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GEORGIA

FINANCIAL SECTOR ASSESSMENT

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A joint IMF and World Bank team conducted virtual missions to Georgia during January-February 2021 and May-June 2021, to update the findings of the Financial Sector Assessment Program (FSAP) conducted in 2014.[1] This report summarizes the main findings of the mission, identifies key financial sector vulnerabilities and developmental issues, and provides policy recommendations.

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GLOSSARY

AML/CFT	Anti-Money Laundering / Combating the Financing of Terrorism
BCP	Basel Core Principles
CBDC	Central Bank Digital Currency
CCB	Capital Conservation Buffer
CCyB	Counter Cyclical Buffer
CICR	Currency-Induced Credit Risk
CPMI	Committee on Payments and Market Infrastructures
CSD	Central Securities Depository
CET1	Common Equity Tier 1 Capital Ratio
D-SIB	Domestic Systemically Important Bank
ELA	Emergency Liquidity Assistance
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Committee
FX	Foreign Exchange
GPSS	Georgia Payment and Settlement System
GRAPE	General Risk Assessment Program
GSE	Georgia Stock Exchange
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IFSC	Interagency Financial Stability Committee
IRB	Internal Ratings-Based
IOSCO	International Organization of Securities Commissions
ISSSG	Insurance State Supervision Service of Georgia
LCR	Liquidity Coverage Ratio
LTV	Loan-to-Value Ratio
M&A	Mergers and Acquisitions
MFI	Micro Finance Institution
MoESD	Ministry of Economy and Sustainable Development
MoF	Ministry of Finance
MoJ	Ministry of Justice
MoU	Memorandum of Understanding
MSMEs	Micro, Small, and Medium-Sized Enterprises
NBG	National Bank of Georgia
NPL	Nonperforming Loan
NPS	National Payment System
NSFR	Net Stable Funding Ratio
OMO	Open Market Operation
P&A	Purchase and Assumption
PA	Pension Agency
PCGS	Partial Credit Guarantee Scheme
PSP	Payment System Provider
PTI	Payment-to-Income Ratio
RLR	Responsible Lending Regulation
RTGS	Real Time Gross Settlement
RWA	Risk-Weighted Asset
SMEs	Small and Medium-Sized Enterprises

EXECUTIVE SUMMARY[2]

Georgia has weathered various shocks well in the past and is showing signs of a strong recovery from the pandemic, while structural vulnerability and uncertainty remain. While having improved significantly pre-pandemic on the back of increasing tourism receipts and steady remittances, current account deficits remain at a high level and are largely financed by foreign direct investment (FDI) and an accumulation of external liabilities. After being hit hard by the Covid pandemic, a strong recovery supported by domestic private consumption, external demand and fiscal stimulus is now underway, while inflationary pressures are still present and significant downside risks remain due to uncertainty around the pandemic.

High dollarization remains a key structural feature, which poses challenges to financial sector policymaking, to foster financial sector development while preserving stability. Dollarization is an important source of financial vulnerability due to credit risk, associated with unhedged borrowing--and liquidity risk--given the limited ability of the central bank to provide backstop liquidity in foreign currency in the presence of systemic liquidity shocks. In addition, despite the progress in de-dollarization of lending in Georgia, the persistent dollarization of savings has resulted in a structural liquidity deficit and high cost of funding in local currency and a lack of demand for local currency debt and equity instruments, which hinders access to finance and market development. Sustained de-dollarization underpinned by the continued strengthening of macroeconomic fundamentals will require long-term efforts. In this context, financial sector policies could help to mitigate risks to financial stability and to improve the foundations for competition, innovation and market development, which in turn could facilitate efforts for sustained market-based de-dollarization.

A well-developed banking sector (with total assets at around 100 percent of GDP) and progress on financial access in Georgia mask a lack of diversity in financial products and services and disparities in financial inclusion. Traditionally underserved low-income and rural clients face continued constraints in accessing financial services, despite the overall account ownership metrics on par with regional averages. Access to finance continues to be one of the major challenges to SME growth. Significant gender gaps remain in terms of both female participation in entrepreneurship and access to finance for female-owned/led firms. Higher costs of SME financing are also driven by a perception of high credit risk due to information asymmetry, as well as demand-side constraints such as informality and weak financial management and business skills. Despite well-developed bank credit products, a lack of diversity of other financial products and services (such as leasing, factoring, equity financing) limits the ability of the financial sector to meet the diverse needs of firms throughout their lifecycle. The capital market is shallow outside the government bond segment. Opportunities for increasing coverage and diversifying products are constrained by dollarization, as well as the concentrated competitive landscape in the financial sector, with market dynamics shaped by the prominent market position of the large banks, not only in the banking sector, but also controlling investment banks/brokerage firms and market infrastructure and expanding into non-financial

[2] The Financial Sector Assessment (FSA) of the World Bank should be read in conjunction with the IMF's Financial System Stability Assessment (FSSA).

segments such as e-commerce. Diversifying sources of finance would be central to the development of the financial sector, as well as resilient and inclusive growth of the economy.

The banking sector has remained resilient through the pandemic, underpinned by proactive policy actions. Since the last FSAP, the NBG has strengthened the legal and regulatory framework for the financial sector by implementing key Basel III standards and other prudential requirements, including for responsible lending and dollarization-related risks. The institutional framework for macroprudential policy has also been strengthened and the macroprudential toolkit is comprehensive. Early during 2020, the NBG required banks to make forward-looking general provisions against expected credit losses based on macro scenarios under the Covid pandemic, restricted capital distributions, and released some of banks' capital buffers. These regulatory measures, combined with significant fiscal and monetary support to the economy, have helped to support the resilience of the banking sector, which is confirmed by the FSAP solvency and liquidity stress testing.

Building on the significant progress made since the last FSAP, continued improvement of financial oversight would remain important for financial stability, as well as providing a sound foundation for further financial development. The regulatory framework for the financial sector has been largely aligned with international standards, and significant progress has been made in strengthening the quality of oversight. Further efforts could be focused on the continued implementation and refinement of risk-based supervision and the formalization of NBG's supervisory processes and procedures, while addressing remaining gaps in specific areas:

- The regulatory regime for the banking sector is generally consistent with Basel standards. The NBG should formalize key supervisory processes: including for supervisory planning and decision making, communication with banks on supervisory assessments, and follow up on banks' actions to implement remedial measures. It should deepen its assessments of banks' governance and risk management and require systemic banks to incorporate internal stress tests in their management of capital and liquidity.

- The regulatory and policy framework for capital markets is generally aligned with international best practice and IOSCO standards. The NBG is encouraged to further its effort in developing its risk-based supervisory approach, while building a strong compliance culture at firm and market level. The NBG should continue to develop risk identification processes and a proportionate yet robust risk scoring model, and adapt its annual supervisory and enforcement plans accordingly. The market surveillance framework of the NBG should be reinforced. The level of monetary sanctions applied for market abuse should be reviewed to provide sufficient deterrence.

- Building on existing progress, the oversight policy framework for payment systems should be finalized and adopted in addition to developing detailed oversight procedures (complementing efforts to promote sound competition in this area). The NBG is advised to continue to develop a comprehensive framework for risk management for the real time gross settlement (RTGS) system and complete the self-assessment of the central securities depositories (CSDs) according to CPMI/IOSCO Principles. Draft legislation on information security currently under discussion should ensure that the NBG retains oversight authority for cyber security in the financial sector.

Further improvement in the AML/CFT framework is key to address elevated integrity risks in several areas. Money laundering/terrorist financing risks stem from the high use of cash in transactions (including real estate purchases), the activities of politically exposed persons, the absence of regulation for providers of virtual assets, and weak regulations for the gaming sector. These risks are compounded by various exemptions from FATF recommendations, including for real estate agents, accountants and virtual asset service providers. The authorities should consider setting maximum cash thresholds for certain transactions, and further strengthen the regulation and supervision of the gaming sector, virtual asset service providers, and real estate agents.

While the authorities have made strides in strengthening the overall financial sector legal and regulatory framework and oversight, developing a diverse, efficient and inclusive financial system would require a long-term vision and policy cohesion. While continued improvement in the legal and regulatory framework and to financial sector oversight would ensure a solid foundation for financial development, implementation of a coherent set of reforms and policies will entail balance among multiple objectives and sometimes difficult policy tradeoffs. The authorities will be faced with the challenges of promoting innovation and competition by ensuring a level playing field and leveraging Fintech development. These challenges should be achieved while safeguarding financial system resilience; addressing disparity in financial inclusion, ensuring responsible lending practices and adequate financial consumer protection; and paying attention to policy cohesion in promoting capital market development. Market development and financial inclusion will also require concerted efforts by policymakers to ensure ownership and coordination.

Commendable progress has been made in developing the retail payment system, and further efforts would help to improve access and efficiency and harness the benefits of innovation and digitalization for the wider financial system and the economy. To ensure a level playing field and promote financial inclusion and efficiency, the authorities should facilitate the access of non-bank payment service providers (PSPs) and microfinance institutions (MFIs) to the payment infrastructure according to risk-based and tiered access criteria. The NBG is taking an essential step to promote e-money, which could serve as a catalyst for financial inclusion, by developing the instant payment system as an interoperability platform among e-money, cards and bank accounts. Further efforts are needed to promote the ecosystem for e-money, including the acceptance of e-money by the government and waiving the restrictions on the reuse of e-money by merchants. NBG could use its oversight powers to mandate direct connection between the two domestic card schemes, while reviewing card acceptance and pricing.

Despite some progress on financial access, a strong commitment from the government is needed to address remaining disparities in financial inclusion. Digital innovations and fintech have the potential to bridge the SME finance gap and deliver enhanced services to underserved clients. Building on existing initiatives that promoted digital innovation and fintech, the authorities should articulate a transparent, pro-innovation fintech vision that encourages competition and prioritizes financial inclusion. Ongoing efforts to establish an online collateral registry and further strengthen the legal framework for secured transactions would help to further improve the credit infrastructure. The government's support programs for SMEs represent a massive public sector investment and should be better aligned and targeted, with results better monitored and evaluated. The partial credit guarantee scheme should be reviewed to ensure alignment with best practices. The government, led by the Ministry of Economy and Sustainable Development and in coordination with the Ministry of Finance, should further demonstrate a clear commitment to the wider financial inclusion agenda by developing a comprehensive National Financial Inclusion Strategy, coordinating action on key legal, regulatory, and institutional reforms.

The NBG is encouraged to continue its ongoing efforts to promote competition in the financial sector. Effective implementation of NBG's competition mandate would require further strengthening of institutional arrangements, including establishing a separate function within the NBG vis-à-vis prudential supervision and reinforcing cooperation with the Competition Agency. Mergers and acquisitions (M&A) involving financial institutions would benefit from a systematized competition review to curb potential negative effects. In addition, competition enforcement in the financial sector would need to be strengthened to prevent anticompetitive behaviors. A systematic assessment of regulations from a competition perspective may help to level the playing field for small players. Finally, ensuring fair access to financial infrastructure (including information and payment systems) would be important for fostering efficient market dynamics.

Capital markets development will take time, and continued efforts are required to build the foundations for long-term market development. With the small size of the economy and a small number of large companies, reaching the size and liquidity of investable instruments required by large investors is inherently difficult to achieve. While there is prominent policy attention to capital market development, it is important to ensure that there is a collective vision among relevant authorities, cohesion in policymaking, and effective inter-institutional coordination. The development of the government bond market should be prioritized as a reliable sovereign yield curve sets the foundation for the development of other segments. The government should commit to maintain a small number of local currency benchmark bonds in sizable amounts to strengthen the yield curve. NBG should review its Open Market Operation (OMO) mechanism with a view to minimizing the impact on the yield curve, while preserving the monetary policy objectives.

The authorities could explore realistic opportunities for capital market development, while managing potential constraints and conflicting objectives. The large domestic savings that will be accumulated in the mandatory funded pension scheme established in 2019 could play a role in capital market development over time, although a sizable part of the assets is expected to be invested abroad. The NBG should set clear expectations about the extent of supervisory scrutiny of the investment policy and strategic asset allocation of the Pension Agency (PA), while the composition of the PA's Supervisory Board set in the law could be revised to ensure independence. Domestic investment would require the development of a sizable base of investable assets and improvement in competition in the bank-dominated financial sector, allowing more space for market development. The development of the covered bonds market may be among the most realistic opportunities in the non-government fixed income market and would require the enactment of the respective legislation. To complement the pension reform and add to the protection of beneficiaries, the introduction of a mandatory insurance of disability and survivorship (D&S) should be considered, which could also contribute to capital market development by creating a new type of institutional investors.

Table 1. Georgia: Key Recommendations

Recommendations and Authority Responsible for Implementation[1/]	Timing[2/]
Financial Stability Analysis	
Encourage banks to retain earnings until pandemic-related uncertainties subside and pre-pandemic capital buffers are restored.	ST
Implement Basel regulation on banks' large exposures as planned.	ST
Macroprudential Policy and Dollarization	
Review calibration of macroprudential tools aimed at reducing dollarization, including via impact assessments.	ST
Enhance public communication to clarify the objectives of foreign exchange interventions.	I
Banking Supervisory Oversight	
Formalize and enhance the governance of key internal processes for supervisory operations and decisions.	I
Review NBG's internal GRAPE scoring and weighting methodology.	ST
Carry out regular in-depth assessments of banks' governance and risk management practices.	ST
Require systemic banks and encourage others to incorporate internal stress testing in capital and liquidity planning.	ST
Capital Markets Oversight	
Continue to develop and implement risk-based supervision for all market participants, while promoting a strong compliance culture at the firm and market level.	ST
Reinforce market surveillance with a surveillance plan and direct access to an audit trail and order flows.	I
Ensure that sanctions for market abuse are sufficiently punitive.	I
Anti-Money Laundering / Countering Financing of Terrorism (AML / CFT) Supervision	
Strengthen regulation/supervision for the gaming sector, virtual asset service providers, and real estate agents. (MoF)	MT
Consider setting maximum thresholds for use of cash in certain transactions.	ST
Financial Safety Nets	
Implement a prompt corrective action framework for banks.	I
Take steps to be able to implement a bridge bank swiftly when needed (MoF, NBG).	I
Prepare crisis contingency plans for banks and adopt regular testing programs. (IFSC, NBG)	ST
Financial Market Infrastructure	
Continue efforts to develop the Instant Payment System and allow direct access of registered PSPs.	ST
Develop detailed procedures for the oversight of payment systems.	I
Complete self-assessments of the two Central Securities Depositories. (NBG, GCSD)	I
Access to Finance	
Define a roadmap for the development of fintech (NBG) and a National Financial Inclusion Strategy (MoF, MoESD, NBG).	ST
Establish an online collateral registry and further strengthen the legal framework for secured transactions. (MoJ, MoESD)	ST
Reform the PCG to bring it in line with international best practices. (MoESD)	I
Financial Sector Competition	
Develop institutional capacity for competition enforcement and advocacy as a separate function within the NBG.	I
Finetune the implementation of the open banking framework, considering more inclusive participation in standard-setting by non-bank players.	I
Carry out impact assessments of laws and regulations in the financial sector from a competition perspective.	ST
Capital Markets Development	
Commit to maintain a small number of sizable standardized benchmark bonds in lari (MoF).	I
Review the OMO mechanism to minimize, its impact on the yield curve and crowding-out of secondary market activity, while preserving the monetary policy objectives.	I
Consider the introduction of a mandatory insurance of disability and survivorship (MOESD).	ST
Enact relevant legislation for covered bonds as planned (MoF, NBG).	I

[1/] Authority responsible for implementation is NBG unless indicated otherwise.
[2/] I Immediate (within 1 year); ST Short term (1-3 years); MT Medium Term (3-5 years)

BACKGROUND

A. Macroeconomic Context

1. **Georgia is a small, open economy with persistent external imbalances.** Strong consumption and private and public investment despite periods of internal and external shocks, combined with a narrow export base, have resulted in persistently high trade deficits (Figure 1). Significant current account deficits have persisted, despite improving from 12.5 percent of GDP in 2016 to 5.5 percent of GDP in 2019, owing to increasing tourism receipts pre-pandemic and steady remittances. Current account deficits are largely financed by FDI and an accumulation of external liabilities. The persistence of these imbalances continues to expose the Georgian economy to external shocks.

