonds	–	106,363	2,621	93,915
Government and municipal bonds	–	33,434	23,942	23,020
Bonds of state-owned companies	–	69,301	4,843	45,285
Total carrying amount	**–**	**209,098**	**31,406**	**162,220**
Loans to customers pledged under sale and repurchase agreements				
Corporate bonds	–	–	–	2,304
Government and municipal bonds	–	3,271	789	955
Bonds of state-owned companies	–	245	18,899	3,542
Total carrying amount	**–**	**3,516**	**19,688**	**6,801**
Related liabilities	**–**	**180,056**	**42,292**	**141,654**

28. Debt securities issued

	2017 RUB MM	*2016 RUB MM*
Bonds	14,394	7,178
Promissory notes	1,291	1,596
Saving certificates	59	–
	15,744	**8,774**

28. Debt securities issued (continued)

The Group had four issues of bonds on the market:

- With an aggregate nominal value of RUB 169 MM maturing in February 2019;
- With an aggregate nominal value of RUB 10 MM maturing in June 2021;
- With an aggregate nominal value of RUB 4,158 MM maturing in July 2021;
- With an aggregate nominal value of RUB 10,046 MM maturing in November 2027;

The annual interest rates on the bonds issued by the Group range from 8% to 9.5%.

29. Other borrowed funds

On 21 September 2015, as a result of an open tender, the State Corporation Deposit Insurance Agency (the "DIA") appointed Sovcombank as an investor for the financial rehabilitation of "Express-Volga Bank" JSC ("EVB"), a subsidiary of a failed bank Probusinessbank OJSC ("Probusinessbank") (Note 34).

On 23 September 2015, the DIA provided Sovcombank a loan of RUB 49,850 MM bearing an interest rate of 0.51% and maturing on 23 September 2025. The DIA granted the loan to enable Sovcombank implement bankruptcy prevention measures in respect of EVB (the "DIA Loan").

The Group pledged as a collateral for the DIA Loan loans to individuals and corporate customers of RUB 45,270 MM (as at 31 December 2016: RUB 49,003 MM).

The DIA, as the bankruptsy administrator of Probusinessbank, recovered and repaid a part of liabilities due from Probusinessbank to its creditors, including EVB. Subsequently, Sovcombank repaid a part of the DIA Loan of total RUB 9,008 MM to the DIA.

The DIA Loan was issued to Sovcombank at the rate of 0.51% p.a., significantly below the market rate. According to IAS 39, loans issued at interest rates other than market interest rates are measured at the date of issuance at fair value, which includes future interest payments and principal debt discounted on the basis of market interest rates. As at the date of issuance of the DIA Loan, the market interest rate used by Sovcombank for similar loans was 14.9%. The fair value of the DIA Loan of RUB 14,920 MM (as at 31 December 2016: RUB 15,206 MM) was recorded as "Other borrowed funds"
:

	2017 RUB MM	***2016 RUB MM***
DIA loan	14,920	15,206
Other	461	485
	15,381	**15,691**

30. Subordinated debt

The Bank's participation in the anti-crisis plan of the Russian Government and the receipt of subordinated loans from the State Corporation Deposit Insurance Agency (the "DIA").

On 27 January 2015, the Russian Government issued Decision No. 98-r approving the Plan of Priority Measures to Ensure Sustainable Development of the Economy and Social Stability in 2015 (the "Anti-crisis Plan"). On 23 January 2015, the Board of Directors of the DIA approved a list of banks, including the Sovcombank, selected to participate in the Anti-crisis Plan.

On 27 April 2015, the DIA provided the Bank five tranches of a subordinated loan totaling RUB 6,273 MM in the form of Russian state bonds ("OFZ") issued by the Ministry of Finance of the Russian Federation. These tranches have maturities of 12 to 19 years.

The Bank's participation in the anti-crisis plan of the Russian Government and receipt of the subordinated loans from the State Corporation Deposit Insurance Agency (the "DIA")

The CBR confirmed that this subordinated loan was eligible to be included into the Bank's capital.

The subordinated loan is recorded as an off-balance sheet item because in accordance with IAS 39 it is classified as "securities lent".

30. Subordinated debt (continued)

Subordinated loan from Sovco Capital Partners N.V.

In March 2017, Sovcombank and Sovco Capital Partners N.V. amended the existing perpetual subordinated loan agreement. Because the terms of the agreement changed significantly, the subordinated loan no longer qualified as an equity component as per IAS 32 *Financial Instruments: Presentation*. The Group re-classified the subordinated loan of USD 94.5 MM (RUB 5,770 MM as at 31 December 2016) to liabilities.

In March 2017, the Bank received a perpetual subordinated loan of USD 22.8 MM (an equivalent of RUB 1,302 MM as at 28 March 2017) from Sovco Capital Partners N.V.

The total principal amount of the perpetual subordinated loan was USD 117.3 MM (an equivalent of RUB 6,757 MM); accrued interest was USD 0.7 MM (an equivalent of RUB 42 MM). The total outstanding amount of the perpetual subordinated loan was USD 118 MM (an equivalent of RUB 6,799 MM).

According to the subordinated loan agreement with Sovco Capital Partners N.V., the Bank may decide whether to pay the interest at its sole discretion. On this grounds, the related interest expense is recognized as dividends.

Type	*Principal, loan currency, thousand*	*Currency*	*Counter-party*	*Interest rate*	*Issue date*	*Maturity date*	*2017 RUB MM*	*2016 RUB MM*
Perpetual subordinated loan	117,300	USD	Sovco Capital Partners N.V.	9.00%	21 March 2017	–	6,799	–
Perpetual subordinated loan	94,470	USD	Sovco Capital Partners N.V.	10.00%	11 July 2016	–	–	5,770
Subordinated debt	470,000	RUB	Sovco Capital Partners N.V.	14.85%	18 October 2016	25 October 2017	–	473
Subordinated debt	1,000,000	RUB	Sovco Capital Partners N.V.	15.00%	18 October 2016	11 April 2017	–	1,011
							6,799	**7,254**

31. Other liabilities

	2017 RUB MM	*2016 RUB MM*
Payables to personnel	2,425	1,624
Deferred revenues	1,835	1,523
Provision for litigations (Note 21)	1,043	134
Payables to suppliers	834	588
Provisions for contingencies (Note 34)	573	710
Accrued expenses on obligatory deposit insurance	343	234
Derivative financial liabilities (Note 18)	317	–
Taxes payable other than VAT and income tax	150	204
VAT payable	52	28
Current income taxes payable	19	600
Settlements on currency conversion operations	11	3
Other	262	149
	7,864	**5,797**

Tthe increase in payables to personnel was mainly due to the accrual of year-end bonuses of RUB 2,007 MM to employees for the financial year of 2017.

Deferred revenues include fees for issuing bank guarantees and corporate loans. Deferred revenues are amortized (recognized in interest income) over the life of the related guarantee or loan.

The increase in provisions for litigations was mainly due to a provision of RUB 755 MM created in respect of a litigation commenced by creditors of Probusinessbank OJSC with regard to transactions predating the declaration of Probusinessbank OJSC bankrupt by the Arbitration court (Note 35).

Payables to suppliers mainly include general and administrative expenses recognized after the reporting date but related to 2017.

Provisions for contingencies include provisions of RUB 382 MM for guarantees and provisions of RUB 191 MM for regress claims in respect of bank guarantees issued to enable public procurement through Group's digital platform mainly for micro- and small businesses.

31. Other liabilities (continued)

The increase in accrued expenses on obligatory deposit insurance was due to the increase in deposits placed by individuals.

"Settlements on currency conversion operations" represent the fair value of the currency swaps the entered into by the Group in order to manage its currency position (currency risk).

32. Deferred tax

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

		Origination and reversal of temporary differences				***Origination and reversal of temporary differences***				
	2015	***In the income statement***	***In other compre-hensive income***	***Effect of business combi-nation***	***2016***	***In the income statement***	***In other compre-hensive income***	***Effect of business combi-nation***	***Disposed in business deconso-lidation***	***2017***
Tax effect of deductible temporary differences										
Other assets	80	156	–	94	330	(162)	–	–	–	168
Due to customers	32	30	–	1	63	(23)	–	–	–	40
Other liabilities	232	(121)	–	18	129	831	–	–	–	960
Asset on the tax loss carried forward	4,038	(5,238)	–	1,200	–	–	–	–	–	–
Deferred tax asset	**4,382**	**(5,173)**	**–**	**1,313**	**522**	**646**	**–**	**–**	**–**	**1,168**
Tax effect of taxable temporary differences										
Financial instruments at fair value through profit or loss	(6,429)	4,917	–	(1,035)	(2,547)	(340)	–	65	–	(2,822)
Financial instruments available for sale	–	–	(397)	–	(397)	–	195	–	–	(202)
Loans to customers	(315)	(308)	–	89	(534)	(805)	–	–	–	(1,339)
Property and equipment and intangible assets	(348)	339	(16)	7	(18)	(223)	(8)	62	–	(187)
Cash and cash equivalents	(48)	(67)	–	–	(115)	(34)	–	–	–	(149)
Placements with banks	(1)	(1,322)	–	57	(1,266)	23	–	–	–	(1,243)
Debt securities issued	10	(20)	–	–	(10)	(1)	–	–	–	(11)
Deferred tax liability	**(7,131)**	**3,539**	**(413)**	**(882)**	**(4,887)**	**(1,380)**	**187**	**127**	**–**	**(5,953)**
Deferred tax asset	**2**	**494**	**–**	**–**	**496**	**(37)**	**–**	**–**	**–**	**459**
Deferred tax liability	**(2,751)**	**(2,128)**	**(413)**	**431**	**(4,861)**	**(697)**	**187**	**127**	**–**	**(5,244)**

33. Equity

As at 31 December 2017 and 2016, the share capital of the Group was RUB 1,716 MM.

On 26 October 2017, Sovco Capital Partners N.V. contributed RUB 470 MM to the additional paid-in capital of Sovcombank.

As at 31 December 2017 and 2016, the total number of authorized ordinary shares with a nominal value of RUB 0.1 each was 17,155,942,700.

In 2016, the Group decreased its share capital through redemption of 1,904,098,073 shares with a nominal value of RUB 190 MM (9.99% of the total number of shares) repurchased from Sovco Capital Partners N.V. in 2014.