2. **Over the past three decades, the economy has been affected by several macro-financial and geopolitical shocks.** In the first half of the 1990s, following a civil war and significant losses of territory, the country experienced large declines in output, several bank failures and hyperinflation, which undermined confidence in banks and the domestic currency and led to a highly dollarized banking system. Inflation was eventually stabilized, and growth resumed over the next decade, as a significantly improved investment climate and aggressive privatization led to strong capital inflows and exchange rate appreciation. From 2008 onwards, Georgia faced various shocks including an armed conflict with Russia, the global financial crisis, various political disturbances and regional tensions, which caused a significant slowdown in the pace of growth compared with the previous decade.

3. **The COVID-19 pandemic is the latest shock to the economy.** During 2020, domestic mobility restrictions together with a collapse of tourism receipts contributed to the largest output decline (of 6.2 percent) since the nineties (Figure 1). The pandemic lowered firms' earnings and household incomes, and led to significant loss of jobs, with the unemployment rate rising from 17.6 percent at end-2019 to 21.9 percent in Q1 2021. The government provided substantial fiscal support for the economy, amounting to 3.8 percent of GDP in 2020 (including unemployment compensation, direct transfers and mortgage subsidies for households, tax relief and credit guarantees for businesses) and a further 2.9 percent in 2021 (mostly for healthcare). The current account deficit for 2020 reached 12.4 percent of GDP and is expected to decline to 5.5 percent of GDP in the medium term, assuming a gradual recovery in exports and a timely implementation of structural reforms to diversify the economy and increase competitiveness.[3] Net FDI fell by 40 percent in 2020. Robust financial support from international financial institutions (IFIs) and the refinancing of a maturing Eurobond of the government helped cover financing needs and supported stable reserves. The NBG meanwhile provided monetary support via cumulative rate cuts of 100 bps. Between end-2019 and end-April 2021, the lari depreciated in nominal terms by about 20 percent against the dollar (before appreciating 9.0 percent in May-July 2021), although the real effective exchange rate has remained mostly stable due to appreciation against key trading partners, including Turkey and Russia.

[3] IMF Country Report No. 21/215.

4. The economy is showing signs of a strong recovery, while inflation pressure is building up and downside risks remain. Supported by domestic private consumption, external demand and fiscal stimulus, the economy has shown a strong rebound in Q2 2021 with growth expected to reach 7.7 percent for the year, while significant downside risks remain. Annual CPI inflation, which had declined sharply during 2020, has risen to 11.9 percent by end-July 2021 (Figure 1), well above the NBG's target of 3 percent.[4] On concerns about exchange-rate pass-through to inflation and rising inflation expectations, the NBG reversed its monetary policy stance during the pandemic and raised the policy rate by 200 bps cumulatively between March and August 2021.

5. Credit growth remains robust, despite slowing significantly during the pandemic. At constant exchange rates, credit slowed to 7.7 percent year-on-year (yoy) in March 2021 compared to about 16 percent before pandemic, but has since picked up again, to 12.6 percent yoy in June, notwithstanding the tightening in interest rates (Figure 1). In recent years, the main drivers of credit growth have gradually shifted from consumer and mortgage lending in 2017-2018 to corporate loans in 2019-2020, largely due to the introduction of responsible lending regulation (RLR) in 2019 curtailing the growth of retail credit. NBG analysis suggests that the credit gap was close to zero before the pandemic and became positive subsequently.

6. Despite progress in reducing dollarization, it remains a key structural feature of the economy and the financial system.[5] At the end of 2016, the government and the NBG adopted a 10-point larization plan to mitigate the financial risks associated with high dollarization. At that time, dollarization of liabilities and loans in the banking sector were at 70.7 percent and 65.4 percent, respectively. As of the end of 2020, dollarization of liabilities and loans in the banking sector remain at levels of 61.4 percent and 55.6 percent, respectively. Foreign currency debt accounts for 80 percent for the public sector debt, 75 percent for corporates and 40 percent for households (Figure 1). A strong preference for foreign currency in savings/deposits persists.

7. Dollarization has significant implications for both financial stability and financial development. Dollarization is an important source of financial vulnerability due to credit risk, associated with unhedged borrowing, and liquidity risk, given the limited ability of central bank to backstop systemic liquidity shocks in foreign currency. In addition, despite the progress in de-dollarization of lending in Georgia, the persistent dollarization of savings has resulted in a structural liquidity deficit and high cost of funding in local currency and a lack of demand for local currency debt and equity instruments, which hinder access to finance and market development. Sustained de-dollarization underpinned by the continued strengthening of macroeconomic fundamentals will require long-term efforts. In this context, financial sector policies could help to mitigate risks to financial stability (see Section "Macroprudential Policy and Dollarization") and to improve the foundations for competition, innovation and market development (see Section "Broadening Markets and Improving Access and Efficiency"), which in turn could facilitate efforts for sustained market-based de-dollarization.

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[4] Since 2009, NBG have operated an inflation targeting framework, coupled with a floating exchange rate regime with sporadic FX interventions.

[5] Dollarization is used in generic terms to reflect holdings of hard currencies.

B. Financial System Overview

8. The Georgian financial sector is bank-centric and characterized by high concentration. The financial sector, which consists almost entirely of banks, has assets amounting to 108 percent of GDP (Table 2). As of the end of 2020, there were 15 commercial banks (93.1 percent of total assets);[6] microfinance organizations (2.4 percent), insurers (1.5 percent), pension funds (2.0 percent) and other non-bank financial institutions. There are nine domestic banks, of which three are domestic systemically important banks (D-SIBs), and the other six are subsidiaries of foreign banks. There are no state-owned banks. After a period of mergers and consolidations, the banking system is now concentrated with the two largest banks, both listed on the London Stock Exchange, making up nearly three-quarters of lending (Figure 2).

9. Banks follow simple business models with asset exposures that are mainly domestic (Figure 2). Banks' assets are largely comprised of loan portfolios and carry only modest exposure to interbank and securities markets, amounting to 16 and 11 percent of total assets respectively. Banks' loan portfolios are split almost evenly between corporates and households, with the latter being mainly for mortgages. On the liability side, banks' funding is deposit-based, with debt issuance, including in foreign markets, comprising about 20 percent of the total. While banks manage the net foreign currency position of their own balance sheets to stay within the NBG requirement (up to 20 percent of capital), they carry high credit exposure to unhedged borrowers of FX loans.

10. There are also a number of non-bank credit institutions. These include 40 registered microfinance institutions (MFIs) and 199 loan issuing entities (LIEs)[7] under the jurisdiction of the NBG, accounting for approximately 2 percent of total financial assets in aggregate. It is estimated that MFIs and LIEs serve around 780,000 customers or 22 percent of the population.[8] Financial leasing is currently not regulated, and the very small market is dominated by two leasing companies, which are subsidiaries of the two large banks.

11. The capital market is shallow and underdeveloped. Only the government bond market offers regular supply in the primary market, while the secondary market is practically inactive. Although the size of the domestic non-government bond market has increased, it is dominated by IFIs. Of the 26 outstanding bonds, nine were issued by IFIs, accounting for more than 50 percent of the outstanding volume (excluding dual listing). Transactions are mostly made over the counter (OTC). The equity market is thin and highly illiquid, with four listed companies and another six admitted to trading on the GSE. Market capitalization stands at 4.8 percent of GDP. During 2019 – 2020, the annual turnover of shares was close to zero (around GEL 50 thousand annually).

12. While the new pension fund has become a fast-accumulating pool of domestic savings, the institutional investor base remains weak and lacks diversification overall. The domestic investor base is small and mainly comprised of the two largest banks, while the share of foreign investors is relatively modest, averaging around 10 percent in recent years in the bond market. A mandatory defined contribution pension scheme (Pillar II) was launched in January 2019, based on

[6] Two small banks merged in July 2021, and the number of banks is 14 at the time of the writing of this report.
[7] Formerly pawn shops, until 2017.
[8] IMF TA report "Strengthening Regulation, Supervision, and Oversight of Micro Lending Institutions", September 2020.

individual accounts. The fund had accumulated GEL1.4 billion (or 1.1 percent of 2020 GDP) as of the end of April 2021, with about 1.15 million registered participants (or about 80 percent of the labor force). While waiting for the selection of a specialized depository for pension fund to start investing, pension assets are placed in Georgian commercial banks, with 62 percent placed in certificates of deposit and time deposits and 38 percent in current accounts as of May 2021.

13. Despite significant growth in the past couple of years, the insurance sector remains small. There are 18 insurance companies, 17 of which are composite companies, and one is non-life only. Total insurance premium amounted to GEL620 million in 2020, at the same level as in 2019, after growing at an average 17 percent per annum since 2016. At 1.25 percent of GDP, insurance penetration remains very low.[9] Life insurance accounted for only 8 percent of total written premium (mainly linked to bank loans), while medical insurance accounted for 40 percent, motor 27 percent, and property 16 percent.

14. Concentrated market structure in the financial sector, in particular, the prominent position of the largest two banking groups, has significant implications for the overall development of the financial sector. The two large banks not only have the largest shares in banking sector, but also owns directly or indirectly the largest brokerage/investment firms, major insurance companies, leasing companies, as well as key parts of the financial infrastructure (GSE, Georgia Central Securities Depository, card switches, credit bureau). Over the past few years, the banking groups have also strategically expanded in emerging non-financial areas such as online e-commerce platforms, as part of their own digital ecosystems. The concentrated structure and associated competitive landscape pose challenges to long-term development of the market, efficiency and access in various aspects, as discussed in the Section “Broadening Markets and Improving Access and Efficiency”.

FINANCIAL STABILITY AND RISK ASSESSMENT

A. Policy Actions Underpinning Overall Resilience

15. Despite challenges, the authorities have maintained a strong commitment to reform over the years. Since the 2015 FSAP, they have made significant progress in implementing the FSAP recommendations (Table 4). This notably includes implementation of the Basel III framework for capital and liquidity. The implementation of a limit on banks’ large exposures has been delayed to mid-2022 due to the pandemic.[10] The authorities have also introduced responsible lending regulation (RLR) for household borrowers based on PTI and LTV ratios (2019); implemented a new banking resolution regime (at end-2019) and deposit insurance scheme (2017); established a Corporate

[9] Insurance penetration is calculated as the ratio of total insurance premiums to gross domestic product.
[10] The Basel III limit requirement on each bank’s large exposures, those that individually exceed 10 percent of a bank’s Tier 1 capital, is that each of these exposures must not exceed 25 percent of a bank’s Tier 1 capital.

Governance Code (2018); strengthened the top-down stress testing framework; and started the publication of an annual Financial Stability Report (since 2019).[11]

16. Several measures have been taken aimed at reducing the level of dollarization in the banking system and mitigating associated risks (Tables 5). These measures include more stringent LTV and PTI requirements for unhedged borrowers in FX (as part of the RLR); the introduction of a CICR pillar 2 capital buffer, which carries higher capital charges on unhedged FX credit; an outright ban on FX loans below 200,000 GEL for households, corporates and SMEs; a Liquidity Coverage Ratio (LCR) requirement for banks in FX; higher reserve requirements and penalty rates of remuneration for banks on their FX deposits;[12] and most recently reserve requirements differentiated by bank based on their level of deposit dollarization.

17. The authorities have also acted swiftly and decisively to mitigate the economic impact of the Covid-19 pandemic and stability risks to the financial sector (Table 6). Support measures included interest rate subsidies on lending to SMEs and households and credit guarantees for financial institutions lending to corporates and SMEs, voluntary loan service moratoria (during Q1-Q3, 2020) and loan restructurings by banks,[13] and provision of lari liquidity by the NBG using swap lines with banks, combined with expanded collateral framework for NBG liquidity support to include SME loans of banks (in addition to mortgage loans). The NBG also partially released the LCR requirement in lari, which was restored in May 2021. In view of increased credit risks, NBG required banks to take general provisions early on, during Q1 2020 – amounting to about 3.5 percentage points of banks' Common Equity Tier 1 (CET1) capital ratios.[14] Simultaneously banks' capital requirements were lowered by about the same amount by releasing the CCB and reducing part of pillar 2 buffers (2/3rd of CICR buffer), which was intended to cushion the impact of materialized risks during times of stress. Restrictions on shareholder payouts and bonuses were also put in place. A timeline for restoration of capital buffers has been announced, and banks will be required to restore CICR buffer by January 1, 2023 and CCB requirement by January 1, 2024.

18. Banks entered the ongoing Covid-19 pandemic with strong capital and liquidity buffers, though profitability took a temporary hit from an early NBG requirement to increase provisions related to the pandemic (Figures 3 and 4; Table 3). Capital ratios strengthened in the years prior to the pandemic even as banks' risk-weighted assets increased. Following the COVID-19 outbreak in 2020, banks' CAR ratios fell by 1.9 percentage points, mainly due to the impact of the required provisions, but by Q1 2021 have risen to 18.2 percent (with Tier 1 ratio at 13.4 percent). Profitability, which was high before the COVID crisis, dropped sharply during 2020 due to increased provisions for

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[11] These measures have helped contain credit growth and with the credit gap close to zero, the countercyclical capital buffer has never been activated.

[12] To reflect the higher systemic liquidity risk from foreign currency deposits and make them a less attractive source of funding for banks, the reserve requirement for FX liabilities is 25 percent compared to 5 percent in lari. Moreover, the remuneration for FX reserve is 50 bps below the Fed Funds rate (20bps below ECB deposit rate for EUR reserves), whereas GEL reserves are remunerated at the monetary policy rate.

[13] During 2020, 63 percent of household loans, 46 percent of SME loans and 30 percent of corporate loans benefited from loan moratoria at least once.

[14] NBG is in transitioning supervisory reporting to be aligned with IFRS standards. Full transition of prudential provisioning requirements to IFRS9 is expected by 2022, while IFRS9 for accounting purpose has been in effect since 2018.

expected credit losses and falling interest income, though it has recovered by early 2021. Asset quality weakened, with NPLs reaching 6.9 percent by Q2 2021 compared with 4.4 percent at end-2019, under NBG's asset classification. Loan impairment varied substantially across banks and was higher on FX loans (NPLs were about 12 percent on dollar loans and 8 percent on euro loans compared to 6 percent on GEL loans as of February 2021) and for sectors more heavily exposed to the effects of the pandemic. Liquidity conditions remained stable overall.

B. Risk Assessment

19. **Macrofinancial vulnerabilities stem from external imbalances and high financial dollarization and are exacerbated by the pandemic.** In the context of a small open economy with high and persistent current account deficits and increasing reliance on external financing, combined with high dollarization, the financial system is exposed to significant structural vulnerabilities. Corporate sector debt has doubled over the last decade to 69 percent of GDP, which is moderately high in cross-country comparison. There is significant variation in debt servicing ability among firms. Household sector debt is 38 percent of GDP, significantly higher than in peer countries, and has tripled in proportion to disposable income over the past decade. Further exchange rate depreciation is a potential risk in a scenario of slow recovery of external demands and financial inflows, which could lead to a sharp increase in both public and private sector debt and put further strains on the debt-servicing ability of a large portion of unhedged borrowers.[15] Financial stability risks could follow from an extended pandemic or less benign external financing conditions.

20. **Stress testing results show that the banking system appears resilient, while continued retention of earnings is encouraged to fully restore capital buffers**. Financial sector resilience was assessed by means of solvency, liquidity, and contagion stress tests of banks.[16] Systemic resilience comes from solid pre-crisis capital buffers—both in terms of size and quality—and robust profitability. Under the baseline scenario, credit losses can be absorbed with a combination of operational profits and capital cushions without threatening financial stability. Under potential adverse scenarios, a few banks could face capital shortfalls, which remain manageable at a system-level.[17] Overall, expected losses ranged between 3–6½ percent of the gross performing loan exposures, which appeared commensurate with current provisioning. Given the widespread impact of the pandemic, the absorption of losses and the replenishment of bank capital buffers is likely to take 2-3 years. The

[15] Three-quarters of corporate loans are in FX, of which only an estimated 20 percent are hedged, with sources of income in FX; 60 percent of SME loans are in FX and almost none are hedged; over 40 percent of household loans are in FX and almost none are hedged. The 2019 Responsible Lending Regulation imposed an outright ban on FX loans below 200,000 GEL for households, corporates and SMEs.

[16] A baseline scenario used the April 2021 WEO forecast, where the economy starts to recover in mid-2021 with benign external financial conditions. Two adverse scenarios over a three-year horizon implied negative GDP shocks of 1-1.5 standard-deviations relative to the baseline under extended pandemic, with the more severe scenario coupled with an external shock that leads to higher sovereign spreads, capital outflows and sharp exchange rate depreciation, with adverse feedback on economic activity. The assessment covered all 15 banks in the system as of end-December 2020.

[17] Under the Extended Pandemic scenario, three banks experienced capital shortfalls of 0.5 percent of GDP relative to minimum Tier 1 capital requirements; while in the Capital Outflows scenario, four banks suffered capital shortfalls that totaled about 1.5 percent of GDP In the extended pandemic scenario, the aggregate capital shortfall for banks is 12.7 million lari or 0.03 percent of their RWA; while in the capital outflows scenario, it is 149 million lari or 0.4 percent of RWA.

authorities are encouraged to continue to enforce retention of banks' earnings until credit losses are absorbed and capital buffers fully restored.

21. Banks have sufficient high-quality liquid assets to survive severe shocks to their deposit base, and other risks are not deemed significant. In liquidity tests, all banks were able to endure extreme shocks to their liabilities, which emulated those at the peak of the 2008–09 Global Financial Crisis, while sustaining their regular operations, even after restricting the gross inflows from loans and securities to zero. Market risk, interbank contagion risk, and risk related to banks' sovereign exposures are not deemed significant.

22. Stress tests of banks' large corporate exposures indicated a moderate shortage of provisions under the adverse scenarios. The FSAP carried out a detailed analysis of the ten largest credit exposures (at conglomerate group level) of each bank and estimated the impact of the above scenarios on key corporate vulnerability indicators and the resulting loan loss provisions under the adverse scenarios. Companies with less than full coverage of their annual debt interest payments with latest available annual earnings accounted for about 12 percent of sampled firms' assets. Stress testing results also indicate that enforcement of Basel concentration limits would have very limited impact on the availability of bank credit to large firms.[18]

MACROPRUDENTIAL POLICY AND DOLLARIZATION

23. The institutional framework for macroprudential policy has been strengthened since the 2015 FSAP and broadly meets the principles of good design. The NBG's mandate for macroprudential policy is rooted in its legal mandate to safeguard financial stability. The NBG has an FSC, comprised of senior NBG staff, and supported by a dedicated financial stability department, which is responsible for formulating and analyzing macroprudential policy proposals. The Organic Law, which grants the NBG supervisory powers over the financial sector (except for the insurance sector), confers it with sufficient "ability to act"; while a legal mandate to safeguard financial stability, a published macroprudential policy strategy, and specific allocation of institutional resources provide enough "willingness to act".[19]

24. The NBG has a comprehensive macroprudential toolkit, including those aimed at addressing the financial vulnerabilities stemming from dollarization. Tools introduced in recent years, such as PTI/LTV ratios, have helped to slow the growth of credit in recent years and to shift its composition from households, for whom indebtedness is high, to corporates. Several aforementioned tools have also been used to reduce dollarization and/or mitigate risks to stability, which is one of the key objectives of macroprudential policy strategy. The NBG is now appropriately focusing its attention on refining the implementation of existing tools rather than expanding the toolkit further.

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[18] Based on loan demand at current level, eight firms are expected to hit single exposure limit with their lender banks, with estimated loan shortage (measure by the difference between requested loan amount and the regulatory limit) at 0.2 percent of GDP.
[19] See IMF (2014), "Staff Guidance Note on Macroprudential Policy"

25. Further asset de-dollarization will depend on banks' ability to raise local currency funding. To the extent that households continue to prefer saving in foreign currency, sources of stable lari funding will remain scarce.[20] In this context, excessive restrictions on FX lending may significantly increase cost of financing and risk financial disintermediation. NBG should consider tightening de-dollarization measures gradually, with the choice and calibration of measures informed by impact assessments, taking into consideration potential unintended consequences for savings, credit intermediation and costs of financing.

26. Further de-dollarization of deposits will require a comprehensive strategy that embeds macroprudential tools with sound macro-economic policies and market development over the longer-term. The NBG has made significant progress in modernizing the monetary policy framework and prudential measures have helped to dis-incentivize intermediation in foreign currency. However, a series of external shocks over the years, which have led to significant depreciation in the exchange rate, may have reduced incentives for saving in local currency and weakened trust in the local currency. Moreover, the perception of a lack in two-way flexibility of exchange rate has constrained the further deepening of the FX derivatives market. Sustained de-dollarization underpinned by fundamentals will require longer-term efforts. As the recovery from the pandemic takes hold, the NBG will need to continue to build a track record of low and stable inflation, supported by sound fiscal policies. A well-designed and communicated FX intervention framework could help to mitigate the perception of conflicting objectives of flexibility and reserve accumulation and to establish more balanced exchange rate expectations.

FINANCIAL OVERSIGHT

A. Banking Supervisory Oversight

27. The NBG has undertaken extensive efforts to upgrade its regulatory regime since the last FSAP. The regulatory capital and liquidity framework is now generally consistent with Basel III standards, with some specific tailoring to the Georgian system, including strengthening of certain rules for the high degree of dollarization in the banking system. In addition, the NBG has introduced a capital surcharge for D-SIBs (which is being phased-in) and amended the large exposure regulation in compliance with Basel standards.

28. The NBG has also made progress in strengthening its supervisory framework, which is evolving towards a risk-based approach. A large share of NBG's supervisory efforts has traditionally focused on reviewing, monitoring and analyzing information to check for compliance with laws, rules and limits and to assess the financial conditions and risks of banks and the banking system. Significant progress has been made since 2017 towards implementing a risk-based supervisory framework, supported by the issuance of a Code of Corporate Governance and the introduction of a General Risk

[20] While the pension fund helps to increase long-term domestic savings in lari, it will remain limited in size compared to the funding needs of the banking sector and portfolio diversification of the pension fund will also limit investments in bank deposits.

Assessment Program (GRAPE) assessment, which is applied to each bank based on weighted scoring of its risks along various dimensions.[21] The NBG's supervisory process revolves around assessment of these scores, which are not disclosed to banks except as a final pillar 2 capital charge.

29. Despite progress in building out its supervisory framework, NBG would benefit from ongoing efforts to develop and formalize internal supervisory processes. More formal procedures should be developed across the entire supervisory cycle, from supervisory planning to decision-making and communications with banks on supervisory assessments, and to follow-up on actions taken by banks to address supervisory concerns in a timely and effective manner.

30. There is scope to enhance existing practices for assessing banks' risk management and governance. NBG supervisory risk assessment framework is generally thorough across key risks, with credit and liquidity risks receiving substantial attention, alongside operational and cyber-related risks. A significant share of supervisory staff resources is spent on monitoring of risks on an ongoing basis, including checking positions against regulatory requirements and limits. The NBG is recommended to undertake more comprehensive qualitative assessments of banks' risk management and governance, to complement the Pillar 2 add-on approach. A key step would be an NBG internal assessment and documented determination of the most important aspects of banks' practices, to be subject to periodic reviews with a mandated schedule to ensure effective supervisory coverage.

31. The NBG should reconsider the specific weightings applied to GRAPE elements and develop internal guidelines to support the GRAPE scoring process. This would include identifying the most important sub-categories across GRAPE elements, considering more heavily weighting risk management of key risks (including concentration and liquidity risks), as well as board and senior management effectiveness with respect to overall risk management and controls. This would also support planning and qualitative assessments by identifying key areas of regular review at banks.

32. The NBG could benefit from further improvements in supervisory follow-up and communication with banks. The NBG should require banks to develop remediation plans to address identified supervisory concerns, and formally review the implementation of those plans. While the NBG communicates its supervisory findings and directives through a variety of channels, the annual GRAPE letter (summarizing key supervisory findings, together with the Pillar 2 capital surcharge) is the main formal form of communication with banks. An enhanced formal process for communications with banks' boards on specific supervisory concerns and the boards' responsibility would help to improve remediation.

33. The NBG should require systemic banks to incorporate internal stress testing into capital and liquidity planning and management processes. In addition to the supervisory stress testing, NBG should require banks to have robust processes that incorporate the potential impact of a stressed operating environment, including for ongoing capital and liquidity planning processes, and greater supervisory attention should be given to assessing the practices of banks to support such efforts.

[21] These include risks related to corporate governance, group structure, business model, credit, liquidity, market exposure, and operations.

B. Cyber Security Oversight

34. The authorities have taken several steps to strengthen regulation and supervision of cyber security for the financial sector in recent years. These steps include a cybersecurity framework for banks and a dedicated cyber risk supervision division within the NBG, a data governance agency (DGA) under the Ministry of Justice of Georgia, and the amendment of a 2012 information security law, which is ongoing. The NBG includes cyber risk as part of the operational component of its GRAPE assessment for banks. Banks are required to carry out an annual audit of cybersecurity and must report any material operational incidents to the NBG. The authorities have coordinated two cyber exercises in the past few years.

35. The draft law on information security should ensure that the NBG maintains the supervisory powers over the financial sector. It is essential that NBG maintains a strong role in designating a financial institution as a critical information system. The sole responsibility of the DGA on cybersecurity aspects of designated financial institutions may hinder the performance of the overall responsibility of the NBG as the supervisor of the financial sector. The two institutions should cooperate and coordinate closely on all cybersecurity aspects related to critical financial institutions and the financial sector in general. The law should clearly reflect the delineation of their roles and responsibilities based on the comparative advantages of the institutions. Corporate governance and human resources aspects of cybersecurity should be under the purview of the NBG, while engineering, technical IT security details, and coordination with other sectors in the country could benefit from the capacities of the DGA.

36. Additional steps might help to further strengthen the cybersecurity oversight framework of the NBG. There is scope to strengthen the framework for offsite supervision of cyber risk and automate the compliance monitoring process.[22] The NBG should also seek to enhance the frequency and sophistication of its testing exercises and develop a testing strategy.

C. Insurance Oversight

37. The Insurance State Supervision Service of Georgia (ISSSG) has largely implemented the recommendations of the last FSAP and is actively preparing for the adoption of the EU Solvency II Directive. The ISSSG has started to collect a supervisory levy as of 2018 and is now financially independent. It has put in place regulations for insurers on solvency, including minimum capital requirements, and risk retention; introduced compulsory motor third party liability (MTPL) insurance for all foreign vehicles; and submitted a draft Law on Domestic MTPL to Parliament that has not yet been approved. The ISSSG is working on an elaboration of regulations for the adoption of the Solvency II Directive, currently focusing on the System of Governance, while adopting a phased approach to develop other elements.

[22] This would include collecting relevant cyber information like gap assessment, summary of incidents, level of concentration of service providers, technology landscape, key risk indicators, compliance status of action points arising on account of NBG supervisory visits, internal audit, external audit and various tests carried out, on a periodic basis.

D. Capital Markets Oversight

38. Overall, the preconditions for the NBG to implement a capital market oversight framework are in place. Since 2018, the NBG has made strides in improving Georgia's capital markets legal and regulatory framework in line with international standards. The NBG has a clear and objectively stated supervisory authority over all key capital market participants. It has broad and comprehensive inspection, investigation, and surveillance powers. The Capital Market Supervision Department at the NBG has been reorganized and the capital market legislative framework updated, although the adoption of the conduct rules for intermediaries remains in progress.[23]

39. While commendable progress has been made in enhancing the supervisory framework and in moving towards risk-based supervision (RBS), further refinement of an RBS methodology for issuers and markets intermediaries is needed. The NBG has developed oversight handbooks that provides a high-level description of its approach to RBS. It should continue to develop its risk identification processes and a proportionate, yet robust risk scoring model. RBS also requires building a strong compliance culture among market participants. The annual enforcement plan should take into consideration emerging and potentially systemic market risks. In addition, some recently adopted conduct requirements should be fully reflected in the supervisory methodology. Finally, building on progress to improve the quality of issuers' financial disclosures, NBG should continue to develop its monitoring program, with an increasing focus on the ongoing and non-financial disclosures. All assessments and analyses should follow a well-documented process.

40. The NBG should further reinforce its market surveillance framework. The market surveillance framework would benefit from further development of supervisory tools including a surveillance plan and direct access to an audit trail and order flows, to facilitate the detection of market abuse.