The Bank's share capital was contributed by the shareholders in Russian rubles. The shareholders are entitled to dividends and any capital distributions in Russian rubles.

In 2017, Sovcombank paid dividends of RUB 3,053 MM (2016: RUB 4,355 MM). In addition to the dividends, interest on the perpetual subordinated loan, recognized as dividends (Note 30, "Subordinated loan from Sovco Capital Partners N.V.") was RUB 458 MM (2016: RUB 258 MM).

34. Commitments

According to its loan agreements, the Group may have outstanding commitments to extend loans. These commitments take a form of approved loans, credit card limits and overdraft facilities.

The Group provides bank guarantees mainly to facilitate public procurement through Group's digital platform to ensure that Group's customers honour their liabilities towards third parties, mainly regional governments and state-owned companies. These bank guarantees have fixed limits and generally extend for a period of up to one year.

34. Commitments (continued)

The commitments by category were as follows:

Contractual amount	*2017 RUB MM*	*2016 RUB MM*
Bank guarantees	112,686	71,812
Loan and credit line commitments	152,412	51,238
	265,098	**123,050**
Provisions for contingencies (Note 21)	(573)	(710)

The bank had 160 thousand of current guarantees of RUB 84,844 MM nominal value in total (as at 31 December 2016: 118 thousand of current guarantees of RUB 58,926 MM nominal value in total) issued by the Group to small and medium businesses to enable supply of goods and services to the State and state-owned companies in accordance with Federal Law No. 44-FZ, *On the Contract System for the Procurement of Goods, Work and Services for Public and Municipal Needs* and Federal Law No. 223-FZ, *On Purchases of Goods, Work and Services by Certain Types of Legal Entities*.

The total number of issued current guarantees was 163 thousand (as at 31 December 2016: 121 thousand).

The total value of not utilised bank guarantee limits was RUB 27,073 MM (as at 31 December 2016: RUB 18,157 MM).

Contractual commitments to issue loans rarely result in actual cash outflow as such commitments may be cancelled or may expire without actual funding being provided. In addition, the majority of the Group's loan agreements provide that the Group may unilaterally refuse to extend a loan.

In July 2014, the Group sold an office building occupied by the Bank and located at the address: Russia, Moscow, Krasnopresnenskaya naberezhnaya, 14, building 1, to a third party. Simultaneously, the Bank and the new owner entered into a long-term rental agreement to rent the office premises occupied by the Bank. The rental agreement expires in September 2024. According to the rental agreement, Sovcombank may unilaterally terminate the agreement starting from July 2018. The office rent before July 2018 represents an operating lease commitment.

Office rent under the rental agreements constitutes operating lease commitments and as at 31 December 2017 and 2016 was as follows:

Operating lease commitments	*2017 RUB MM*	*2016 RUB MM*
No later than 1 year	193	291
From 1 to 5 years	111	186
	304	**477**

35. Contingencies

Contingencies

In September 2017, the Group entered into an option agreement to purchase securities, under which the Group undertakes to pay RUB 1,500 MM when it fails to meet specific conditions and may not receive any compensation in this case. Management of the Group believes that the failure to meet those conditions is possible but not probable.

Litigation related to "Express-Volga Bank" JSC ("EVB")

In August 2015, the CBR revoked the banking license of Probusinessbank OJSC ("Probusinessbank"). In September 2015, Sovcombank won an open tender and was appointed as an investor for the financial rehabilitation of EVB. In September 2015, the State Corporation Deposit Insurance Agency (the "DIA") included EVB, the Bank's subsidiary at that date, in the register of Probusinessbank's creditors. In October 2015, the Moscow Arbitration Court declared Probusinessbank bankrupt.

In October 2017, a group of minority creditors of Probusinessbank successfully challenged in a court the decision by the DIA to include EVB into the register of Probusinessbank's creditors. The DIA and EVB did not agree with the court ruling and filed an appeal. In December 2017, the court of appeal canceled the initial court ruling and ruled to reject the claim of minority creditors. The minority creditors challenged the ruling of the court of appleal but the court upheld the ruling of the court of appeal in March 2018. On these grounds, the Group did not create a provision for this litigation.

35. Contingencies (continued)

Litigation related to "Express-Volga Bank" JSC ("EVB") (continued)

In December 2017, the minority creditors of Probusinessbank challenged actions of the bankruptsy administrator of Probusinessbank (the DIA) with regard to certain transactions predating declaration of Probusinessbank bankrupt by the Arbitration court. In December 2017, the Group estimated the risk of a cash outflow from EVB as possible and created a provision of RUB 755 MM in respect of this litigation. The provision covers the entire amount of possible cash outflow from the Bank into Probusinessbank's insolvency estate in respect of this litigation, leaving out possible return of funds from the insolvency estate (Note 21). The Group's management believes that accrued provisions for legal proceedings cover the entire amount of possible risks and litigation costs.

In November 2016, Sovcombank won a right to acquire "Poidem!" OJSC, a bank – subsidiary of Probusinessbank, on an open auction organised by the DIA. The funds raised as a result of the auction formed Probusinessbank's insolvency estate and subsequently were allocated to all Probusinessbank's creditors. In December 2016, Sovcombank signed an agreement to sell 100% of shares of "Poidem!" OJSC to the management of this bank. In November 2017, minority creditors of Probusinessbank challenged the results of the open auction in relation to "Poidem!" OJSC. In December 2017, the court upheld the results of the open auction. On these grounds, the Group did not create a provision for this claim.

In February 2017, the minority creditors of Probusinessbank filed a request to declare invalid several transactions of RUB 46 BN in total (the "Transactions") related to a repayment of interbank loans by Probusinessbank to EVB. The minority creditors believe that EVB had a preferential treatment in settlement of liabilities shortly before Probusinessbank was declared bankrupt. Should the court uphold the claim of minority creditors, EVB's rights of claim from Probusinessbank will increase proportionaly. The Group's management believes that the Group will not experience an outflow of economic benefits because the claim by minority creditors is inconsistent with the actual events of 2015. On these grounds, the Group did not create a provision for this claim.

Tax contingencies

Certain provisions of Russian tax, currency and customs legislation as currently in effect are vaguely drafted which may often result in their different interpretation (which, inter alia, may apply retrospectively), inconsistent and selective application and frequent and unpredictable changes. Interpretation of this legislation by the Group in relation to the operations and activities of the Group may be challenged by the respective state authorities. The tax authorities may be taking a more assertive position in their interpretation of the applicable legislation, in carrying out tax audits and in making tax assessments. Consequently, the tax authorities may challenge transactions and tax accounting methods that have not been challenged in the past. Fiscal periods remain open and subject to review by the tax authorities in course of the on-site tax audits for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. Under certain circumstances tax reviews may cover longer periods.

In 2017 certain anti - abuse rules were effectively introduced into the Russian Tax Code. These rules prohibit a taxpayer from reducing the tax base (tax amount) by misrepresenting information on economic events and objects of taxation or in case of lack of business purpose. At the moment it is unclear how the Russian tax authorities and/ or Russian courts will interpret this new rules in practice; therefore, there is uncertainty regarding the application of these new rules and their possible interpretation by the Russian tax authorities in respect of the Group's activities, including banking activity and/ or operations in financial markets, including transactions with securities and other property rights. It is possible that with the evolution of these rules and changes in the approach of the Russian tax authorities and/or courts to their application and interpretation, additional taxes and related fines and penalties may be assessed, which could negatively impact the financial condition of the Group. The details of such contingent liabilities are not disclosed in the financial statements because of the uncertainty of the potential outcome in case of different interpretation of tax law by the Russian tax authorities. However, the management believes in the positive outcome of this matter, if challenged by the tax authorities.

Russian transfer pricing legislation allows the Russian tax authority under certain circumstances to apply transfer pricing adjustments and impose additional profits tax and VAT liabilities in respect of all controlled transactions if the transaction price differs from the market level of prices determined for tax purposes and such deviation resulted in the underpayment of the tax to the revenue. The list of controlled transactions includes transactions performed with related parties (subject to certain conditions) and certain types of cross-border transactions.

Starting from 1 January 2015, new rules on taxation of controlled foreign companies were introduced into the Russian tax legislation, as well as the concept of determining the tax residency of organizations and the beneficial owner of income. The adoption of these rules in its entirety is associated with an increase in the administrative and, in some cases, tax burden on Russian taxpayers engaged in transactions with foreign companies.

The Management of the Group believes that its interpretation of the applicable legislation is reasonable and will be sustained.

36. Risk management

Risk management is one of the Group's most important internal processes. The ultimate goal of the Group risk management policy is to ensure that significant types of risk are identified early and mitigated in advance.

Risk management policies and procedures

The Group identifies, assesses and mitigates existing and emerging risks through a combination of risk management tools and processes, as well as strict compliance with the Group's corporate governance principles. Risk management policies and processes are reviewed regularly to reflect changes in market conditions, products and services offered, as well as emerging best practice in risk management.

The Supervisory Board of the Group has an overall responsibility for establishing the risk management framework, overseeing the management of key risks, reviewing the Group's risk management policies and procedures and approving significant counterparty exposures.

The Management Board of the Group is responsible for the application of the risk management system and implementation of risk mitigation measures, as well as for ensuring that the Group operates within the established risk limits.

The application of risk management policies is subject to a regular review by the Internal Audit Department.

Financial risks, such as credit, market and liquidity risks, are managed by the Credit Committees and the Liquidity Management Committee ("LMC").

The primary types of risk affecting the Group are:

- Market risk (which includes interest rate, currency and prepayment risks);
- Credit risk;
- Liquidity and funding risk;
- Operational risk.

Market risk

Market risk is a risk that the Group's profit and/or net assets will decrease due to unfavorable changes in the market (including fluctuations and increased volatility of interest rates, expected inflation rates, credit spreads and prices for equity and bonds, foreign exchange rates, prices for real estate and commodities and other instruments).

The Group is exposed to a number of market risks, the principal ones being: interest rate, currency and prepayment risks.

The Group manages its market risk using a methodology approved by the Management Board and applies a range of indicators to identify whether the risk assumed by the Group is in line with the approved risk limits and potential market conditions. Senior management regularly communicates all significant risk exposures to appropriate committees responsible for monitoring and oversight.

To manage the risk related to non-trading transactions, the Group offsets corresponding assets and liabilities against one another and the remaining risk mitigates by currency swaps. In the course of managing the risk related to non-trading transactions, the Group monitors and controls the exposure arising from the excess of the margin of interbank rates over the CBR's rates through the appropriate hedging.

36. Risk management (continued)

Market risk (continued)

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Group sets limits on the acceptable level of mismatch for interest rate revision. The sensitivity of the fair value of such instruments includes the effect of the plausible changes in risk-free interest rate for one year. The above parameter is measured by reference to the effect of the fair value of the fixed-rate financial instruments at fair value through profit or loss, loans issued to customers and attracted deposits carrying a floating interest rate. Such measurement envisages applying the assumption of a parallel shift in the yield curve.

Currency	*Increase in basis points*	*Sensitivity of net interest income 2017*	*Sensitivity of net gain on financial instruments at fair value through profit or loss 2017*	*Sensitivity of net gain on financial instruments at fair value through profit or loss 2016*
RUB	100	403	(6,048)	(3,093)
USD	100	69	(626)	(1,716)
EUR	100	144	–	(13)

Currency	*Decrease in basis points*	*Sensitivity of net interest income 2017*	*Sensitivity of net gain on financial instruments at fair value through profit or loss 2017*	*Sensitivity of net gain on financial instruments at fair value through profit or loss 2016*
RUB	100	(403)	6,048	3,093
USD	100	(69)	626	1,716
EUR	100	(144)	–	13

To reduce interest rate risk, the Bank enters into long-term interest rate swaps with Russian and foreign banks. More detailed information is presented in the section “Derivative financial instruments” (Note 18).

Currency risk

The Group has assets and liabilities denominated in several foreign currencies. Currency risk arises when the actual or forecast assets denominated in a foreign currency mismatch the liabilities in the same currency. The Group’s policy requires that total currency risk exposure does not exceed 10% of net assets attributable to shareholders.

To manage currency risk mainly arising from the mismatch of volumes of foreign currency assets and liabilities, the Group enters into currency swaps for the respective currencies through the Moscow Exchange.

Sensitivity of the Group’s annual profit or loss and net assets attributable to shareholders to changes in foreign currency exchange rates as at 31 December 2017 and 2016 was as follows:

	2017	*2016*
	Profit or loss RUB MM	*Profit or loss RUB MM*
20% appreciation of USD vs. RUB	(12)	1,309
20% depreciation of USD vs. RUB	12	(1,309)
20% appreciation of EUR vs. RUB	(14)	(3)
20% depreciation of EUR vs. RUB	14	3

36. Risk management (continued)

Currency risk (continued)

The table below shows the breakdown of assets and liabilities by currency as at 31 December 2017:

	RUB RUB MM	*USD RUB MM*	*EUR RUB MM*	*Other RUB MM*	*Total RUB MM*
Assets					
Cash and cash equivalents	33,985	544	5,397	36	**39,962**
Mandatory cash balances with the CBR	2,975	–	–	–	**2,975**
Placements with banks	32	5,162	4,144	–	**9,338**
Financial instruments at fair value through profit or loss:					
- held by the Group	100,270	38,550	–	1,223	**140,043**
- pledged under sale and repurchase agreements	79,583	129,265	–	250	**209,098**
Available-for-sale investment securities	3,935	–	–	–	**3,935**
Loans to customers	233,230	25,255	7,760	–	**266,245**
Investments in associates	8,224	–	–	–	**8,224**
Assets held for sale	425	–	–	–	**425**
Investments in car leasing joint venture	506	–	–	–	**506**
Investment property	58	–	–	–	**58**
Property and equipment and intangible assets	4,942	–	–	–	**4,942**
Goodwill	728	–	–	–	**728**
Deferred tax asset	459	–	–	–	**459**
Other assets	2,560	1	–	–	**2,561**
Total assets	**471,912**	**198,777**	**17,301**	**1,509**	**689,499**
Liabilities					
Due to banks	110,440	83,695	–	–	**194,135**
Due to customers	345,346	9,454	4,109	5	**358,914**
Debt securities issued	15,608	70	66	–	**15,744**
Other borrowed funds	14,920	461	–	–	**15,381**
Subordinated debt	–	6,799	–	–	**6,799**
Deferred tax liability	5,244	–	–	–	**5,244**
Other liabilities	7,523	341	–	–	**7,864**
Total liabilities	**499,081**	**100,820**	**4,175**	**5**	**604,081**
Net balance sheet position as at 31 December 2017	**(27,169)**	**97,957**	**13,126**	**1,504**	**85,418**
Net off-balance sheet position as at 31 December 2017	**112,461**	**(98,017)**	**(13,195)**	**(1,249)**	**–**
Net position as at 31 December 2017	**85,292**	**(60)**	**(69)**	**255**	**85,418**
Credit-related commitments	**249,041**	**15,241**	**816**	**–**	**265,098**

36. Risk management (continued)

Currency risk (continued)

The table below shows the breakdown of assets and liabilities by currency as at 31 December 2016:

	RUB RUB MM	*USD RUB MM*	*EUR RUB MM*	*Other RUB MM*	*Total RUB MM*
Assets					
Cash and cash equivalents	14,095	1,932	5,413	25	**21,465**
Mandatory cash balances with the CBR	3,017	–	–	–	**3,017**
Placements with banks	64	–	320	–	**384**
Financial instruments at fair value through profit or loss:					
- held by the Group	43,882	46,124	341	1,245	**91,592**
- pledged under sale and repurchase agreements	70,901	122,725	–	–	**193,626**
Available-for-sale investment securities	7,086	–	–	–	**7,086**
Loans to customers	223,462	14,957	1	–	**238,420**
Investments in associates	802	–	–	–	**802**
Assets held for sale	134	–	–	–	**134**
Investments in car leasing joint venture	456	–	–	–	**456**
Investment property	288	–	–	–	**288**
Property and equipment and intangible assets	4,963	–	–	–	**4,963**
Goodwill	728	–	–	–	**728**
Deferred tax asset	496	–	–	–	**496**
Other assets	1,870	–	–	2	**1,872**
Total assets	**372,244**	**185,738**	**6,075**	**1,272**	**565,329**
Liabilities					
Due to the CBR	326	42,292	–	–	**42,618**
Due to banks	63,551	81,628	17	–	**145,196**
Due to customers	262,167	9,472	4,826	2	**276,467**
Debt securities issued	8,471	142	161	–	**8,774**
Other borrowed funds	15,206	485	–	–	**15,691**
Subordinated debt	1,484	–	–	–	**1,484**
Deferred tax liability	4,861	–	–	–	**4,861**
Non-controlling interests	525	–	–	–	**525**
Other liabilities	5,791	6	–	–	**5,797**
Total liabilities	**362,382**	**134,025**	**5,004**	**2**	**501,413**
Net balance sheet position as at 31 December 2016	**9,862**	**51,713**	**1,071**	**1,270**	**63,916**
Net off-balance sheet position as at 31 December 2016	**47,453**	**(45,169)**	**(1,085)**	**(1,199)**	**–**
Perpetual subordinated debt received	**–**	**5,770**	**–**	**–**	**5,770**
Net position as at 31 December 2016	**57,315**	**774**	**(14)**	**71**	**58,146**
Credit-related commitments	**111,372**	**11,642**	**36**	**–**	**123,050**

Prepayment risk

Prepayment risk is the risk that the Group will fail to receive income from its assets as planned because some of its customers repay or request repayment earlier or later than expected.

The Group evaluates the prepayment risk for consumer loans. In 2017, the amount of consumer loans repaid prior to maturity was RUB 41,064 MM or 84.48% in addition of expected payments (2016: RUB 9,097 MM or 23.11%). Prepaid loans do not significantly impact the Group's financial results and equity at the end of the current reporting period.

Credit risk

Credit risk is defined as the risk that parties which have contractual relationship with the Group fail to fail to honour their obligations. Adverse changes in the credit quality of the Group's borrowers and counterparties, or in their behavior, would be expected to reduce the value of the Group's assets and increase the Group's write-downs and allowances for impairment.

Group performance is closely related to the macroeconomic environment and other factors, including, inter alia, change in economic growth rates in the Russian Federation, changes in consumer spending, excessive consumer indebtedness, growth of unemployment and changes in market interest rates. All these factors may influence the Group's risk profile. The possibility of further macroeconomic downside risk remains.

36. Risk management (continued)

Credit risk (continued)

The Group takes certain actions to mitigate credit risk, i.e.:

- It designs prudent risk management policies and also sets limits on the level of exposure in light of cyclical changes in the macroeconomic environment;
- It clearly defines levels of authority (including independently set and monitored credit limits for counterparties, access to effective scoring models, credit policies, etc.);
- It applies robust credit processes and risk control methods;
- It has permanently operating committees, which ensure that risks are identified, analyzed and managed, and that sufficient allowances for impairment of distressed and impaired loans (taking account of the Group's latest view of current and expected market conditions, as well as refinancing risk) are made.

The Credit committee is a standing body of the Group, authorized to make decisions on all issues relating to the Group's credit operations. The credit risk policy is defined by the Group's Credit committee considering the recommendations from the Risk department and is subject to the Management Board's approval. The Risk department is generally responsible for the application of procedures and policies approved by the Credit committee, as well as for the regular valuation of guarantees and collateral, either automatically or based on an expert opinion, both during the approval phase for issuing a new loan or upon the renewal of an existing credit facility.

The Group has policies and procedures for the management of credit exposures (both for on-balance sheet and off-balance sheet items), including the requirement to set limits on the concentration of the corporate loan portfolio. The Group's Credit policy establishes the following:

- Review procedures and approval process for different types of loan products;
- Methodology for the creditworthiness assessment of lessees;
- Methodology for the creditworthiness assessment of borrowers (legal entities and individuals);
- Methodology for the creditworthiness assessment of issuers and insurance companies;
- Methodology for the evaluation and monitoring of collateral;
- Procedures for the ongoing monitoring of loans and other products exposed to credit risk;
- Procedures for collecting payments from different types of borrowers and lessees.

The policies, methodologies and procedures related to the credit risk are analyzed and, if necessary, reviewed at least annually taking into account recommendations obtained in the course of internal audits.

All retail loan applications are reviewed by the Risk department by means of statistical modeling, loan application data verification and by considering a number of criteria, including, inter alia, the applicant's indebtedness, source of income, history with the Bank, etc. Some retail loan applications are subject to additional verification by the Bank's Economic security department. All underwriting procedures are subject to approval by the Credit committee.