41. Continued supervisory attention is required to ensure that the deficiencies of the Georgia Stock Exchange (GSE) are adequately addressed. Given the remaining deficiencies of the GSE and concerns over the viability of its current business model, the NBG should monitor the adequacy of the GSE's strategic choice. It should further scrutinize GSE's managerial and organizational arrangements and take supervisory actions, as necessary, to ensure that the GSE continues to meet the conditions of its authorization.

42. Enforcement on market misconduct should be strengthened to provide sufficient deterrence. The current level of monetary sanctions does not provide sufficient deterrence for market misconduct and needs to be revised. In addition, the most serious infringements to market rules, such as market abuse, should be made public. Criminal enforcement should also be strengthened.

E. AML/CFT

43. Georgia has made some progress in enhancing its legal AML/CFT framework since the last FSAP, although room for improvement remains. A 2020 MONEYVAL assessment noted NBG's

[23] Capital market regulatory framework was not reviewed in the context of this assessment, which is focused on the supervisory framework.

adoption of a risk-based approach to AML/CFT supervision, reform of legal and regulatory frameworks and strengthening of "fit and proper" checks for financial institutions. Nevertheless, there is room for improvement, as Georgia only scores sufficient ratings for AML/CFT effectiveness on two out of eleven performance benchmarks.

44. The financial sector faces elevated money-laundering and terrorist financing risks in a number of areas, for which the authorities should take additional steps in risk mitigation. Money laundering risks stem from the high use of cash in transactions (including for real estate purchases); the activities of politically exposed persons; the absence of regulation for providers of virtual assets; and weak regulations for the gaming sector. These risks are compounded by various exemptions from FATF recommendations, including for real estate agents, accountants, and virtual asset service providers. The authorities should consider setting maximum cash thresholds for various transactions, make efforts to strengthen the analysis of suspicious transactions reported by banks, include virtual asset service providers in the AML framework by end-2021 as planned, and further strengthen licensing and supervision for the gaming sector.

FINANCIAL SAFETY NETS

45. The authorities have recently taken steps to strengthen their crisis management, bank resolution and financial safety net arrangements. NBG and Banking Laws were amended in December 2019 to upgrade the legal regimes for bank liquidation and systemic bank resolution, to establish an *ex post* funded Resolution Fund, and to introduce a bank recovery planning regime. The NBG has subsequently issued a comprehensive set of regulations and rules to support implementation of the new legal regimes, which clarified the roles and responsibilities of the NBG and MoF in systemic cases (including coordination on potential emergency liquidity assistance and temporary public financing), expanded the coverage of the new Deposit Insurance System from GEL 5,000 to GEL 15,000 on local and FX deposits of natural persons,[24] and established a new Interagency Financial Stability Committee (IFSC), consisting of MoF, the NBG, the Deposit Insurance Agency and the ISSSG, to coordinate bank resolution issues.

46. The authorities should further strengthen the procedural regime for bank resolution, financial safety nets and crisis management, based on a review with reference to the FSB's *Key* Attributes: Although the authorities have most of the mechanisms needed to resolve banks in the system, there is scope for simplifying the creditor hierarchy to make it consistent with deposit insurance coverage, clarifying recovery planning requirements and triggers, and mitigating potential legal challenges to liquidators and the NBG. The authorities should also lay the operational groundwork for a bridge bank so that it is immediately available when needed, for example, in case of failure of multiple small banks where mass liquidation and P&A by large banks in the system might not be feasible.

[24] Expansion of eligibility to legal entities is pending in the Parliament.

47. The NBG has extensive early intervention powers but has not yet adopted a formal corrective action framework to guide the use of the powers. Among those powers is the ability to require banks to take actions defined in their recovery plans. A formal prompt corrective action policy framework should be adopted. One of the primary goals of this framework is to enable the authorities to intervene when the bank is deemed likely to fail and prior to balance sheet insolvency.

48. The authorities should proceed with resolution planning for systemic banks and prepare formal contingency plans for crisis situations. Resolution planning for the three SIBs is underway. Initial plans, setting out the preferred resolution strategy, variants on the strategy, and an analysis of impediments to resolution action, will be presented to the NBG Resolution Committee by year-end 2021. Given pandemic-related stresses, the Resolution Committee could consider whether banks other than the SIBs should be prioritized for resolution planning in 2021. The authorities should also develop national-level contingency plans along with testing programs. The different forms of official financing for bank resolution should be clarified. Further steps should be taken to strengthen DIA funding arrangements, include securing a backstop line of credit from the MoF to be able to replenish the insurance fund in time of need.

FINANCIAL MARKET INFRASTRUCTURE

49. The national payment system (NPS) in Georgia comprises the Georgia Payment and Settlement System (GPSS), card switches, and various payment services and instruments. GPSS consists of the Real Time Gross Settlement (RTGS) system, the NBG Central Securities Depository (NBG CSD), and Georgian Central Securities Depository (GCSD). The RTGS is the main settlement system for large value and retail transactions that are sent in batches. NBG CSD is the depository and settlement system for government securities, while GCSD is the depository and settlement system for corporate bonds and equities traded on Georgia Stock Exchange (GSE). Both NBG CSD and GCSD operate from the same platform in NBG and with a unified backend settlement, under the Georgia Securities Settlement System (GSSS).[25] The cards market includes the two domestic card switches, and a few international card schemes, dominated by Mastercard and Visa. There is active card issuance and usage in Georgia, although reliance on cash remains prevalent. The use of e-money is limited to bill payments and person-to-person transfers, with few e-money issuers. In 2020, the authorities announced plans to develop a Central Bank Digital Currency (CBDC) (Appendix I).

50. There has been significant progress with the development of different payment system pillars since the last FSAP. The FMI has been upgraded, with the introduction of the central securities depository systems, closely integrated with the RTGS. Access to payment services has been expanded significantly through the development of regulations for e-money issuance and the rapid expansion in card issuance. Significant improvements in legal and regulatory framework took place in addition

[25] Both NBG CSD and GCSD operate from the NBG as one platform. However, the assessment addresses them as separate CSDs, as they have different participants, markets, and instruments, and hence they have separate risk profiles and are treated as separate securities depositories.

to the enhancements in NBG's oversight function, as evidenced by the RTGS self-assessment and the regular off-site and on-site inspections of payment service providers (PSPs).

51. The NBG should adopt a comprehensive framework for managing risks of the RTGS, expanded beyond operational risks to improve the management of credit, liquidity, and collateral risks. The NBG management should approve an action plan to mitigate risks identified in the self-assessment. The NBG would need to develop procedures to manage a RTGS participant default and methods to measure credit exposure in the case of the value of collateral falling short of the credit provided to a defaulted participant. The collateralization policies should also be updated to ensure securities are marked to market, at least on daily basis, and to request a margin call, as needed.

52. The two central securities depositories, NBG CSD and GCSD, should be designated as financial market infrastructure and be subject to assessment against the CPMI/IOSCO PFMI. It is crucial for the NBG, as the NPS overseer, to assess the various types of risks associated with the CSDs. The NBG should perform self-assessment of the CSDs according to CPMI/IOSCO Principles, similar to the RTGS self-assessment. This practice aims to monitor and measure the relevant risks and adopt adequate measures to mitigate those risks. In addition, The NBG should publish the associated CPMI/IOSCO disclosure framework.

53. The NBG should take actions to enhance the competitiveness environment for non-bank PSPs. In order to allow registered non-bank PSPs to provide payment services on a level playing field vis-à-vis banks, the former should be given direct access to FMI, based on appropriate risk assessment and tiered access criteria. Access of non-banks could be subject to certain prudential requirements and without access to central bank credit. In addition, NBG should monitor the behavior of commercial banks and ensure non-discriminatory practices against non-bank PSPs.

54. Development of an eco-system for e-money could bolster its role as a catalyst in financial inclusion. E-Money could act as an alternative payment instrument, especially for unbanked and underserved individuals and small businesses. The NBG is taking an essential step by developing the instant payment system as an interoperability platform among e-money, cards and bank accounts. Further measures, including the acceptance of e-money by the government, in collaboration with the State Treasury of the MOF, and waiving restrictions of reuse of e-money by merchants would help to expand the e-money services to financially excluded communities.

55. There is significant scope for enhancement of card acceptance services. Despite the large number of issued cards and the continuous increase in card transactions, the current card market conditions could hamper acceptance at micro and small merchants. NBG could use its oversight powers to mandate direct connectivity between the two domestic card switches to enhance efficiency. NBG should work with market participants to address the issues of high interchange fees and merchant discount rates and the lack of intermediaries, through a detailed study of the acceptance market and applying incentives and other policy measures to boost electronic payment acceptance by merchants.

56. The NBG's oversight responsibility over the NPS is legally established, while there is scope for improvement in its policies and procedures to support effective oversight. NBG has drafted oversight policies, including the NPS oversight framework and the normative act to designate systemically important payment systems and market infrastructure, which should be formally adopted. In addition, developing detailed procedures for the oversight division would help to ensure effective conduct of oversight activities and proper assessment of the national payment system risks, change planning and crisis management.

BROADENING MARKETS AND IMPROVING ACCESS AND EFFICIENCY

57. While commendable progress has been made in strengthening the overall financial sector legal and regulatory framework and oversight, many challenges remain in developing a diverse, efficient and inclusive financial system. Persistent dollarization (especially of savings/deposits) remains a significant constraint for access to finance and market development. Further challenges stem from the prominent market position of the large incumbents, shaping market dynamics not only in the banking sector, but also in the capital markets and financial market infrastructure and expanding into non-financial segments such as e-commerce through the development of fintech ecosystem within the conglomerate groups. Implementation of a coherent set of reforms and policies around a vision for long-term development will entail balance among multiple objectives and sometimes difficult policy tradeoffs – between stability and competition/innovation, and between short-term priorities and long-term development. Market development and financial inclusion will also require concerted efforts by policymakers to ensure ownership and coordination.

A. Enhancing Financial Inclusion and Access to Finance

58. Progress on financial access in Georgia masks a financial sector that lacks diversity, hindering broader financial inclusion, especially for MSMEs and traditionally underserved low-income and rural clients. While 61 percent of Georgian adults reported ownership of a store-of-value transaction account in 2017, up from 40 percent in 2014, Georgia did not perform well on other measures of financial inclusion: only 5 percent saved at a financial institution in 2017 (against a regional average of 37 percent), 18.5 percent used a debit or credit card to make a purchase (ECA average 38.5 percent), and 9.5 percent used a mobile phone or the internet to access an account (ECA average 23 percent). Access to finance remains one of the major challenges to MSME growth in Georgia.[26] Although access to bank loans and credit lines have increased in recent years, products and services (including non-bank) that are tailored to the diverse needs of SMEs across their lifecycle are not widely available. The bank-dominated sector's offering is characterized by traditional types of loans with high collateral requirements. Demand side constraints to SMEs accessing financial services also remain significant, including issues with weak business skills, poor financial recordkeeping, low transparency, cash preferences, small scale, lack of eligible collateral, and access to markets. Significant

[26] Access to finance was the second most cited constraint for doing business in Georgia.

gender gaps remain in terms of both female participation in entrepreneurship and access to finance for female-owned/led firms.

59. Expanded product diversity across the SME lifecycle should be fostered by advancing key reforms on leasing, factoring, and crowdfunding. Leasing and factoring for SMEs are very limited in Georgia yet are key instruments to enable SMEs to preserve and expand cash on hand for profit-generating activities. As key legal reforms are advanced and provide regulatory clarity to providers, sensitizing the market to the usefulness of these instruments could help spur demand. Supporting Fintech-based factoring platforms and cloud-based accounting and e-invoicing could generate further opportunities for diversified financial services. The government could also leverage digitized public sector payments and stimulate the development of reverse factoring backed by accounts payables to SMEs. Venture capital is nascent and angel investing is also minimal.[27] In addition, the authorities should consider conducting research and explore feasibility to introduce crowdfunding and provide a clear regulatory framework for marketplace finance for SMEs, while managing consumer protection risks.

60. Credit infrastructure could be further improved by establishing a fully online notice-based collateral registry system, and its use should be encouraged through partial credit guarantees. Heavy dependence on immovable collateral can drive uneven outcomes for SMEs without significant property assets, especially for women-owned and rural SMEs. Guarantees will not achieve their purpose if lenders use them as a buffer for an already well-collateralized loan, whereas a well-designed public guarantee program could help stimulate finance secured by movable collateral (such as machinery, equipment, or receivables).

61. Unexploited opportunities exist to encourage digitalization and leverage digital means to reduce information asymmetry on SMEs. Digitalization should be encouraged to both address business needs and to help improve the bankability of SMEs by generating alternative data by which to assess creditworthiness. Beyond the macroeconomic issues that affect all lending in Georgia, higher costs to SMEs specifically are driven by a perception of high credit risk, as SMEs are frequently informal, have poor financial reporting and governance, and rely largely on cash for transactions. Improving retail payments infrastructure to enable interoperability between bank accounts and e-money accounts could help facilitate development of alternative payments providers, as well as reduce transaction costs for SMEs and support development of e-commerce. In addition, creating an enabling legal framework to enhance collection of alternative data (e.g., postpaid utility services, payments data, public databases, etc.) for individuals and SMEs – with appropriate data and consumer protection safeguards to support inclusive credit reporting – could help to further support expanded access to finance for SMEs.

62. The authorities should articulate a transparent, pro-innovation fintech vision that encourages competition and prioritizes financial inclusion. Fintech has the potential to bridge the SME finance gap and deliver services to underbanked clients in Georgia by disrupting traditional models and widening access to a diverse range of tailored financial services. Currently, Fintechs in the market are not providing consumer-facing products but acting as service providers to leading financial

[27] There is no legal framework for supporting angel investments.

institutions. NBG has taken positive steps to respond to promote fintech development, including establishing a Fintech directorate to monitor market developments, track potential risks, and initiate several Fintech-related initiatives. NBG's "Open Regulation" approach sets out to balance innovation and risk by employing an adaptive, agile regulatory process. NBG has set up apparatuses to operationalize this model and tested its response to rapidly deploy digital onboarding technologies. Further pipeline projects underway that are most key to enhancing SME Finance include instant payments, cloud framework, crowdfunding, and open banking. While the regulatory response to Fintech has been embracing, it could be further articulated to provide a framework to improve competition and spark market actions towards addressing the gaps in SME finance and remaining disparities in financial inclusion.

63. While the Government has undertaken significant efforts to improve SME access to finance, there is room for improvement in the areas of integration of programs, as well as monitoring and evaluation. Interventions span multiple agencies and include direct financial support through grants, interest rate subsidies, partial credit guarantees, as well as extensive technical support and training and ecosystem innovation investment. These initiatives represent a massive public sector investment, raised to a budgeted 294M GEL in 2021 (from expenditures of 144M GEL in pre-pandemic 2019) to support Covid economic recovery. Despite these efforts, without a universal definition for SMEs or consolidated data on SME finance, evaluating the effectiveness of interventions and targeting new interventions remains challenging.