The Group considers corporate lending to be a strategic activity. Nevertheless, it takes a highly selective approach to corporate lending, in particular with regards to approval of new corporate borrowers. Corporate loan applications are checked by client managers and are then passed on to the Risk department. The Risk department prepares an independent report based on a structured analysis focusing on the customer's business, reputation, history with the Bank and financial performance. The Financial monitoring department and the Economic security department independently review every corporate loan application and generate a report reflecting their opinion, in particular, on whether the credit policy requirements are met. During the loan approval process, guarantees and collateral are valued and the guarantor's ability to meet its obligations is assessed. Every corporate loan application is subject to approval by the Credit committee and/or the Supervisory board, depending on the loan amount.

The Group continuously monitors the performance of individual credit exposures and regularly assesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements (for legal entities), income information (for individuals) and other information submitted by the borrower or otherwise obtained by the Group. Where the market value of the collateral is assessed as impaired, the borrowers are usually required to provide additional collateral.

The Group's maximum exposure to credit risk is generally represented by the fair value of financial assets recognized in the balance sheet and the off-balance sheet credit-related commitments. The impact of possible reversal of assets and liabilities to reduce potential credit exposure is not significant.

In the table below, cash and cash equivalents and loans to banks and customers of high grade are those with a minimal level of credit risk, normally with a credit rating on or close to the sovereign level or very well collateralized.

36. Risk management (continued)

Credit risk (continued)

Other borrowers with a good financial position and good debt service history are included into the standard grade.

Though the substandard grade comprises loans below standard grade, they are not individually impaired.

For bonds, a high grade is equivalent to a Fitch or S&P (Moody's) BBB- or Baa3 rating (the sovereign credit rating of the Russian Federation) and above, while standard grade is equivalent to a rating below BBB- (Baa3) but above B- (B3), while substandard is below B- (B3).

Loans to constituent entities and municipalities of the Russian Federation, government and municipal bonds and bonds of state-owned companies are classified as standard grade.

		Neither past due nor impaired					
As at 31 December 2017	***Notes***	***High grade***	***Standard grade***	***Substan-dard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents, except for cash on hand	16	30,462	3,512	–	–	–	**33,974**
Placements with banks	17	3,024	6,314	–	–	–	**9,338**
Loans to customers	19						
Loans to individuals							
Consumer loans		–	40,664	–	2,625	–	**43,289**
Car loans		–	54,076	–	1,618	–	**55,694**
Credit cards		–	7,790	–	351	–	**8,141**
Mortgages		–	28,145	–	1,383	–	**29,528**
Loans to corporate customers							
Loans to constituent entities and municipalities of the Russian Federation		–	24,758	–	4	–	**24,762**
Loans to corporate customers		–	79,684	–	–	2,312	**81,996**
Loans to small businesses and other loans to customers		–	2,129	–	170	–	**2,299**
Bonds of state-owned companies		–	5,815	–	–	–	**5,815**
Corporate bonds		–	10,429	–	–	–	**10,429**
Government and municipal bonds		–	4,292	–	–	–	**4,292**
Total		**33,486**	**267,608**	**–**	**6,151**	**2,312**	**309,557**

		Neither past due nor impaired					
As at 31 December 2016	***Notes***	***High grade***	***Standard grade***	***Substan-dard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents, except for cash on hand	16	13,486	2,501	20	–	–	**16,007**
Placements with banks	17	–	384	–	–	–	**384**
Loans to customers	19						
Loans to individuals							
Consumer loans		–	46,548	–	3,217	–	**49,765**
Car loans		–	20,213	–	1,262	–	**21,475**
Credit cards		–	5,549	–	341	–	**5,890**
Mortgages		–	2,674	–	497	–	**3,171**
Loans to corporate customers							
Loans to constituent entities and municipalities of the Russian Federation		–	69,305	–	392	–	**69,697**
Loans to corporate customers		–	44,647	–	–	834	**45,481**
Loans to small businesses and other loans to customers		–	4,020	–	203	–	**4,223**
Bonds of state-owned companies		–	26,251	–	–	–	**26,251**
Corporate bonds		557	9,711	–	–	–	**10,268**
Government and municipal bonds		–	2,199	–	–	–	**2,199**
Total		**14,043**	**234,002**	**20**	**5,912**	**834**	**254,811**

36. Risk management (continued)

Credit quality of loans to individuals

The credit quality of loans to individuals is assessed and managed by the Group based on the number of days overdue. The tables below show the credit quality of loans to individuals based on the number of days overdue as at 31 December 2017 and 2016:

As at 31 December 2017:

	Gross loans RUB MM	*Impairment RUB MM*	*Net loans RUB MM*	*Impairment to gross loans %*
Consumer loans				
- Not overdue	40,969	(305)	40,664	0.74%
- Overdue less than 30 days	1,617	(126)	1,491	7.79%
- Overdue from 30 to 89 days	1,178	(648)	530	55.01%
- Overdue from 90 to 179 days	1,282	(1,006)	276	78.47%
- Overdue from 180 to 360 days	2,607	(2,279)	328	87.42%
Total consumer loans	**47,653**	**(4,364)**	**43,289**	**9.16%**
Credit cards				
- Not overdue	8,000	(210)	7,790	2.63%
- Overdue less than 30 days	316	(94)	222	29.75%
- Overdue from 30 to 89 days	281	(213)	68	75.80%
- Overdue from 90 to 179 days	308	(277)	31	89.94%
- Overdue from 180 to 360 days	317	(287)	30	90.54%
Total credit cards	**9,222**	**(1,081)**	**8,141**	**11.72%**
Mortgages				
- Not overdue	28,391	(246)	28,145	0.87%
- Overdue less than 30 days	642	(51)	591	7.94%
- Overdue from 30 to 89 days	334	(69)	265	20.66%
- Overdue from 90 to 179 days	291	(93)	198	31.96%
- Overdue from 180 to 360 days	282	(86)	196	30.50%
- Overdue more than 360 days	288	(155)	133	53.82%
Total mortgages	**30,228**	**(700)**	**29,528**	**2.32%**
Car loans				
- Not overdue	54,270	(194)	54,076	0.36%
- Overdue less than 30 days	1,086	(96)	990	8.84%
- Overdue from 30 to 89 days	543	(179)	364	32.97%
- Overdue from 90 to 179 days	404	(235)	169	58.17%
- Overdue from 180 to 360 days	403	(308)	95	76.43%
Total car loans	**56,706**	**(1,012)**	**55,694**	**1.78%**
Total loans to individuals	**143,809**	**(7,157)**	**136,652**	**4.98%**

36. Risk management (continued)

Credit quality of loans to individuals (continued)

As at 31 December 2016:

	Gross loans RUB MM	*Impairment RUB MM*	*Net loans RUB MM*	*Impairment to gross loans %*
Consumer loans				
- Not overdue	47,048	(500)	46,548	1.06%
- Overdue less than 30 days	2,095	(178)	1,917	8.50%
- Overdue from 30 to 89 days	1,223	(611)	612	49.96%
- Overdue from 90 to 179 days	1,339	(1,007)	332	75.21%
- Overdue from 180 to 360 days	2,908	(2,552)	356	87.76%
Total consumer loans	**54,613**	**(4,848)**	**49,765**	**8.88%**
Credit cards				
- Not overdue	5,728	(179)	5,549	3.13%
- Overdue less than 30 days	238	(39)	199	16.39%
- Overdue from 30 to 89 days	145	(81)	64	55.86%
- Overdue from 90 to 179 days	178	(141)	37	79.21%
- Overdue from 180 to 360 days	430	(389)	41	90.47%
Total credit cards	**6,719**	**(829)**	**5,890**	**12.34%**
Mortgages				
- Not overdue	2,766	(92)	2,674	3.33%
- Overdue less than 30 days	140	(7)	133	5.00%
- Overdue from 30 to 89 days	78	(6)	72	7.69%
- Overdue from 90 to 179 days	38	(5)	33	13.16%
- Overdue from 180 to 360 days	110	(27)	83	24.55%
- Overdue more than 360 days	396	(220)	176	55.56%
Total mortgages	**3,528**	**(357)**	**3,171**	**10.12%**
Car loans				
- Not overdue	20,213	–	20,213	0.00%
- Overdue less than 30 days	526	–	526	0.00%
- Overdue from 30 to 89 days	190	–	190	0.00%
- Overdue from 90 to 179 days	189	–	189	0.00%
- Overdue from 180 to 360 days	357	–	357	0.00%
Total car loans	**21,475**	**–**	**21,475**	**0.00%**
Total loans to individuals	**86,335**	**(6,034)**	**80,301**	**6.99%**

Credit quality of loans to corporate customers

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

	Gross loans RUB MM	*Impairment RUB MM*	*Net loans RUB MM*	*Impairment to gross loans %*
Loans to corporate customers				
Unimpaired loans*	**128,113**	**(1,007)**	**127,106**	**0.79%**
Impaired loans:				
- Not overdue	3,010	(698)	2,312	23.19%
- Overdue less than 90 days	132	(28)	104	21.21%
- Overdue more than 90 days and less than 1 year	167	(112)	55	67.07%
- Overdue more than 1 year	39	(23)	16	58.97%
Total impaired loans	**3,348**	**(861)**	**2,487**	**25.72%**
Individual impairment	3,010	(698)	2,312	23.19%
Collective impairment	338	(163)	175	48.22%
Total loans to corporate customers	**131,461**	**(1,868)**	**129,593**	**1.42%**

* Including corporate bonds of RUB 10,551 MM, bonds of state-owned companies of RUB 5,933 MM, government and municipal bonds of RUB 4,298 MM reclassified into loans to corporate customers (Note 19).

36. Risk management (continued)

Credit quality of loans to corporate customers (continued)

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

	Gross loans RUB MM	*Impairment RUB MM*	*Net loans RUB MM*	*Impairment to gross loans %*
Loans to corporate customers				
Unimpaired loans*	**158,005**	**(1,316)**	**156,689**	**0.83%**
Impaired loans:				
- Not overdue	1,043	(209)	834	20.04%
- Overdue less than 90 days	510	(21)	489	4.12%
- Overdue more than 90 days and less than 1 year	142	(98)	44	69.01%
- Overdue more than 1 year	112	(49)	63	43.75%
Total impaired loans	**1,807**	**(377)**	**1,430**	**20.86%**
Individual impairment	1,043	(209)	834	20.04%
Collective impairment	764	(168)	596	21.99%
Total loans to corporate customers	**159,812**	**(1,693)**	**158,119**	**1.06%**

* Including bonds of state-owned companies of RUB 26,587 MM, corporate bonds of RUB 10,386 MM, government and municipal bonds of RUB 2,212 MM reclassified into loans to corporate customers (Note 19).