64. A good practice is to have a champion within the government to address the challenges in financial inclusion and take the lead to develop a comprehensive National Financial Inclusion Strategy. Starting with a thorough financial inclusion diagnostic, on both demand and supply side, and public-private stakeholder consultation to underpin a strategy, targeted action should be organized around pillars of SME Development, Fintech, Financial Education, and other identified priorities. Based on the diagnostic, government support programs should be further aligned, targeted, sequenced, and timebound to avoid market distortions. To address data gaps, NBG can act to collect data on SME credit portfolios using a uniform definition, including leveraging the implementation of the credit registry.

65. The Partial Credit Guarantee Scheme (PCGS) should be reformed to bring it in line with international best practices and help it achieve its catalytic role in the development of real and financial sectors. Several areas for reform could benefit the PCGS, including on its legal and regulatory framework, corporate governance, risk management, operational framework, mission statement, and results measurement. Some key areas that would require further strengthening include price sustainability; dependance from budgetary allocations; and upfront cash transfers to participating financial institutions, which is an inefficient use of public resources. Moreover, it is important to set expectations on program duration and graduation, as the financed SMEs establish a track record of timely repayment.

B. Promoting Competition

66. Market concentration in the banking system, while not a problem per se, remains high as compared to peers and has increased in the past few years. The two largest banks in Georgia have a market share of more than 70 percent for all major banking products and quantitative measures for concentration indicate very high concentration across market segments and regions. Levels of concentration have increased over the past five years driven also by a major merger, with market dynamics pointing to a bipartite market, where the top two banks enjoy a prominent and growing market share, while the remaining thirteen banks compete for the remaining part of the market and in niche segments. New market entrants are scarce as the banking market shows signs of saturation and the FinTech segment remains small.

67. In addition, the largest banks are part of wider conglomerate economic groups that are further shaping market dynamics. In some cases, these conglomerates include insurance companies as well as key parts of the financial infrastructure. Over the past few years, the conglomerates have also strategically expanded in emerging non-financial areas such as online e-commerce platforms and enveloped their products through digital ecosystems. The intertwined nature of banks, financial infrastructure and non-financial operators within the same economic group raises concerns about potential exclusionary practices, such as tying of banking and insurance products, exclusive dealings, or preferential access to data.

68. The National Bank of Georgia (NBG) has competition enforcement powers in the financial sector, but effective implementation would require further strengthening institutional arrangements. First, recent amendments to the competition law will enable NBG to effectively enforce competition law and engage in advocacy initiatives in the financial sector, in addition to its core mandate as a prudential regulator. Second, the Georgian National Competition Authority (GNCA) maintains its role as competition watchdog when other sectors are involved in the investigated conduct or merger. The institutional setup for the analysis of competition issues in the financial sector is thus complex and potentially prone to conflict. The NBG has recently approved regulations for the implementation of the competition law in the financial sector.[28] Further developing clear mechanisms for intra- and inter-institutional cooperation will be critical to foster competition in the financial sector. A separate competition function should be established within the NBG to minimize potential conflict of objectives vis-à-vis prudential supervision.

69. While competition impact has been taken into consideration, mergers and acquisitions involving financial institutions would benefit from a systematized competition review to curb potential negative effects. NBG has considered competition in the assessment of mergers and acquisitions among financial institutions but, absent implementing regulations, these operations had not been submitted to a full antitrust review previously. In addition, conglomerates involving banks have expanded into adjacent markets, notably insurance and e-commerce, without being caught by the obligation to notify competition authorities of the merger. Systematized control over mergers would help to limit potential negative effects arising from market consolidation through imposing structural remedies (i.e. potential divestments ex ante) or behavioral remedies (i.e. conduct to be implemented by the parties ex post), as conditions for approval.

[28] NBG regulations "The Rule on Market Analysis and Procedure on Submission and Consideration of Notification about Concentration" and "The Rule on Investigation, Submission and Consideration of Complaints on Alleged Violations of Competition" were approved in June 2021. https://www.nbg.gov.ge/index.php?m=340&newsid=4237&lng=eng

70. In addition, the new Competition Law enables the NBG to discipline potential anticompetitive behavior of financial operators. On the one hand, certain practices observed in the sector (e.g., bundling of financial and non-financial products) might require scrutiny to assess if they are limiting competition in the affected markets. Providing clear guidance on the criteria to consider financial operators as dominant and analytical tools/methodology to identify exclusionary conduct would be important to enhance legal certainty and complement ongoing NBG efforts to promote efficient market behavior such as its "Principles on Ecosystems." On the other hand, collusion is more difficult to detect. While no such practices have been identified in Georgia, anticompetitive agreements and concerted practices are common in the financial sector across countries. Uncovering anticompetitive agreements requires clear tools to access evidence and conduct investigations while respecting due process. In addition, a clear exemption regime to allow those agreements that are efficiency enhancing is also critical to ensure predictability and legal certainty.

71. The prominent position of large banks in the financial infrastructure calls for strong competition safeguards to ensure fair access of competitors/new entrants. While the NBG has taken critical regulatory steps to promote access to data, from regulating the Credit Bureau to developing an innovative framework for Open Banking, some concerns remain regarding:

- Access to credit information. Vertical integration between the Credit Bureau and the largest banks requires close monitoring to ensure that access/pricing conditions do not unduly favor large incumbents. To this end, ensuring that access criteria established in the regulation are applied fairly and non-discriminatorily to non-regulated operators in practice would be key to support the development of innovative business models.

- Access to data through open banking. In this context, it would be important to clarify key aspects of the open banking framework including the definition of Third Party Providers especially FinTechs, ensure inclusive standard setting, as well as a rollout schedule taking into consideration the implementation capacity/costs of smaller banks.

72. While the NBG has taken a proactive regulatory approach to foster entry and level the playing field in the banking sector, close monitoring of implementation will be important to ensure the achievement of the intended outcome. The NBG is developing new licensing regimes for 'digital banks' and for 'micro-banks' to enable entry of new types of operators, which could potentially promote contestability. The NBG has also tackled potential competition concerns both in the financial and non-financial sectors, through ex-ante regulation to prevent tying/bundling of banking and insurance products or by developing principles for financial ecosystems to prevent access to digital platform information from benefiting certain banks. Effective implementation would require close monitoring**.**

73. Moreover, a systematic assessment of regulations from a competition perspective may help to level the playing field for small players. Regulation geared to tackle a market failure in the financial sector might have untended consequences from the point of view of competition. While the NBG has focused on interventions from a prudential point of view, embracing a competition lens will enable it to minimize, where possible, potential restrictions to competition caused by new prudential rules. A systematic regulatory assessment of impact on competition would be critical to identify potential concerns in rules, guidelines or broader prudential interventions and, when possible, design less distortive alternatives that still preserve the prudential policy objective.

C. Developing Capital Markets

74. **Prominent policy attention has been given to capital market development in Georgia in the past few years.** Notable developments include recent and ongoing legislative initiatives to support market development, the strengthening of capital market supervisory capacity at the NBG, improvement in the debt management strategy of the MOF and the launch of the primary dealer system, tax reform on financial instruments and transactions, the introduction of a funded pension scheme, and the preparation of capital market development plan by MOESD. Well-developed domestic capital markets could contribute to Georgia's sustainable economic growth. In the context of bank dominance in the financial sector and high dollarization, capital market development could also contribute to more effective mobilization of domestic savings, diversification in the sources of financing for the corporate and household sector, including access to debt in longer tenors, and the de-dollarization efforts.

75. **There are inherent constraints facing many small developing markets that are not unique to Georgia, as well as peculiarity of domestic context that affects CMD potential.** With the small size of the economy and a small number of large companies, reaching the size and liquidity of investment supply required by large investors is inherently difficult to achieve. On the supply side, capital markets in Georgia are mostly comprised of government bonds, with a largely inactive secondary market. The domestic non-government bond market in local currency is dominated by international financial institutions (IFIs) while local issuers prefer issuances in foreign currency. The equity market is thin and highly illiquid. On the demand side, foreign participation in the domestic government bond market has varied over time and remained modest overall, reaching 12 percent pre-pandemic. Despite some interest, demand from long-term foreign investors is constrained by below-investment-grade sovereign rating and underdevelopment of the currency hedging market. Domestic institutional investor base is small and lacks diversity. Retail investors maintain a strong preference for savings in foreign currency. The dominance of large banks in the capital market, through direct and indirect ownership of investment banks/brokers and market infrastructure, also poses a challenge for capital market development. The government is also considering the introduction of a voluntary funded pension scheme (Pillar III).

76. **In this context, setting expectations for a long-term strategy with clear prioritization and effective coordination is essential.** Policy attention should be focused on improving the enabling conditions for long-term capital market development, while exploring realistic opportunities in the short- to medium-term. Accordingly, the timeline of the capital market development plan should be well-balanced with a long-term vision and clear prioritization and sequencing. It is also important to ensure that there is a collective vision among relevant authorities, cohesion in policymaking, and effective inter-institutional coordination.

77. **Further effort for capital market development should be built on continued progress towards improving Georgia's credit standing and overall attractiveness of the market.** The economy has experienced persistent current account deficits and a buildup of external liabilities,

which, together with various external shocks, have led to significant currency depreciation in the last six years. These trends pose some uncertainty to investors, shape investors' perception of Georgia's sovereign risk, and affect investor demand. Continued efforts to improve macro-financial fundamentals and build trust in lari, improve overall competitive landscape of the financial sector, together with the development of a deep and liquid FX spot market and hedging products, would help to strengthen the enabling conditions for CMD. The authorities' track record and credibility in reforms and overall policymaking is a clear strength in continuing to improve market fundamentals and support CMD in the longer term.

78. Given the early stage of market development and the inherent constraints on market potential, development of government bond market should be a priority, which also sets the foundations for the development of other segments through a reliable sovereign yield curve. An important consideration for the development of a local government bond market is to commit to maintain a small number of benchmark bonds in sizable amounts to strengthen the yield curve. The decision to refinance the maturing Eurobond in 2021 with a new issue has significantly constrained the net supply of domestic government securities, which is a setback from a market development perspective. While progress has been made in building the Primary Dealer system, the limited benchmark supply poses practical challenge to increasing secondary market activity. Non-benchmark bonds should gradually be replaced by benchmark issuance. At this stage, the authorities should focus on issuing fixed-rate government instruments and avoid market fragmentation. Also, the use of liability management operations would primarily allow to increase benchmark sizes while keeping the government refinancing risk under control, and it could also improve price discovery and stimulate liquidity in the secondary market.

79. Development of government bond market would also entail further attention to policy cohesion and coordination. In contrast to the limited net supply of government securities and almost non-existence of secondary market activity, NBG's OMOs through outright purchase of government bonds have been sizable. NBG conducts OMOs through periodical auctions for the purpose of systemic liquidity provision, to address the structural liquidity deficit in local currency due to the highly dollarized funding structure of banks, combined with prudential constraints on FX lending. Furthermore, auction results show that most purchases have been conducted at a yield discount compared to the theoretical yield curve calculated using only primary auction results, although the NBG cap the yield discount at 50 basis points. While it is critical to maintain monetary policy objectives, the impact of the sizable OMOs on secondary market activity and the yield curve warrants a careful assessment, given the market context and the importance the authorities attach to CMD.

80. NBG should review its OMO mechanism with the aim to minimize impact on yield curve, and, where possible, reduce crowding out of private sector participation, while preserving the monetary policy objectives. The NBG could assess other options for liquidity injection to reduce the need for bond purchases and review its OMO auction design to minimize the impact on the yield curve.

81. While the current money market instruments available are adequate to support capital markets, some adjustments could help to improve their efficiency. Implementation of a securities lending facility could support PD system in transactions with clients and resolve potential settlement mismatches when local banks trade bonds with foreign investors.

82. **The development of non-government fixed-income market face inherent constraints, and covered bonds market may present an opportunity.** In addition to the afore-mentioned constraints on the demand side, the number of large corporates that could potentially issue bonds is limited from a cost-benefit perspective. The current competitive landscape of the financial sector also implies that new issuances of corporate bonds may only come to market as the few largest companies reach large exposure limits with domestic banks. Development of the covered bonds market may be among the more realistic opportunities, as it is an asset class with longer tenors and added safety due to mortgage collateral. If designed and priced appropriately, covered bonds could be attractive for long-term investors, such as the new pension fund. Covered bonds would also create other benefits, such as improving NBG's collateral management and supporting the fixed-to-term pricing of mortgages. In this regard, it is essential to enact a robust legislation on covered bonds.

83. **Equity market development is also constrained by the disadvantages associated with a small and illiquid market as well as weak investor base.** While a small number of IPOs (limited by the size and overall corporate structure of the economy) could be explored, both potential issuers and investors see limited advantages in listing or investing in shares in a small and illiquid market. Developing collective investor schemes under the new investment fund law may help to tap the interest of retail investors, including for equity market, although the preference for savings in foreign currency would require long-term efforts to overcome.

84. **The authorities should focus on concrete steps to improve the efficiency of the stock exchange.** Overall, the stock exchange is an expensive business that requires massive and continuous investments in technology, connectivity, risk management, and products. Taking into consideration the lack of sustainable revenue streams and the historical performance of the GSE and weighing the costs and benefits of future investment given the limited growth potential of the markets, the GSE should evaluate the viability of potential alternatives including: (i) organic growth; (ii) strategic partnership; (iii) regional integration; and (iv) the intermediate solutions such as leasing an internationally recognized system. Enhanced supervisory scrutiny on the organizational arrangements and strategic decisions of the exchange will also be important to address potential conflicts of interests associated with the majority ownership of GSE by the two largest banks.

85. **The large domestic savings that will be accumulated in the new pension fund over time could play a role in domestic CMD, although potential constraints and conflicting objectives would need to be carefully managed.** While the conservative investment regulation in place until 2023 has helped to build trust in the pension system, it is important to ensure a sound transition towards well diversified investment portfolios, including investments abroad. The strong governance of the PA's investment board offers a sound base for supporting investment policies consistent with the long-term objectives of contributors. The additional opportunities for CMD offered by the new pension system (e.g., in the development of the local government bond and covered bond market) would be successful to the extent that the market is capable to develop a sizable base of investable assets, and the overall competitive landscape in the financial sector offers opportunities for new instruments to emerge. As the rate of accumulation of the pension fund is likely to outgrow the

capacity of the economy to issue capital market instruments, the authorities would need to monitor the risks of over-appreciation of domestic assets. The implications of international investment should also be anticipated, given potential impact on monetary policy and de-dollarization objectives of the NBG.

86. The governance and the supervisory framework of the PA could be reviewed to improve effectiveness. The NBG should set clear expectations about the extent of supervisory scrutiny of the investment policy and strategic asset allocation of the PA. In addition, given that the specific functions and responsibilities of the PA's Supervisory Board are tightly linked to institutional operation of the PA, as the pension fund grows, the composition of the Supervisory Board set in the law could be revised to ensure independence and competency and to prevent the risks of potential political interference.

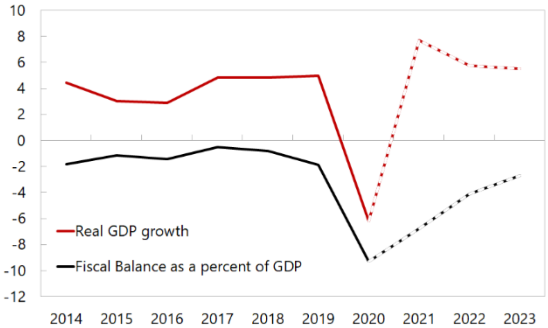
87. The design of the payout phase is still a pending task, but the introduction of a mandatory disability and survivorship insurance would help to increase the credibility on the new pension system, reduce government contingent liabilities, and expand the institutional investor base. As the pension system matures, it would be desirable to develop a payout phase that protects individuals against longevity risk. Meanwhile, the creation of a mandatory insurance of disability and survivorship (D&S) should be considered. Depending on the ambition in terms of replacement rates, the contributions to this D&S scheme could be in the range of 1 percent to 1.5 percent of wages. Also, to make it a low-cost scheme, the insurance provider could be selected through an international auction, while the PA would continue acting as the administrator of phased withdrawals. Overall, this system would complement the pension reform and would add to the protection of people against disability and loss of a family's breadwinner, especially in the context of the absence of a social security system (first pillar). The D&S implies the creation of a new type of institutional investor that would contribute to CMD in Georgia, especially through investments in the fixed income market.

Figure 1. Indicators of Macro-financial Conditions

2021 Q1 or latest available

GDP and Fiscal Balance

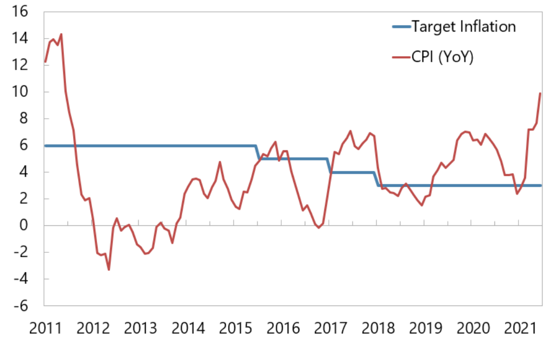
(percent, yoy)



Sources: Georgian authorities; IMF staff estimates.

Inflation

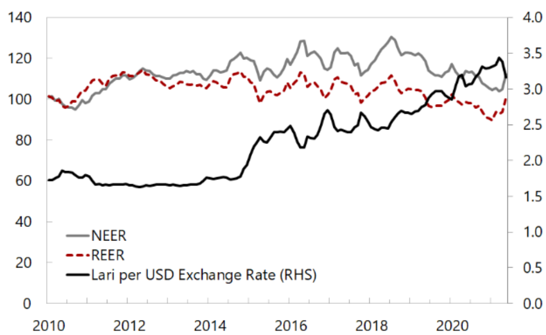
(percent, Jan 2011 - Jun 2021)



Sources: NBG; IMF staff calculations.

Exchange Rate

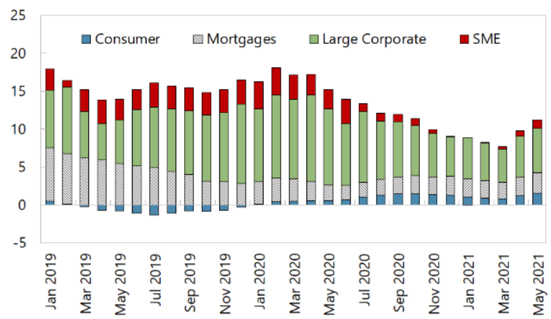
(Jan 2010 = 100, Jan 2010 - Jun 2021)



Sources: NBG; IMF staff calculations.

Decomposition of Credit Growth

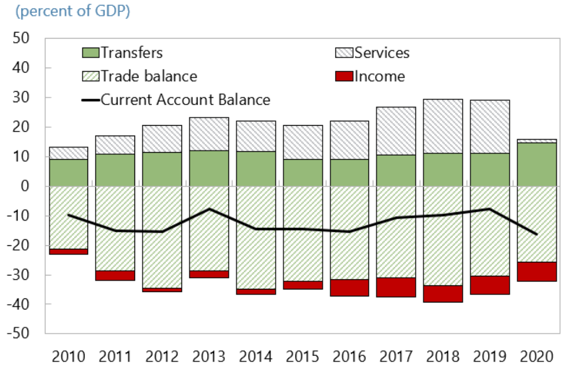
(In percent)



Sources: NBG; IMF staff calculations.

Current Account Balance

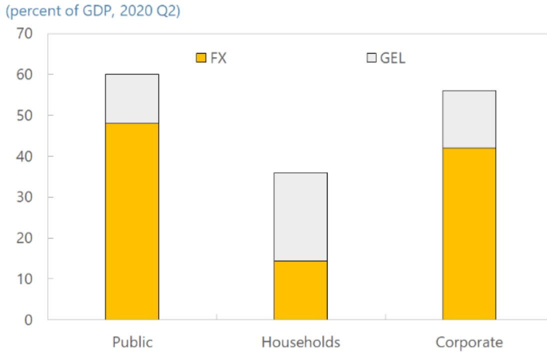
(percent of GDP)



Sources: NBG; Ministry of Finance; IMF staff estimates.

Sectoral Debt Composition

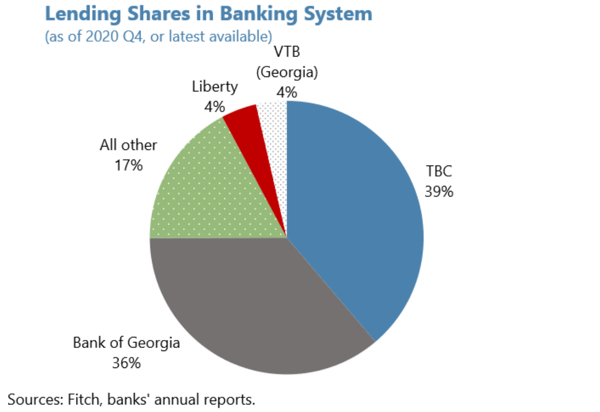
(percent of GDP, 2020 Q2)

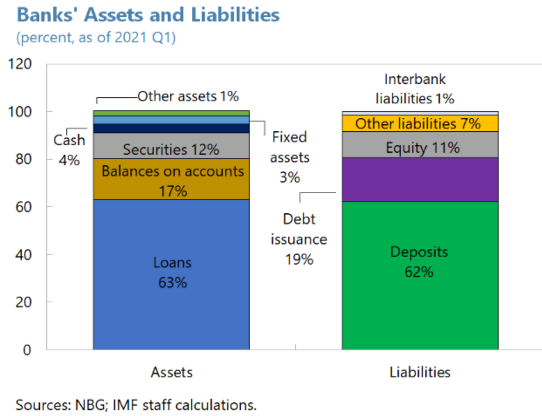


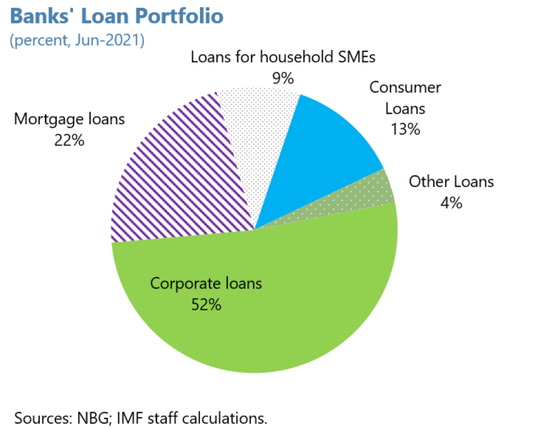
Source: NBG

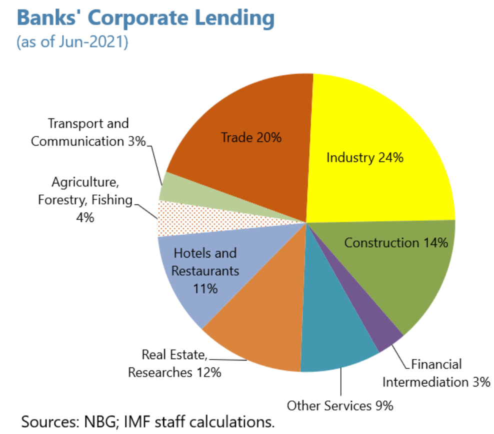
Figure 2. Banking Sector Structure

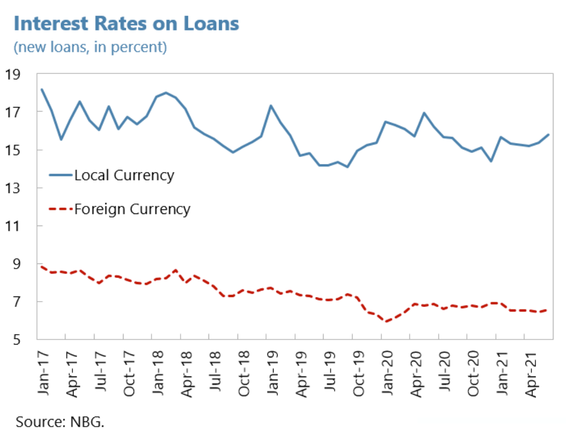
2021 Q1 or Latest Available (percent)











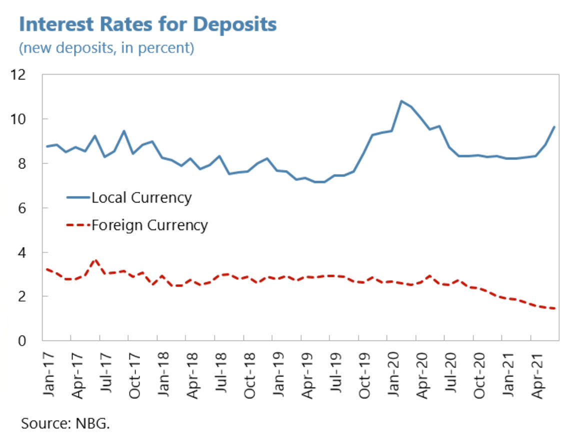
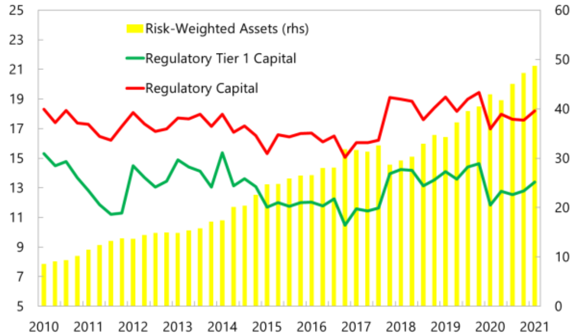


Figure 3. Banking Sector Developments

2021 Q1 (percent)

Bank Capital and Risk-Weighted Assets

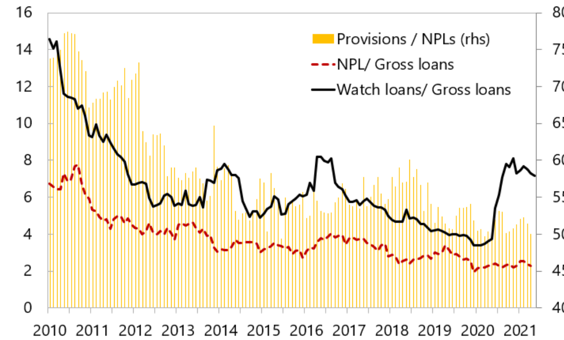
(percent of risk-weighted assets, billions of GEL respectively)



Source: IMF FSI Database; NBG.

Banks' Asset Quality

(percent, Jan 2010 - May 2021)

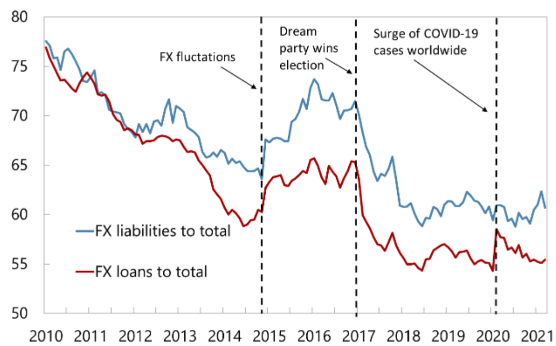


Sources: NBG; IMF FSI Database.

Note: NPL/Gross loans shown above reflects the share of 90-day past due loans, as reported in the IMF FSI, not based on NBG's asset classification.

Share of Foreign Currency Loans and Liabilities

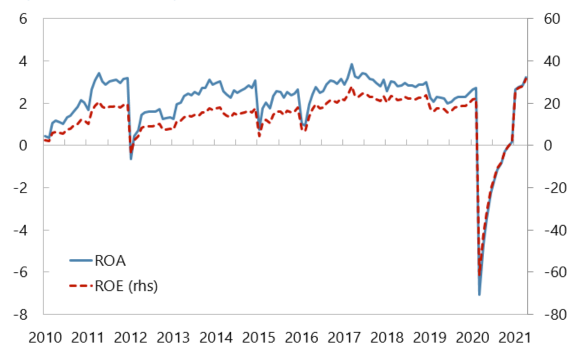
(percent, Jan 2010 - Apr 2021)



Source: NBG.

Banks' Profitability

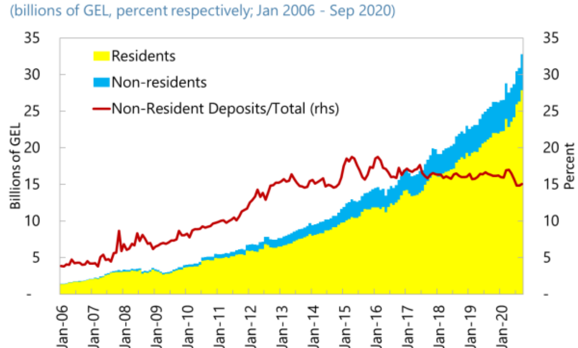
(percent, Jan 2010 - Apr 2021)



Source: IMF FSI Database.