Impairment assessment

Collectively assessed allowances

The Group assesses impairment on a collective basis in two circumstances:

- for loans to customers that are not individually significant (including car loans, mortgages, consumer loans, minor loans to corporate customers and finance lease receivables); and
- for individuallysignificant loans where there is no objective evidence of individual impairment.

The Group reviews each portfolio separately evaluates impairment allowances on each reporting date.

The Group estimates impairment allowances for loans to individuals based on statistics in relation to past historical losses and, where there is sufficient statistical data available, based on peer group statistics for comparable loan groups.

The Group estimates the impairment allowance for corporate loans based on an analysis of the future cash flows for impaired loans or based on statistics in relation to past losses on loan portfolios for which no indication of impairment is identified.

Loan impairment results from one or more events that occurred after the initial recognition of the loan and that have an impact on the estimated future cash flows associated with the loan, and which can be reliably estimated.

The objective indicators of loan impairment include the following:

- overdue payments under the loan agreement;
- deterioration in the financial position of the borrower; and
- deterioration in the business environment or negative changes in the borrower's market.

Individually assessed allowances

The Group determines appropriate allowances for each individually significant loan or advance on an individual basis. Factors considered when determining the loan loss allowance include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected payout should bankruptcy occur, the availability of other financial support, the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date unless unforeseen circumstances require more careful attention.

36. Risk management (continued)

Credit quality of loans to corporate customers (continued)

Allowances created in respect of securities reclassified to corporate loans

An allowance for corporate bonds reclassified to corporate loans is calculated on the basis of the long-term issuer rating assigned by international rating agencies (S&P, Fitch and Moody's) to each issuer of bonds and the probability of default of the issuer within one year. The probability of default of each issuer within one year is determined on the basis of the Fitch Ratings agency research "Global Corporate Finance 2016 Transition and Default Study" as the average probabilities of default of the issuer of each rating in emerging economies within one year during the period 1990-2016. The allowance varies from 0.19% to 2.90%.

Liquidity and funding risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

Liquidity and funding risk limits are set by the Supervisory Board and are reviewed and approved annually by the Management Board.

The Group's liquidity and funding position is underpinned by its significant customer deposit base and has been supported by interbank (repo) funding secured by the diversified portfolio of liquid assets, which the Group maintains in order to be able to respond to unforeseen liquidity needs.

The Group continuously and on a daily basis monitors and controls whether its operations are in line with the regulator's liquidity requirements and monitors the market environment and intra-Group circumstances, focusing on early indicators of liquidity risk either on the market or within the Group. In 2017 and 2016, the Bank's operations complied with all regulatory liquidity requirements.

The Group carries out stress testing of its liquidity position against a range of scenarios on a monthly basis. The results of stress testing are reviewed by the LMC monthly. The Group's liquidity risk limits are calculated in relation to a number of parameters impacting changes in liquidity.

The liquidity management policy of the Group consists of:

- Projecting cash flows by major currency and calculating the level of liquid assets necessary in relation thereto;
- Maintaining a diverse range of funding sources;
- Managing the concentration and profile of debt;
- Maintaining a portfolio of highly marketable assets that can easily be sold as protection against any interruption to cash flows;
- Maintaining liquidity and funding contingency plans;
- Monitoring balance sheet liquidity ratios against regulatory requirements.

The Treasury Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury Department then builds an adequate portfolio of short-term liquid assets, largely made up of short-term liquid trading securities, bank deposits and other interbank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

36. Risk management (continued)

Liquidity and funding risk (continued)

The following tables show the undiscounted cash flows related to the Group's financial liabilities, guarantees and off-balance sheet credit-related commitments on the basis of their earliest possible contractual maturity. The total gross inflow and outflow disclosed in the table is the contractual undiscounted cash flow related to the financial liability or commitment. The Group's expected cash flows related to these financial liabilities and off-balance sheet credit-related commitments may vary significantly from this analysis.

Financial liabilities as at 31 December 2017	*On demand and less than 1 month*	*From 1 to 3 months*	*From 3 months to 1 year*	*From 1 to 5 years*	*More than 5 years*	*Total gross outflow*	*Carrying amount*
Due to banks	184,327	1,993	2,589	–	5,519	**194,428**	**194,135**
Due to customers	133,513	67,986	84,967	90,289	–	**376,755**	**358,914**
Debt securities issued	74	362	16,164	316	31	**16,947**	**15,744**
Other borrowed funds	463	51	157	833	41,410	**42,914**	**15,381**
Subordinated debt	47	98	458	2,434	37,791	**40,828**	**6,799**
Other liabilities	3,587	–	–	–	–	**3,587**	**3,587**
Total financial liabilities	**322,011**	**70,490**	**104,335**	**93,872**	**84,751**	**675,459**	**594,560**
Credit-related commitments	**68,682**	**20,626**	**51,866**	**117,913**	**6,011**	**265,098**	**265,098**

Financial liabilities as at 31 December 2016	*On demand and less than 1 month*	*From 1 to 3 months*	*From 3 months to 1 year*	*From 1 to 5 years*	*More than 5 years*	*Total gross outflow*	*Carrying amount*
Due to the CBR	42,657	–	–	–	–	**42,657**	**42,618**
Due to banks	143,811	205	1,236	312	58	**145,622**	**145,196**
Due to customers	100,637	65,547	78,240	42,625	–	**287,049**	**276,467**
Debt securities issued	73	190	8,192	936	444	**9,835**	**8,774**
Other borrowed funds	–	54	677	875	45,071	**46,677**	**15,691**
Subordinated debt	20	34	166	1,450	1,047	**2,717**	**1,484**
Other liabilities	2,215	–	–	–	–	**2,215**	**2,215**
Total financial liabilities	**289,413**	**66,030**	**88,511**	**46,198**	**46,620**	**536,772**	**492,445**
Credit-related commitments	**34,552**	**14,023**	**24,091**	**50,384**	**–**	**123,050**	**123,050**

The breakdown of monetary assets and liabilities by their expected maturities, as determined by the Group's management, as at 31 December 2017 is provided in the table below. Assets and liabilities are allocated by their remaining contractual maturities, except financial instruments at fair value through profit or loss and certain customer accounts. Securities included in financial instruments at fair value through profit or loss are shown in the "Less than 1 month" category because the Group's management believes that all of these financial instruments could be sold within one month in the normal course of business or the Group could pledge these financial instruments as collateral for loans from the CBR.

	Less than 1 month RUB MM	*From 1 to 3 months RUB MM*	*From 3 months to 1 year RUB MM*	*Subtotal less than 1 year RUB MM*	*From 1 to 5 years RUB MM*	*More than 5 years RUB MM*	*Subtotal more than 1 year RUB MM*	*No maturity and overdue RUB MM*	*Total RUB MM*
Assets									
Cash and cash equivalents	39,962	–	–	**39,962**	–	–	–	–	**39,962**
Mandatory cash balances with the CBR	872	556	677	**2,105**	637	–	**637**	233	**2,975**
Placements with banks	3	2,139	3,195	**5,337**	3,448	553	**4,001**	–	**9,338**
Financial instruments at fair value through profit or loss									
held by the Group	140,043	–	–	**140,043**	–	–	–	–	**140,043**
pledged under sale and repurchase agreements	209,098	–	–	**209,098**	–	–	–	–	**209,098**
Available-for-sale investment securities	–	–	–	–	–	–	–	3,935	**3,935**
Loans to customers	9,770	25,319	50,170	**85,259**	129,668	47,722	**177,390**	3,596	**266,245**
Investments in associates	–	–	–	–	–	–	–	8,224	**8,224**
Investments in car leasing joint venture	–	–	–	–	–	–	–	506	**506**
Other assets	204	–	–	**204**	–	–	–	–	**204**
Total assets	**399,952**	**28,014**	**54,042**	**482,008**	**133,753**	**48,275**	**182,028**	**16,494**	**680,530**
Liabilities									
Due to banks	184,034	1,993	2,589	**188,616**	–	5,519	**5,519**	–	**194,135**
Due to customers	105,101	67,127	81,680	**253,908**	76,888	–	**76,888**	28,118	**358,914**
Debt securities issued	74	358	15,060	**15,492**	232	20	**252**	–	**15,744**
Other borrowed funds	461	–	–	**461**	–	14,920	**14,920**	–	**15,381**
Subordinated debt	–	–	–	–	–	–	–	6,799	**6,799**
Other liabilities	3,587	–	–	**3,587**	–	–	–	–	**3,587**
Total liabilities	**293,257**	**69,478**	**99,329**	**462,064**	**77,120**	**20,459**	**97,579**	**34,917**	**594,560**
Net position as at 31 December 2017	**106,695**	**(41,464)**	**(45,287)**	**19,944**	**56,633**	**27,816**	**84,449**	**(18,423)**	**85,970**
Cumulative gap as at 31 December 2017	**106,695**	**65,231**	**19,944**	**19,944**	**76,577**	**104,393**	**84,449**	**85,970**	**–**
Credit-related commitments	**68,682**	**20,626**	**51,866**	**141,174**	**117,913**	**6,011**	**123,924**	**–**	**265,098**

36. Risk management (continued)

Liquidity and funding risk (continued)

The breakdown of monetary assets and liabilities by their expected maturities, as determined by the Group's management, as at 31 December 2016 is provided in the table below:

	Less than 1 month RUB MM	*From 1 to 3 months RUB MM*	*From 3 months to 1 year RUB MM*	*Subtotal less than 1 year RUB MM*	*From 1 to 5 years RUB MM*	*More than 5 years RUB MM*	*Subtotal more than 1 year RUB MM*	*No maturity and overdue RUB MM*	*Total RUB MM*
Assets									
Cash and cash equivalents	21,465	–	–	**21,465**	–	–	**–**	–	**21,465**
Mandatory cash balances with the CBR	851	705	816	**2,372**	401	–	**401**	244	**3,017**
Placements with banks	–	–	–	**–**	–	384	**384**	–	**384**
Financial instruments at fair value through profit or loss:									
Held by the Group	91,592	–	–	**91,592**	–	–	**–**	–	**91,592**
Pledged under sale and repurchase agreements	193,626	–	–	**193,626**	–	–	**–**	–	**193,626**
Available-for-sale investment securities	–	–	–	**–**	–	–	**–**	7,086	**7,086**
Loans to customers	44,984	8,982	48,147	**102,113**	128,563	4,660	**133,223**	3,084	**238,420**
Investments in associates	–	–	–	**–**	–	–	**–**	802	**802**
Investments in car leasing joint venture	–	–	–	**–**	–	–	**–**	456	**456**
Other assets	129	–	–	**129**	–	–	**–**	–	**129**
Total assets	**352,647**	**9,687**	**48,963**	**411,297**	**128,964**	**5,044**	**134,008**	**11,672**	**556,977**
Liabilities									
Due to the CBR	42,618	–	–	**42,618**	–	–	**–**	–	**42,618**
Due to banks	143,576	202	1,126	**144,904**	255	37	**292**	–	**145,196**
Due to customers	77,993	64,615	74,750	**217,358**	36,787	–	**36,787**	22,322	**276,467**
Debt securities issued	73	188	7,608	**7,869**	653	252	**905**	–	**8,774**
Other borrowed funds	–	–	485	**485**	–	15,206	**15,206**	–	**15,691**
Subordinated debt	–	–	–	**–**	1,484	–	**1,484**	–	**1,484**
Other liabilities	2,215	–	–	**2,215**	–	–	**–**	–	**2,215**
Total liabilities	**266,475**	**65,005**	**83,969**	**415,449**	**39,179**	**15,495**	**54,674**	**22,322**	**492,445**
Net position as at 31 December 2016	**86,172**	**(55,318)**	**(35,006)**	**(4,152)**	**89,785**	**(10,451)**	**79,334**	**(10,650)**	**64,532**
Cumulative gap as at 31 December 2016	**86,172**	**30,854**	**(4,152)**	**(4,152)**	**85,633**	**75,182**	**79,334**	**64,532**	**–**
Credit-related commitments	**34,552**	**14,023**	**24,091**	**72,666**	**50,384**	**–**	**50,384**	**–**	**123,050**

The values in all the tables above represent carrying amounts of the assets and liabilities as at the reporting date and do not include future interest payments.

According to the Russian legislation, individual depositors may withdraw their term deposits at any time before maturity. Management believes that diversification of on-demand accounts and deposits by number, type of clients, as well as the past experience of the Group during several economic cycles in the Russian Federation indicate that on-demand and term customer accounts provide the most long-term and stable source of funding for the Group.

Current accounts and demand deposits of legal entities are shown in the "No maturity and overdue" category because the Group's statistics and past experience confirm that these accounts can be considered as a stable and long-term source of financing.

From 30 September 2017, the Group classifies available-for-sale investment securities as financial assets with no maturity. For this reason, the comparative data as at 31 December 2016 was transferred from "Less than 1 month" category to "No maturity and overdue" category to ensure the comparability.

The Group has undrawn credit line facilities with the CBR and other financial institutions. The Group estimates that the liquidity gaps in the tables above will be covered by the balances of current accounts and deposits from customers, as well as from the undrawn credit line facilities with the CBR and other financial institutions.

36. Risk management (continued)

Operational risk

Operational risk is the risk of loss arising from deficiencies or errors in internal processes, human error, fraud or external events.

The Group is exposed to the following principal operational risks:

- IT systems: the risk of financial loss resulting from insufficient development of IT or from poor maintenance processes. The robustness of IT solutions and their permanent availability to the Group's customers and employees are of crucial importance for the Group;
- information security: the risk of data leakage, loss or theft of sensitive data. The overall market level of this risk is growing rapidly due to increasingly sophisticated fraudulent actions and mobility of criminals;
- third-party and in-house fraud: the risk that the Group and/or its customers will incur a financial loss as a result of third-party or in-house fraud;
- customer servicing: the risk that new issues will arise or control deficiencies and weaknesses will be identified in existing processes that the Group's customers face as the business continues to evolve.

The Group regularly analyses and reviews the management enhancement processes and makes appropriate investments. The Group makes investments in the IT infrastructure and significant investments to ensure information security, resilience and improvement of the appropriate functions.

The Group is implementing an annual program for enhancing the technology, processes and manual controls with an emphasis on preventing and detecting fraud in real time. The Group has an efficient and robust fraud identification and prevention operating model, including Group-wide policies and operational controls.

Significant operational risks are regularly reported to appropriate committees and are communicated to senior management. The risks are managed through a range of strategies: prevention, mitigation, transfer (including insurance), and acceptance of risks.

37. Related party transactions

Parties are considered to be related if one party has an ability to control the other party or exercise significant influence over the other party in making operational and financial decisions as defined by IAS 24 *Related Party Disclosures*. The Group determines that the parties are related based on the substance of the relationship, not merely the legal form of such relationship.

Total remuneration included in employee compensation (Note 12):

	2017 RUB MM	***2016 RUB MM***
Members of the Supervisory Board	352	75
Management Board	1,337	757
	1,689	**832**

As at 31 December 2017, outstanding balances with related parties were as follows:

	The shareholder of the Group[(1)] RUB MM	***Joint venture[(2)] RUB MM***	***Key management personnel[(3)] RUB MM***	***Other related parties[(4)] RUB MM***	***Total RUB MM***
Loans, gross	**–**	**502**	**492**	**3,323**	**4,317**
Less: allowance for impairment	–	(6)	(9)	(49)	**(64)**
Loans, net	**–**	**496**	**483**	**3,274**	**4,253**
Deposits	–	–	73	205	**278**
Financial instruments at fair value through profit or loss	1,775	1,922	–	–	**3,697**
Current accounts	43	24	403	290	**760**
Other borrowed funds	–	–	461	–	**461**
Subordinated debt	6,799	–	–	–	**6,799**
Other liabilities	–	–	1,713	–	**1,713**
Guarantees received	–	1,004	–	11,805	**12,809**

37. Related party transactions (continued)

Outstanding balances with related parties as at 31 December 2016 were as follows:

	The shareholder of the Group[(1)] RUB MM	*Joint venture[(2)] RUB MM*	*Key management personnel[(3)] RUB MM*	*Other related parties[(4)] RUB MM*	*Total RUB MM*
Loans, gross	**1,688**	**1,829**	**460**	**3,688**	**7,665**
Less: allowance for impairment	–	–	–	(42)	**(42)**
Loans, net	**1,688**	**1,829**	**460**	**3,646**	**7,623**
Deposits	–	–	343	1,212	**1,555**
Financial instruments at fair value through profit or loss	2,566	–	–	–	**2,566**
Current accounts	15	5	236	251	**507**
Other borrowed funds	–	–	485	–	**485**
Subordinated debt	1,484	–	–	–	**1,484**
Other liabilities	–	–	954	–	**954**
Guarantees received	–	1,854	–	11,957	**13,811**

Transactions with related parties, which are included in the consolidated statement of profit or loss for the year ended 31 December 2017, are presented in the table below:

	The shareholder of the Group[(1)] RUB MM	*Joint venture[(2)] RUB MM*	*Key management personnel[(3)] RUB MM*	*Other related parties[(4)] RUB MM*	*Total RUB MM*
Interest income	205	65	81	430	**781**
Interest income on financial instruments at fair value through profit or loss	120	158	–	–	**278**
Interest expense on deposits	–	–	(7)	(107)	**(114)**
Interest expense on subordinated debt	(101)	–	–	–	**(101)**
Interest expense on other borrowed funds	–	–	(26)	–	**(26)**
Allowance for loan impairment	–	(6)	(9)	(7)	**(22)**
Fee and commission income	–	17	–	18	**35**
Gains less losses from foreign currencies	(39)	–	(8)	(15)	**(62)**
General and administrative expenses	–	(11)	(18)	–	**(29)**

Transactions with related parties, which are included in the consolidated statement of profit or loss for the year ended 31 December 2016, are presented in the table below:

	The shareholder of the Group[(1)] RUB MM	*Joint venture[(2)] RUB MM*	*Key management personnel[(3)] RUB MM*	*Other related parties[(4)] RUB MM*	*Total RUB MM*
Interest income	171	178	39	419	**807**
Interest income on financial instruments at fair value through profit or loss	103	–	–	–	**103**
Interest expense on deposits	–	–	(34)	(115)	**(149)**
Interest expense on subordinated debt	(559)	–	–	–	**(559)**
Allowance for loan impairment	–	7	9	(33)	**(17)**
Fee and commission income	2	3	2	8	**15**
Gains less losses from foreign currencies	352	–	9	(132)	**229**

(1) Sovco Capital Partners N.V. is a sole shareholder of the Group (Note 1).

(2) Sollers-Finance LLC is a car leasing joint venture. Sollers LLC, one of the largest car manufacturers in Russia, and the Group are equal shareholders (50/50) of the joint venture.

(3) Key management personnel are those with authority and responsibility for planning, directing and controlling the activities of the Group. Key management personnel of the Group are members of the Management Board and the Supervisory Board.

(4) Other related parties mainly comprise companies under significant influence of the key management personnel.

38. Fair value of financial instruments

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of IAS 7 *Financial Instruments: Disclosures*. Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction other than in forced sale or liquidation. As no readily available market exists for a large part of the Group's financial instruments (specifically extended loans) at which such financial assets would be traded on a regular basis, judgment is necessary in arriving at fair value based on current economic conditions and the specific risks attributable to a given instrument. The estimates presented herein are not necessarily indicative of the amounts the Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

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

The Group determines classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy.