Banks' Deposits and Non-Resident Proportion

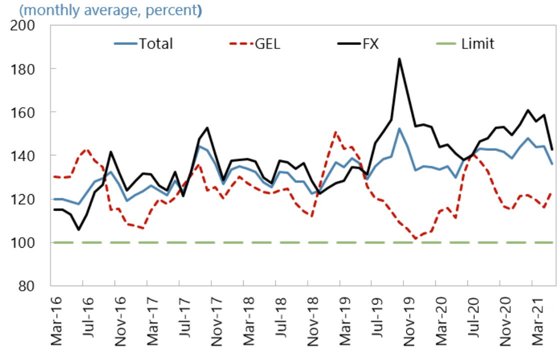
(billions of GEL, percent respectively; Jan 2006 - Sep 2020)



Source: NBG

Liquidity Coverage Ratio

(monthly average, percent)

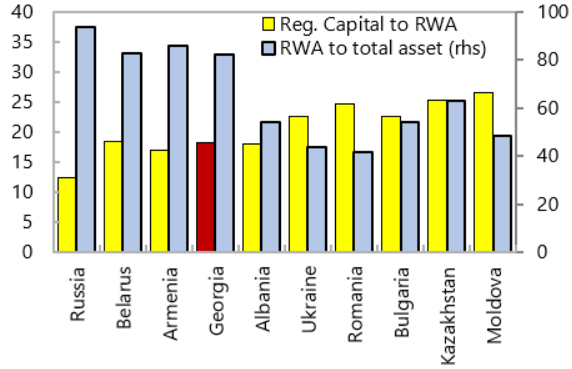


Source: NBG.

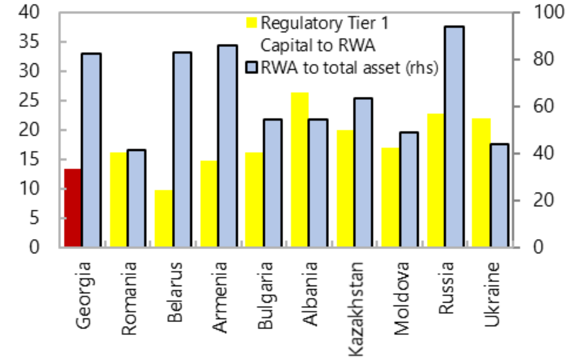
Figure 4. Comparison of Selected Financial Soundness Indicators

2021 Q1 or Latest Available (percent)

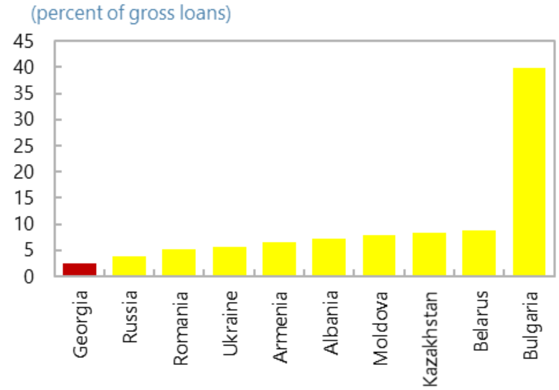
Regulatory Capital to Risk-weighted Assets
(percent)



Regulatory Tier 1 Capital to Risk-weighted Assets
(percent)

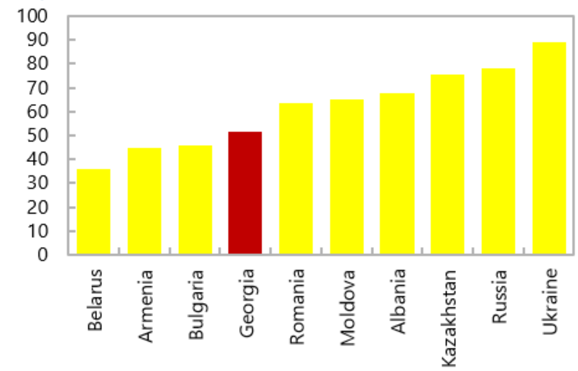


Asset quality (NPL ratio)
(percent of gross loans)



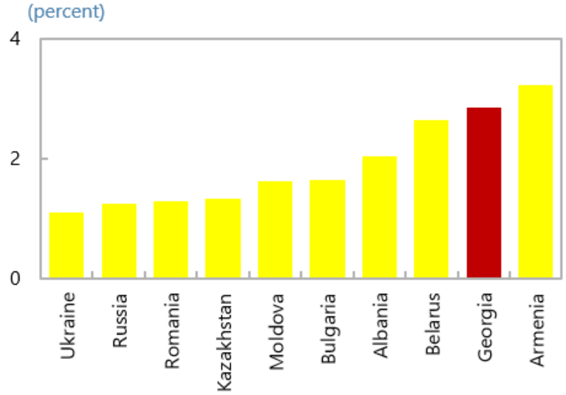
1/ NPLs based on IMF FSI methodology.

Provisions to NPL
(percent)

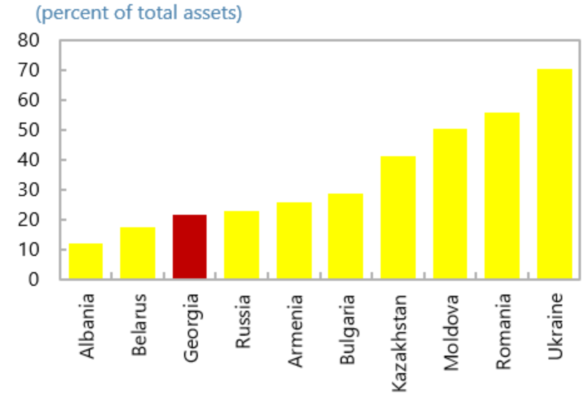


1/ Specific provisions based on IMF FSI methodology

Return on Assets
(percent)



Liquid Assets Ratio
(percent of total assets)



Source: IMF FSI Database.

Table 1. Selected Economic Indicators, 2015–22

(In percent year-on-year or as stated)

	2015	2016	2017	2018	2019	2020	2021	2022
							Projected	
National accounts and prices 1/			(annual percentage change; unless otherwise indicated)					
Real GDP	3.0	2.9	4.8	4.8	5.0	-6.2	7.7	5.8
Output Gap			-1.9	-1.5	-0.6	-3.9	-1.0	-0.4
Nominal GDP (in billion of laris)	33.9	35.8	40.8	44.6	49.3	49.4	57.5	64.5
Nominal GDP (in billion of U.S. dollars)	15.0	15.1	16.2	17.6	17.5	15.9	17.8	19.7
GDP per capita (in thousand of U.S. dollars)	4.0	4.1	4.4	4.7	4.7	4.3	4.8	5.3
GDP deflator, period average	5.7	2.6	8.4	4.3	4.9	6.9	8.3	6.1
CPI, Period average	4.0	2.1	6.0	2.6	4.9	5.2	9.3	5.4
CPI, End-of-period	4.9	1.8	6.7	1.5	7.0	2.4	13.1	3.2
Core CPI, End-of-period			3.1	0.5	3.8	3.7	...	...
Investment and saving					(in percent of GDP)			
Gross national saving	14.5	17.7	19.2	21.4	19.8	13.7	15.6	17.0
Investment	26.3	30.2	27.3	28.1	25.3	26.2	25.6	24.6
Public	5.2	4.8	5.7	6.4	8.0	8.6	8.0	7.4
Private	21.1	25.4	21.6	21.7	17.3	17.6	17.5	17.2
Consolidated government operations					(in percent of GDP)			
Revenue and grants	26.3	26.9	27.1	26.4	27.1	25.1	25.7	26.1
o.w. Tax revenue	23.5	24.4	24.3	23.4	23.7	22.2	22.9	23.6
Expenditures	28.6	29.5	28.2	27.7	28.9	34.4	32.2	29.7
Expense	23.4	24.7	22.6	21.3	21.4	26.2	25.0	22.7
Net acquisition of non-financial assets					7.6	8.1	7.2	7.0
Capital spending	5.2	4.8	5.7	6.4	8.0	8.6	8.0	7.4
Privatization Proceeds					-0.4	-0.4	-0.8	-0.4
Net Lending/Borrowing (GFSM 2001)	-1.1	-1.4	-0.5	-0.8	-1.8	-9.2	-6.5	-3.6
Budget Lending					0.2	0.1	0.2	0.3
Augmented Net lending / borrowing (EFF definit	-2.4	-2.8	-2.7	-2.3	-2.1	-9.3	-6.6	-3.9
General government debt 3/			45.1	38.9	40.4	60.0	54.2	53.6
o.w. Foreign-currency denominated	30.3	33.3	32.4	31.6	32.0	47.5	43.9	42.1
General government debt net of government deposits 3/			42.6	36.4	37.5	53.6	50.7	50.9
Money and credit			(annual percentage change; unless otherwise indicated)					
Credit to the private sector	N.A.	18.6	18.6	19.9	20.7	22.4	10.5	11.8
In constant exchange rate	3.9	11.8	18.3	17.7	16.1	9.0	14.0	8.5
Broad money	17.3	21.1	14.6	13.9	17.6	24.6	14.1	19.7
In constant exchange rate (estimate)	5.8	13.4	15.8	15.1	14.3	14.4	18.7	15.2
Broad money (excl. fx deposits)	-3.8	14.8	27.9	15.9	18.8	18.8	16.8	19.5
Deposit dollarization (percent of total) 4/	66.8	69.9	63.7	63.1	64.0	61.4	66.7	66.2
Credit dollarization (percent of total)	63.1	64.6	56.1	57.1	55.4	55.7	55.0	54.9
Credit to the private sector (percent of GDP)	44.8	50.3	52.4	57.4	62.8	76.6	72.6	72.4
External sector				(in percent of GDP; unless otherwise indicated)				
Current account balance (in billions of US$)	-1.8	-1.9	-1.3	-1.2	-1.0	-2.0	-1.8	-1.5
Current account balance	-11.8	-12.5	-8.1	-6.8	-5.5	-12.5	-10.0	-7.6
Trade balance	-26.3	-25.6	-23.4	-23.4	-21.3	-19.8	-19.1	-18.1
Terms of trade, goods (percent change)	-3.3	-7.6	10.4	-0.5	-0.7	5.8	-2.1	0.5
Gross international reserves (in billions of US$)	2.5	2.8	3.0	3.3	3.5	3.9	3.8	4.0
In percent of IMF Composite measure (floating	94.7	95.7	95.1	95.4	98.3	107.6	98.5	98.5
Gross external debt	102.4	105.3	106.7	101.4	106.6	129.5	116.8	111.8
Gross external debt, excl. intercompany loans	77.9	84.4	85.6	83.1	87.7	109.0	95.9	91.7
Laris per U.S. dollar (period average)	2.27	2.37	2.51	2.53	2.82	3.11	...	...
Laris per euro (period average)	2.52	2.62	2.83	2.99	3.15	3.55	...	...
REER (period average; CPI based, Jan 2010=100)	104.0	107.5	105.2	106.2	100.5	97.5	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ National accounts numbers include the impact of GDP rebasing, which increased GDP levels while leaving growth rates unchanged.

2/ Augmented Net lending / borrowing (EFF definition) = Net lending / borrowing - Budget lending.

3/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.

4/ Includes nonresident deposits.

Table 2. Financial sector structure, 2016-2020

	2016		2017		2018		2019		2020		
	#	*Assets (GEL m.)*	#	*Assets (GEL m.)*	#	*Assets (GEL m.)*	#	*Assets (GEL m.)*	#	*Assets (GEL m.)*	*% Total Assets*
Commercial Banks	**16**	**30,216**	**16**	**34,593**	**15**	**39,692**	**15**	**47,183**	**15**	**56,871**	**93.1%**
domestic capital control (100%)	1	1,322	1	1,194	1	1,100	1	1,220	1	1,406	2.3%
foreign capital participation (less than 50%)	1	72	1	53	1	70	1	76	1	80	0.1%
foreign capital participation (50% and more)	14	28,755	14	33,347	13	38,513	13	45,887	13	55,385	90.6%
Foreign Banks Branches	1	68	-	-	-	-	-	-	-	-	-
Insurance Corporations and Pension Schemes		**565**		**607**		**914**		**1,364**		**2,151**	**3.5%**
Insurance Companies	14	542	16	580	17	743	17	799	18	916	1.5%
Pension Funds (schemes)	2	22	3	27	4	171	4	565	5	1,235	2.0%
Other Financial Intermediaries		**2,732**		**2,019**		**1,470**		**1,867**		**1,941**	**3.2%**
Microfinance Organizations	81	2,020	75	1,524	67	1,470	48	1,379	40	1,476	2.4%
Loan Issuing Entities (till 2017 - Pawnshops)	…	712	875	495	…	…	204	488	198	465	0.8%
Financial Auxiliaries		**165**		**137**		**353**		**134**		**142**	**0.2%**
Stock Exchanges	2	4	2	4	2	4	2	6	2	…	…
Securities Central Depositary	1	1	1	1	1	2	1	2	1	2	0.0%
Independent Registrars of Securities	1	...	1	...	4	3	4	3	4	3	0.0%
Brokerage Companies (Securities dealers)	6	43	7	59	9	52	9	62	8	83	0.1%
Exchange Bureaus (Active)	1,200	118	1,126	73	1,018	292	848	62	792	54	0.1%
Total		***33,678***		***37,357***		***42,428***		***50,547***		***61,105***	***100.0%***

Note: Of the 13 banks with 50% or more foreign participations, 6 banks are foreign subsidiaries (accounting for about 10 percent of banking assets), and the others are domestic banks operating only/predominantly in Georgia.
Source: NBG.

Table 3. Financial Soundness Indicators for the Banking Sector

(Q2 2021, in percent)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 Q2
Capital Adequacy											
Regulatory capital to risk-weighted assets	17.1	17.0	17.2	16.5	16.7	15.1	19.1	18.4	19.5	17.6	19.2
Regulatory tier 1 capital to risk-weighted assets	11.3	13.4	13.0	13.1	12.0	10.5	14.0	13.5	14.6	12.8	14.8
Asset quality											
Non-performing loans to total gross loans (IMF FSI data)	4.5	3.7	3.0	3.0	2.7	3.4	2.8	2.7	1.9	2.3	2.2
Non-performing loans to total gross loans (NBG)	8.6	9.3	7.5	7.6	7.5	7.3	5.9	5.5	4.4	8.2	6.7
Provisions to non performing loans	70.9	59.1	59.0	57.6	55.8	56.1	54.8	54.2	51.9	50.8	50.2
Sectoral Composition of loans											
Loans to residents	98.8	98.4	97.9	97.4	96.4	97.8	97.6	97.4	97.4	96.4	96.3
Inter-bank loans	0.2	0.2	0.9	0.8	0.4	0.2	0.1	0.0	0.1	0.2	0.0
Other financial corporations	1.1	1.2	0.8	1.2	1.6	1.4	0.9	0.7	0.7	0.0	0.0
General government	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non financial corporates	59.9	58.4	54.9	51.4	51.9	50.1	48.3	46.3	49.1	47.1	46.4
Other domestic sector	37.4	38.6	41.4	44.0	42.5	46.1	49.2	50.5	47.5	49.1	49.9
Loans to non-residents	1.2	1.6	2.1	2.6	3.6	2.2	2.4	2.6	2.6	3.6	3.7
Profitability											
Net income (yoy percent change)	93.0	-50.4	144.1	28.4	10.5	32.1	18.8	13.3	-1.1	n.a.	n.a.
Return on assets (ROA)	3.2	1.3	2.9	3.1	2.7	3.2	3.1	3.1	2.5	0.2	4.0
Return on equity (ROE)	19.3	7.8	16.5	17.6	17.7	22.1	23.3	23.5	20.4	1.4	37.3
Interest margin to gross income	61.1	59.8	60.0	60.0	60.8	58.0	58.9	61.0	58.1	58.1	57.1
Non interest expenses to gross income	62.3	59.8	55.7	53.4	51.0	49.8	51.8	49.6	52.9	56.5	46.8
Liquidity											
Liquid assets to total assets	28.7	27.3	27.5	22.2	23.4	22.8	21.3	21.6	19.6	21.4	20.9
Liquid assets to short term liabilities	44.4	44.8	43.1	34.8	35.6	34.0	32.1	27.1	24.2	25.6	26.8
Total LCR				130.2	120.8	119.2	129.6	123.7	133.3	138.7	144.2
LCR in GEL				143.5	117.3	108.4	120.3	126.0	101.5	114.9	116.3
Other											
Household Debt to GDP	13.1	14.7	20.0	24.4	27.2	32.1	33.7	36.7	33.7	41.9	43.3
Residential real estate loans to total loans	18.0	18.1	19.4	21.3	26.4	28.2	28.9	32.4	31.6	32.8	33.0
Commerical real estate loans to total loans	33.5	30.8	29.7	29.0	26.2	27.6	25.5	24.4	26.3	31.8	31.3
Foreign Currency denominated loans to total loans	68.7	67.4	62.1	60.3	64.2	65.4	56.9	56.9	55.1	55.3	52.4
Foreign Currency denominated liabilities to total liabilities	68.7	69.3	65.9	63.6	70.7	70.7	63.5	61.4	61.6	61.4	58.7

Sources: National Bank of Georgia, IMF FSI database.