	Fair value measurement using			
As at 31 December 2017	***Quoted prices in active markets (Level 1) RUB MM***	***Significant observable inputs (Level 2) RUB MM***	***Significant unobservable inputs (Level 3) RUB MM***	***Total RUB MM***
Assets measured at fair value				
Financial instruments at fair value through profit or loss	46,817	302,324	−	**349,141**
Available-for-sale investment securities	−	−	3,935	**3,935**
Investment property	−	−	58	**58**
Property and equipment and intangible assets	−	−	718	**718**
Assets for which fair values are disclosed				
Cash and cash equivalents	39,962	−	−	**39,962**
Mandatory cash balances with the CBR	−	−	2,975	**2,975**
Placements with banks	−	32	9,306	**9,338**
Loans to customers	−	18,297	252,730	**271,027**
Other assets	−	−	204	**204**
Liabilities measured at fair value				
Derivative financial liabilities	−	317	−	**317**
Liabilities for which fair values are disclosed				
Due to banks	−	−	194,135	**194,135**
Due to customers	−	−	361,057	**361,057**
Debt securities issued	−	14,489	1,291	**15,780**
Other borrowed funds	−	−	15,381	**15,381**
Subordinated debt	−	−	6,799	**6,799**
Other liabilities	−	−	3,270	**3,270**

38. Fair value of financial instruments (continued)

	Fair value measurement using			
As at 31 December 2016	***Quoted prices in active markets (Level 1) RUB MM***	***Significant observable inputs (Level 2) RUB MM***	***Significant unobservable inputs (Level 3) RUB MM***	***Total RUB MM***
Assets measured at fair value				
Financial instruments at fair value through profit or loss	33,625	251,593	–	**285,218**
Available-for-sale investment securities	–	–	7,086	**7,086**
Investment property	–	–	288	**288**
Property and equipment and intangible assets	–	–	1,092	**1,092**
Assets for which fair values are disclosed				
Cash and cash equivalents	21,465	–	–	**21,465**
Mandatory cash balances with the CBR	–	–	3,017	**3,017**
Placements with banks	–	48	319	**367**
Loans to customers	–	39,778	200,012	**239,790**
Other assets	–	–	129	**129**
Liabilities for which fair values are disclosed				
Due to the CBR	–	–	42,618	**42,618**
Due to banks	–	–	145,196	**145,196**
Due to customers	–	–	277,708	**277,708**
Debt securities issued	–	7,201	1,596	**8,797**
Other borrowed funds	–	–	15,691	**15,691**
Subordinated debt	–	–	1,484	**1,484**
Other liabilities	–	–	2,215	**2,215**

Financial assets at fair value through profit or loss

Trading securities valued using valuation models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Movements in Level 3 financial instruments measured at fair value

The following table shows a reconciliation of the opening and closing balances of Level 3 financial assets and liabilities, which are recorded at fair value:

	At 1 January 2017	*Gains/ (losses) recorded in the statement of profit or loss*	*Gains/ (losses) recorded in other comprehensive income*	*Purchases*	*Sales*	*Settlements*	*Transfers from Level 1 and Level 2*	*Transfers to associates*	*At 31 December 2017*
Financial assets									
Financial instruments at fair value through profit or loss	–	1,089	–	5	(1,090)	(4)	–	–	–
Available-for-sale investment securities	7,086	1,024	(977)	2,803	(300)	–	–	(5,701)	3,935
Total Level 3 financial assets	**7,086**	**2,113**	**(977)**	**2,808**	**(1,390)**	**(4)**	**–**	**(5,701)**	**3,935**

38. Fair value of financial instruments (continued)

Financial assets at fair value through profit or loss (continued)

During 2016, the Group transferred certain financial assets at fair value through profit or loss from Level 1 and Level 2 to Level 3 of the fair value hierarchy. The carrying amount of the financial assets transferred was RUB 2,210 MM. The reason for the transfers from Level 1 and Level 2 to Level 3 was that the market for these securities became inactive, which led to a change in the method used to determine fair value.

	At 1 January 2016	*Gains/ (losses) recorded in the statement of profit or loss*	*Gains/ (losses) recorded in other comprehensive income*	*Purchases*	*Sales*	*Settlements*	*Transfers from Level 1 and Level 2*	*At 31 December 2016*
Financial assets								
Financial instruments at fair value through profit or loss	–	(7,143)	–	5,659	(726)	–	2,210	–
Available-for-sale investment securities	–	149	1,985	2,321	–	–	2,631	7,086
Total Level 3 financial assets	**–**	**(6,994)**	**1,985**	**7,980**	**(726)**	**–**	**4,841**	**7,086**

Gains or losses on Level 3 financial instruments included in profit or loss for the period comprise:

	2017			*2016*		
	Realized gains/ (losses) RUB MM	*Unrealized gains/ (losses) RUB MM*	*Total RUB MM*	*Realized gains/ (losses) RUB MM*	*Unrealized gains/ (losses) RUB MM*	*Total RUB MM*
Total gains/(losses) recognized in profit or loss for the period	394	1,719	**2,113**	554	(7,548)	**(6,994)**

Effect of changes in significant unobservable inputs on the measurement of financial instruments categorized within Level 3 of the fair value hierarchy

The following tables show quantitative information about significant unobservable inputs used in the fair value measurement categorized within Level 3 of the fair value hierarchy:

31 December 2017	*Carrying amount RUB MM*	*Valuation technique*	*Unobservable inputs*	*Range (weighted average value)*
Financial instruments at fair value through profit or loss				
Finance	–	Discounted cash flows	Credit risk of the issuer	100%
Available-for-sale investment securities				
Equity securities				
Finance	3,074	Discount to capital	Net assets	70%-90%
Energy	400	Value of net assets	Net assets	Not applicable
IT	300	Price of the most recent transaction	Price of the most recent transaction	Not applicable
Rating agencies	111	Value of net assets	Net assets	Not applicable
IT	50	Value of net assets	Net assets	Not applicable
Investment property	58	Market and income approach	Discount for sale	10%
Property and equipment and intangible assets	718	Market and income approach	Discount for sale	10%

38. Fair value of financial instruments (continued)

Financial assets at fair value through profit or loss (continued)

31 December 2016	*Carrying amount RUB MM*	*Valuation technique*	*Unobservable inputs*	*Range (weighted average value)*
Financial instruments at fair value through profit or loss				
Finance	–	Discounted cash flows	Credit risk of the issuer	100%
Available-for-sale investment securities				
Equity securities				
Finance	4,888	Value of net assets	Net assets	Not applicable
IT	1,687	Value of net assets	Net assets	Not applicable
Energy	400	Value of net assets	Net assets	Not applicable
Rating agencies	111	Value of net assets	Net assets	Not applicable
Investment property	288	Market and income approach	Discount for sale	10%
Property and equipment and intangible assets	1,092	Market and income approach	Discount for sale	10%

In order to determine possible alternative assumptions as at 31 December 2017, the Group adjusted discount to capital to the rage of 70%-90% in respect of shares in the Finance sector. From the Group's perspective, it is within the range of possible alternative assumptions. As at 31 December 2017, carrying amount of shares in the Finance sector is RUB 3,074 MM. Effect of possible alternative assumptions on the fair value measurement is estimated within the range from RUB (121) MM to RUB 589 MM.

Transfers between Level 1 and Level 2

The following tables show transfers between Level 1 and Level 2 of the fair value hierarchy for financial assets measured at fair value for the years ended 31 December 2017 and 2016:

	2017 RUB MM	*2016 RUB MM*
Financial instruments at fair value through profit or loss		
Government and municipal bonds	4,025	655
Corporate bonds	3,909	533
Bonds of state-owned companies	628	787
Total transfers from Level 1 to Level 2	**8,562**	**1,975**

The above financial instruments were transferred from Level 1 to Level 2 as they ceased to be actively traded during the period and their fair values were consequently obtained through valuation techniques using observable market inputs.

	2017 RUB MM	*2016 RUB MM*
Financial instruments at fair value through profit or loss		
Corporate bonds	4,245	1,910
Bonds of state-owned companies	4,115	1,053
Government and municipal bonds	1,272	5,602
Corporate shares	–	818
Total transfers from Level 2 to Level 1	**9,632**	**9,383**

The financial instruments presented above were transferred from Level 2 to Level 1 as they became actively traded during the reporting period and their fair values were consequently determined using quoted prices in an active market.

38. Fair value of financial instruments (continued)

Financial assets at fair value through profit or loss (continued)

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

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

	Carrying amount 2017	*Fair value 2017*	*Unrecognized gain/(loss) 2017*	*Carrying amount 2016*	*Fair value 2016*	*Unrecognized gain/(loss) 2016*
Financial assets						
Cash and cash equivalents	39,962	39,962	–	21,465	21,465	–
Mandatory cash balances with the CBR	2,975	2,975	–	3,017	3,017	–
Placements with banks	9,338	9,338	–	384	367	(17)
Loans to customers	266,245	271,027	4,782	238,420	239,790	1,370
Other assets	204	204	–	129	129	–
Financial liabilities						
Due to the CBR	–	–	–	42,618	42,618	–
Due to banks	194,135	194,135	–	145,196	145,196	–
Due to customers	358,914	361,057	(2,143)	276,467	277,708	(1,241)
Debt securities issued	15,744	15,780	(36)	8,774	8,797	(23)
Other borrowed funds	15,381	15,381	–	15,691	15,691	–
Subordinated debt	6,799	6,799	–	1,484	1,484	–
Other liabilities	3,270	3,270	–	2,215	2,215	–
Total unrecognized change in the fair value			**2,603**			**89**

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

Cash and accounts with the CBR

The carrying amount of cash and accounts with the CBR approximates their fair value due to the relatively short-term maturity of these financial instruments.

Amounts due from and to credit institutions

For financial assets and financial liabilities that are liquid or have a short-term maturity (less than three months) it is assumed that their carrying amount approximates their fair value.

Loans and advances to customers

The estimate is made by discounting scheduled future cash flows of the individual loans with estimated maturities using prevailing market rates as of the respective year-end.

Debt securities issued

Fair value of debt securities issued is determined on the basis of the available market prices of bonds issued at the year-end.

Due to customers

The estimate is made by discounting scheduled future cash flows through the estimated maturity using prevailing market rates as at the respective year-end.

39. Business combinations and disposal of subsidiaries

Acquisition of LAFA VENTURES LIMITED

On 16 August 2017 (the "Acquisition Date"), the Group acquired a 100% interest in LAFA VENTURES LIMITED ("LAFA").

LAFA is a developer of mobile application for electronic money transfers "Ubank".

The main reasons for the acquisition of LAFA were existing contracts with major smartphone producers to preinstall "Ubank" on all smartphones sold in Russia, 10 million active users of "Ubank" and highly qualified team of IT developers.