Table 4. Status of Key Recommendations of the Georgia 2015 FSAP	
Recommendation	**Progress**
Financial Sector Oversight	
Introduce explicit regulatory provisions in areas highlighted in the Basel Core Principles (BCP) Assessment rather than rely on the NBG's broad powers (NBG).	**Done.** By the end of 2017 and 2019, the Parliament of Georgia approved legislative amendments to the Organic Law on NBG and the "Law on the Activities of Commercial Banks". These amendments further strengthened the NBG's authority to regulate banking groups on a consolidated level, to enhance the requirements of licensing and transferring of significant shares of commercial banks, to have the explicit power to exercise risk-based supervision and to create enhanced framework for the resolution of commercial banks.
Implement the definition of large exposures consistent with Basel standards (NBG).	**Done.** The regulation on the concentration of the exposures and large exposures for commercial banks in accordance with Basel III was approved in November 2019. The definition is fully consistent with relevant Basel standard. Implementation of this regulation has been delayed through June, 2022 owing to the pandemic.
Require Boards to take the lead in developing the banks' risk appetite and conveying desired risk-taking parameters to management (NBG).	**Done.** The NBG has developed a Corporate Governance Code for commercial banks (approved in September 2018) that defines the responsibilities of supervisory boards of commercial banks. These include setting banks' risk parameters in consultation with senior management.
Enhance the capacity of the Banking Supervision Department, including through recruitment, higher salaries, and specialized training (NBG).	**Pending.** The NBG plans to modify its remuneration system with salaries based on the complexity of work. The NBG primarily recruits fresh university graduates as staff, and seek to retain employees by providing opportunities for training and secondment.
Financial Stability	
Amend the NBG law to strengthen its macroprudential mandate (NBG).	**Done.** The Financial Stability Committee (FSC) of the NBG now defines the NBG's macroprudential policy strategy.
Implement the countercyclical capital buffer regime and the LCR of Basel III (NBG).	**Done.** In addition to the CCyB and the LCR, the NBG has implemented the NSFR as of 2019. Activation of the CCyB is considered by the FSC on a quarterly basis.
Implement the capital surcharge for systemically important banks (NBG).	**Done.** The Regulation on Identification of Systemically Important Banks and Determination of the Systemic Buffer was implemented in December 2017. Relevant amendments to the Regulation on Capital Adequacy Requirements for Commercial Banks have also been issued. The D-SIB buffer will phase-in gradually for three systemically important banks and will be fully loaded by December 2021.
Employ macroprudential instruments to address FX risks and support larization: (i) limit FX lending to unhedged borrowers; (ii) adjust liquidity regulations to provide stronger incentives for attracting local currency deposits; and (iii) promote stable long-term funding instruments, through more favorable treatment of FX CDs in reserve requirements (NBG).	**Done.** In addition, Retail Credit Regulation has implemented more conservative requirements (PTI, LTV, Loan Maturity) for FX unhedged borrowers and the current Stress Test framework provides an FX exchange rate depreciation scenario, which has a corresponding impact on regulatory capital.

Table 4. Status of Key Recommendations of the Georgia 2015 FSAP (continued)	
Ensure that banks continue to build adequate capital buffers as long as foreign currency loans dominate the loan portfolios (NBG).	**Done.** In addition, the recent Stress Test framework will also account for this risk in the regulatory capital requirement.
Develop a comprehensive framework for bottom-up stress testing by banks (NBG).	**Done.** Pillar 2 regulation includes a stress test buffer for commercial banks. Guidance on the calculation of this buffer has been provided to banks. While a stress test buffer will not be applied during Q3 2020 due to the Covid-19 situation, results from banks in this period are expected to provide an indication of the buffer range for the banking sector.
Ensure systemic risk assessments and policy responses are effectively communicated, including by the regular publication of financial stability reports (NBG).	**Done.** The NBG has been publishing an annual Financial Stability Report since 2019. It is complemented by an Annual Report, which covers analysis of systemic risks. The Financial Stability Committee meets on a quarterly basis with a predefined calendar and publishes a summary statement and decisions. It also holds a press conference semiannually. A formal Macroprudential Strategy document is available on the NBG website.
Crisis Management and Safety Nets	
Revise emergency liquidity assistance policy to mitigate the NBG's exposure to financial risk (NBG, (MOF).	**Done.** The NBG Law was amended to require a MoF guarantee of any ELA to a bank whose solvency is in doubt, such as a bank undergoing resolution.
Overhaul the bank resolution regime, by implementing effective resolution tools and reinforcing safeguards in the resolution process (NBG, MOF).	**Done.** A new bank resolution and safeguards framework, which was designed with the help of IMF experts, was implemented at end-2019. All implementing regulations and rules were adopted by end-2020.
Introduce a deposit insurance scheme underpinned by features in line with international best practices (MOF, NBG).	**Done.** A deposit insurance scheme based on the IADI's Core Principles for Effective Deposit Insurance Systems was established in 2017.
Set up a Financial Stability Council, comprising the NBG, MOF, securities and insurance regulatory agencies, and relevant stakeholders (authorities).	**Done.** The 2019 NBG Law amendments established a new Interagency Financial Stability Committee comprised of the NBG, MoF, DIA and Insurance State Supervision Service.
Enhance requirements for adequate recovery and resolution plans for systemically important banks (NBG).	**Done.** The 2019 amendments to the Banking and NBG Laws included requirements for all banks to prepare recovery plans and update them annually, and for the NBG to prepare resolution plans for SIBs and other banks for which liquidation may give rise to systemic risks, and to update them annually.

Table 4. Status of Key Recommendations of the Georgia 2015 FSAP (continued)	
Financial Sector Development	
Develop a comprehensive financial sector development strategy, including revisiting existing government interventions to eliminate inefficiencies (MOF, MOE, and NBG).	**Partial and in progress.** The authorities have made significant progress in strengthening the legal and regulatory framework and have taken various initiatives involving elements of financial development, while there is room for improvement in coherence and coordination. Government interventions entail a significant fiscal outlay and further scope for improving efficiency exists.
Prepare a time-bound strategy for capital market development, including regulatory reform, institutional strengthening, and, possibly, establishing a market maker (MOF, MOE).	**In progress.** The MoE and NBG, with the support of ADB and the involvement of other government entities and private sector representatives, are preparing a new capital market development strategy. Significant progress has been made in upgrading capital market legal/regulatory framework and increasing NBG's supervisory capacity. The NBG became an associate member of the IOSCO in 2018 and is seeking to become a signatory to the IOSCO MMoU.
Designate and empower a capital market regulator for capital markets (MOF, MOE).	**Done.** In the process of seeking to become a signatory to the IOSCO MMoU, the NBG identified major gaps in supervisory powers for capital markets oversight, which have been addressed via recent amendments to the securities market law (approved by parliament of Georgia in July 2020).
Complete institutional reform of the insurance sector and strengthen the regulatory framework (MOF, MOE).	**Done.** The minimum capital requirement for insurance companies has been raised and essential regulations (on solvency requirements and risk retention) put in place. A supervisory levy was introduced in 2018, and ISSSG has become financially independent. Current effort is focused on transposing Solvency II into a new Insurance Law.
Establish a regulatory framework for credit reporting to enhance the safety, efficiency, and protection of data privacy (MOF, MOE, and NBG).	**Done.** New laws provide the NBG with the power to supervise credit information bureaus and relevant regulations have been issued.
Improve implementation of the secured transaction regime (MOE, MOJ).	**In Progress.** The MoESD is leading an ongoing effort, in collaboration with MOJ and NBG.A movable collateral registry has yet to be operationalized. Legal and regulatory framework for secured lending also requires strengthening.

Table 5. Key Measures Relevant to Financial Stability (2017–2020)

Instruments	Details	Implementation Date
Capital Measures		
Regulatory Capital Thresholds	Increase in minimum regulatory capital for banks to GEL 50 million.	May 2017
Capital Ratios	Alignment of capital ratios with Basel III and introduction of Pillar 2 Capital Requirements	December 2017
Capital Conservation Buffer	- CCB (2.5 percent) introduced as part of the Basel III implementation - CCB released as part of response to Covid-19	December 2017 April 2020
Unhedged Currency Induced Credit Risk Buffer	- Pillar 2 buffer equivalent to 75 percent additional risk weighting for foreign currency assets - Two-thirds of this buffer was released as part of the NBG response to Covid-19	December 2017 April 2020
Countercyclical Capital Buffer (CCyB)	CCyB introduced but not activated	December 2017
Systemic Buffer	DSIB Buffers (between 1.5 and 2.5 percent) introduced for three identified DSIBs to be phased in gradually through December 2021.	December 2019
Leverage Ratio	Minimum requirement of 5 percent	September 2018
Capital Distributions	As part of response to Covid-19, the NBG prohibited use of relief on capital requirements for dividend payouts, share buybacks, equity investments, increases in variable remuneration for management, or other types of distributions and payments.	April 2020
Liquidity-related Measures		
Reserve Requirements	Short-term FX Deposits - Increase in reserve requirement from 20 to 25 percent. - Further increase from 25 to 30 percent. - Reduction from 30 to 25 percent. Lari Deposits - Reduction of reserve requirements from 7 to 5 percent.	July 2018 March 2019 October 2019 July 2018

Table 6. Financial and Prudential Measures in Response to Covid-19	
Government Support Measures	• A credit guarantee scheme amounting to GEL 330 million was introduced to help businesses cope with the pandemic. • An interest subsidy scheme amounting to GEL 70 million was provided to family-owned, small and medium-sized hotels to co-finance up to 80 percent of the annual interest rate on their loans. • Another subsidy scheme covered 4 percentage points of the interest rate for new mortgage loans for 5 years for physical persons. The scheme only applied to lari-denominated mortgages below GEL200,000 to purchase newly built residential apartments between June 1, 2020 and January 1, 2021. • 600 million GEL in debt issuance for support of banks' liquidity (see below).
Liquidity Measures	• In April 2020, the MoF issued an extra 600 million GEL of government securities and deposited the lari proceeds with commercial banks as long-term deposits. • In April 2020, the NBG introduced swap lines (for up to $400 million) with banks and microfinance institutions in order to provide GEL liquidity to the system. The swaps, which have a one-month maturity, may be renewed on a monthly basis until April 2022. • Moreover, the NBG activated the stand-by swap instrument, which enables banks to get GEL liquidity in exchange for foreign currency, at a penalty rate. • In June 2020, the NBG provided commercial banks with the opportunity to receive liquidity support from the NBG against a collateral of SME loans. Microfinance institutions may also seek financing from commercial banks against SME loans, if these meet certain criteria. This mechanism will phase out from 2022 and expire at end-2023. • In May 2020, for a period of one year, banks were allowed to use their foreign currency buffers for GEL liquidity management (LCR in lari relaxed from 75 percent to zero). • The NBG reduced its policy rate by 50 bps on April 29, 2020; by 25 bps on June 24, and again by 25 bps on August 5.
Capital and lending Measures	• In March 2020, the NBG reduced capital requirements for commercial banks by reducing their capital conservation buffer (2.5 percent of RWA) and a portion of their pillar 2 buffer (2/3 of their currency-induced credit risk buffer). • In March 2020, the NBG also postponed an increase in CET1 and Tier 1 capital requirements that would have come from an increase in banks' Concentration (HHI) and GRAPE buffers. • Commercial banks offered renewable three-months grace period on loans to their customers. • In March 2020, the NBG issued a guideline on the computation of expected credit losses during the Covid-19 crisis. This guideline indicated that banks' loan exposures to borrowers facing temporary liquidity problems and enjoying payment holidays should not be regarded as exposures with a significant increase in credit risk and should not be provisioned solely for that reason. • The regulation on Credit Concentration and Large Risks in Commercial Banks which should have been enacted from June 2020, was postponed by a year and a half. • The NBG suspended on-site inspections of entities under its supervision, except for money laundering inspections which were performed remotely. • The NBG introduced a moratorium on fines on regulated entities arising from breaches due to the crisis.

Appendix I. Central Bank Digital Currency

The National Bank of Georgia (NBG) is considering launching a retail CBDC to enhance payment system efficiencies and financial inclusion. At this early stage, the NBG has developed principles for its preferred technical design features and has invited technology firms, Fintech companies, and interested financial institutions to tender proposals on how to develop a CBDC that meets the stated principles.

As CBDCs can have important macro financial stability implications, the CBDC design should be aligned with policy objectives while allowing innovation by third parties. The NBG should control the issuance and destruction of money, the register/account system, and the rules of operation while banks and other third parties provide end-user services.

To ensure a seamless process, consideration could be given to establishing a joint taskforce with the Ministry of Finance. This would coordinate the exploration of the CBDC, experimental testing of technical solutions and further analysis of purposes and consequences of introducing a CBDC. The task force could be supported by sub-committees comprised of private sector individuals to focus on both technology and non-technology aspects, including implications for monetary policy, financial stability, integrity, inclusion etc.

The mission acknowledges the NBG's plans to provide a controlled environment for testing technical solutions. This could help identify the preferred characteristics of Digital Gel, uncover potential unintended consequences, and help reveal relevant economic and regulatory issues. The NBG may also want to ensure that non-bank payment service providers for CBDCs have strong cyber resilience frameworks; undertake financial and digital literacy programs to support financial inclusion objectives; and conduct an analysis of the public law aspects of CBDC under central bank and monetary law.