39. Business combinations and disposal of subsidiaries (continued)

Acquisition of LAFA VENTURES LIMITED (continued)

Fair value of identifiable net assets and liabilities of LAFA VENTURES LIMITED

The Bank determined the fair value of the identifiable net assets and liabilities of LAFA and the consideration received is in line with all available data in accordance with IFRS 3 *Business Combinations*. The fair value of identifiable net assets and liabilities of LAFA as at the Acquisition Date was as follows:

	RUB MM
Assets	
Cash and cash equivalents	47
Property and equipment and intangible assets	515
Other assets	4
Total assets	**566**
Liabilities	
Deferred tax liability	8
Other liabilities	48
Total liabilities	**56**
Identifiable net assets	**510**

	RUB MM
Consideration transferred	760
Fair value of identifiable net assets of LAFA as at the Acquisition Date	(510)
Goodwill arising on acquisition	**250**

40. Changes in liabilities arising from financing activities

	Debt securities issued	*Subordinated loans*	*Total liabilities arising from financing activities*
Carrying amount as at 31 December 2015	**1,024**	**6,958**	**7,982**
Proceeds from issue	8,188	2,000	**10,188**
Redemption	(2,035)	(1,952)	**(3,987)**
Reclassification to equity instruments	–	(6,070)	**(6,070)**
Translation differences	–	566	**566**
Other	1	(18)	**(17)**
Carrying amount as at 31 December 2016	**7,178**	**1,484**	**8,662**
Proceeds from issue	10,367	1,302	**11,669**
Redemption	(3,032)	(1,470)	**(4,502)**
Reclassification from equity instruments	–	5,412	**5,412**
Translation differences	–	83	**83**
Other	(119)	(12)	**(131)**
Carrying amount as at 31 December 2017	**14,394**	**6,799**	**21,193**

The “Other” line includes the effect of accrued but not yet paid interest on debt securities issued, other borrowed funds and subordinated loans. The Group classifies interest paid as cash flows from operating activities.

41. Goodwill

Goodwill recorded in the Group's balance sheet is tested for impairment at least annually as required by IAS 36 *Impairment of Assets*.

Goodwill acquired through combinations of assets with indefinite lives is allocated to one cash-generating unit.

The carrying amount of goodwill and its changes are allocated to the cash-generating units as follows:

	Retail banking RUB MM
Goodwill as at 31 December 2015	**364**
Acquisitions through business combinations	593
Impairment	(229)
Goodwill as at 31 December 2016	**728**
Acquisitions through business combinations	250
Impairment	(250)
Goodwill as at 31 December 2017	**728**

Impairment of goodwill identified in 2016 relates to the repayment of loan portfolios acquired by the Group following the acquisition of Kreditny Ostrov Primorye LLC in March 2008.

The Group wrote off goodwill of RUB 250 MM, recognised upon acquisition by the Group LAFA, in 2017.

42. Capital adequacy

The Group manages its capital in accordance with the Russian legislation and requirements of the Central Bank of Russia on standalone basis. The Group maintains an adequate capital buffers in order to cover risks inherent in the Group's activities, the primary asset of which is the Bank.

The Bank's capital adequacy is monitored based on the principles and ratios stipulated in the Basel Capital Accord of 1988, ratios established by the CBR, and certain other measures. The primary objective of capital management is to monitor compliance of the Bank's capital with the CBR's requirements and to maintain strong credit ratings to ensure the Bank's operation.

The CBR's capital adequacy ratio

According to the CBR, banks are required to maintain a capital adequacy ratio of 8% of risk-weighted assets, computed based on RAS (the ratio is calculated based on the statutory financial statements prepared in accordance with Russian accounting legislation).

As at 31 December 2017 and 2016, the Bank's capital adequacy ratio on this basis exceeded the statutory minimum established by the CBR.

Capital adequacy ratio under the Basel Capital Accord of 1988

As at 31 December 2017 and 2016, the Group's capital adequacy ratio calculated in accordance with the Basel Capital Accord of 1988, taking into account subsequent amendments on incorporate market risk inclusion, was as follows:

	2017	***2016***
Tier 1 capital	82,170	55,634
Tier 2 capital	13,502	14,445
Total equity	**95,672**	**70,079**
Risk-weighted assets	**579,649**	**438,307**
Tier 1 capital adequacy ratio	14.2%	12.7%
Total capital adequacy ratio	16.5%	16.0%

43. Principal consolidated subsidiaries, associates and joint ventures

A list of the principal consolidated subsidiaries, associates and joint ventures of the Group as at 31 December 2017 and 2016 is provided below:

		Voting rights	
	Relationship	***31 December 2017***	***31 December 2016***
Sovremenny Kommerchesky Innovatsionny Bank LLC	Subsidiary	50.01%	50.01%
Silhouette JSC	Subsidiary	50.01%	50.01%
AeroPlaza LLC	Subsidiary	−	100.00%
Metcombank JSC	Subsidiary	−	100.00%
Garanti Bank – Moscow JSC	Subsidiary	−	100.00%
Express-Volga Bank JSC	Subsidiary	100.00%	100.00%
RTS-Tender LLC	Subsidiary	100.00%	100.00%
KOMANA HOLDINGS LTD	Subsidiary	100.00%	100.00%
Investitsionnoye Agentstvo LLC	Subsidiary	100.00%	−
LAFA VENTURES LTD	Subsidiary	100.00%	−
Sollers-Finance LLC	Joint venture	50.00%	50.00%
Kostromskoy Zavod Avtokomponentov JSC	Associate	49.60%	49.60%
Cbonds.ru LLC	Associate	24.90%	24.90%
Shatalet LLC	Associate	49.00%	49.00%
Rosevrobank JSB	Associate	24.34%	−

In 2017, as a result of agreements to amend the Group's structure, the non-controlling interest of RUB 1,498 MM, which was recognized as a liability and relate to Sovremenny Kommerchesky Innovatsionny Bank LLC, was transferred to JSC Silhouette and reclassified to equity. This amendment was recorded in a separate line of the consolidated statement of changes in equity and had no effect on the consolidated profit or loss of the Group.

Merger of Metcombank JSC with Sovcombank PJSC

On 7 October 2016, the Group acquired 100% of voting shares in Metcombank JSC, a retail bank specialising in car loans, from Severgroup.

On 27 March 2017, following the completion of operational integration with the Group, Metcombank JSC merged with Sovcombank and CBR revoked the banking license of Metcombank JSC at the request of Sovcombank. Sovcombank assumed all legal rights and obligations of Metcombank JSC.

Merger of Garanti Bank − Moscow JSC with Sovcombank PJSC

On 5 December 2016, the Group acquired 100% of the voting shares in Garanti Bank − Moscow JSC from Turkiye Garanti Bankasi Anonim Sirketi (Turkey) and Garanti Bilisim Teknlojici ve Ticaret T.A.S. (Turkey), which are both subsidiaries of Banco Bilbao Vizcaya Argentaria S.A. (Spain).

On 27 April 2017, following the completion of operational integration with the Group, Garanti Bank − Moscow JSC merged with Sovcombank and the CBR revoked the banking license of Garanti Bank − Moscow JSC at the request of Sovcombank. Sovcombank assumed all legal rights and obligations of Garanti Bank − Moscow JSC.

Acquisition of shares in Rosevrobank JSB

In October and December 2017, Sovcombank acquired 9.16% and 5.70% shares of Rosevrobank. As a result of transactions that took place in 2017, Sovcombank's direct share in Rosevrobank as at 31 December 2017 reached 24.34%. As at 31 December 2017, the carrying amount of direct investments in Rosevrobank was RUB 7,445 MM. As at 31 December 2017, the Group holds 15.5% in REG Holding Limited, which owns 64.7% of shares in equity of Rosevrobank. Investments in REG Holding Limited of RUB 3,054 MM are recorded as available-for-sale investment securities. The Group is in the process of purchase price allocation of acquisition cost to Rosevrobank's net assets.

Rosevrobank is incorporated in the Russian Federation. Its principal business activity is the issuance of loans to small and medium enterprises ("SME") and cash and settlement services.

The shares in Rosevrobank were purchased to gain, at a favorable price, expertise with SMEs and to get access to the bank's sustainable business model that had generated material net profit for the bank over a number of years.

In January 2018, Sovcombank acquired 11.00% of shares in Rosevrobank from European Bank of Reconstruction and Development. As at the date of these consolidated financial statements, the Group did not have control over Rosevrobank.

44. Subsequent events

Acquisition of shares in Rosevrobank JSB (continued)

In March 2018, Sovcombank announced a purchase of a controlling share in Rosevrobank. As a result of this announcement, credit rating agencies confirmed Sovcombank's credit rating at the following levels:

- Fitch Ratings: BB-, outlook was upgraded to positive.
- S&P: BB-, outlook was confirmed at stable.
- Moody's: Ba3, outlook was confirmed at stable.
- ACRA: ruA (Russian national scale), outlook was confirmed at stable.

Placement of subordinated bonds

On 7 March 2018, the Bank issued and sold perpetual subordinated bonds series 1V02 for USD 100 MM with a coupon rate of 8.75% p.a. (State Registration Number 41000963V of 22 January 2018), and 11-year subordinated bonds series 2V03 for USD 150 MM with a coupon rate of 8.25% p.a. (State Registration Number 41400963V of 22 January 2018).

On 26 March 2018, after receiving an approval from the CBR, the Bank included the subordinated bonds series 1V02 to the additional capital and subordinated bonds series 2V03 to additional paid-in capital.

Conversion of a subordinated loan

On 26 March 2018, the CBR approved the Bank's request to convert a perpetual subordinated loan of USD 117 MM issued by Sovco Capital Partners N.V. (Note 30) to its core capital. The Bank increased its core capital in accordance with the CBR's approval of 2 April 2018.

Acquisition of Sovcomcard LLC

In accordance with a decision of the Group's Supervisory Board, Sovcombank acquired a 100% interest in Sovcomcard LLC (hereinafter, "Sovcomcard") from third parties for RUB 1,106 MM in February 2018. Sovcomcard was incorporated in 2017 to develop "Halva" installment card project and is the owner of Halva trademark in the Russian Federation. The Bank has not yet finalized the measurement of the fair value of identifiable net assets and liabilities of Sovcomcard LLC.

Dividend distribution

In accordance with decision of Sovco Capital Partners N.V., the sole shareholder of Sovcombank, the Bank distributed dividends of RUB 3,820 MM in March 2018.