International Investment Bank

Consolidated financial statements

Year ended 31 December 2012
Together with Independent Auditors' Report

CONTENTS

INDEPENDENT AUDITORS' REPORT

Consolidated statement of financial position ... 1
Consolidated income statement ... 2
Consolidated statement of comprehensive income ... 3
Consolidated statement of changes in equity ... 4
Consolidated statement of cash flows ... 5

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principal activities ... 6
2. Basis of preparation ... 7
3. Summary of accounting policies ... 8
4. Significant accounting judgments and estimates ... 20
5. Cash and cash equivalents ... 22
6. Deposits with banks and other financial institutions ... 23
7. Available-for-sale investment securities ... 23
8. Held-to-maturity investment securities ... 24
9. Loans to customers ... 24
10. Assets held for sale ... 26
11. Investment property ... 27
12. Property and equipment ... 27
13. Other assets and liabilities ... 28
14. Due to banks and other financial institutions ... 29
15. Equity ... 29
16. Contingencies and loan commitments ... 30
17. Leases ... 30
18. Interest income and interest expense ... 31
19. Net gain/(loss) from foreign currencies ... 31
20. General and administrative expenses ... 31
21. Risk management ... 31
22. Fair values of financial instruments ... 42
23. Related party disclosures ... 43
24. Capital adequacy ... 44
25. Discontinued operations ... 44

ERNST & YOUNG

CJSC Ernst & Young Vneshaudit
Sadovnicheskaya Nab., 77, bld. 1
Moscow, 115035, Russia
Tel: +7 (495) 705 9700
+7 (495) 755 9700
Fax: +7 (495) 755 9701
www.ey.com

ЗАО «Эрнст энд Янг Внешаудит»
Россия, 115035, Москва
Садовническая наб., 77, стр. 1
Тел.: +7 (495) 705 9700
+7 (495) 755 9700
Факс: +7 (495) 755 9701
ОКПО: 00139790

Independent auditors' report

To the Council of the International Investment Bank

We have audited the accompanying consolidated financial statements of the International Investment Bank and its subsidiaries (hereinafter the "Group"), which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated income statement, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

22 March 2013

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

(Thousands of Euros)

	Note	*31 December 2012*	*31 December 2011*
Assets			
Cash and cash equivalents	5	8,407	13,901
Deposits with banks and other financial institutions	6	91,807	111,244
Investment securities available-for-sale	7	100,104	71,035
Investment securities held-to-maturity	8	–	423
Loans to customers	9	49,105	44,252
Assets held for sale	10	10,744	1,910
Investment property	11	52,409	50,287
Property and equipment	12	51,449	49,940
Other assets	13	3,051	1,451
Assets of disposal group	25	–	10,368
Total assets		**367,076**	**354,811**
Liabilities			
Due to banks and other financial institutions	14	3,788	1
Current customer accounts		2,396	2,382
Other liabilities	13	5,803	5,773
Liabilities of disposal group	25	–	2,727
Total liabilities		**11,987**	**10,883**
Equity	15		
Subscribed capital		1,300,000	1,300,000
Callable capital		(1,134,752)	(1,085,505)
Paid-in capital		**165,248**	**214,495**
Revaluation reserve for investment securities available-for-sale		4,340	(2,351)
Revaluation reserve for property		33,375	31,091
Foreign currency translation reserve		–	70
Retained earnings less net income for the year		149,870	98,244
Net income for the year		2,256	2,379
Total equity		**355,089**	**343,928**
Total equity and liabilities		**367,076**	**354,811**

Signed and authorized for release on behalf of the Board of the Bank

Nikolay Kosov — Chairman of the Board

Eugeny Atanassov — Managing Director of the Financial Department

22 March 2013

The accompanying notes 1-25 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2012

(Thousands of Euros)

	Note	2012	2011
Financial result from continuing operations			
Interest income	18	8,690	8,516
Interest expenses	18	(32)	(55)
Net interest income		**8,658**	**8,461**
(Provision) for loan impairment	9	(4,782)	(6,158)
Net interest income/(expense) after provision for loan impairment		**3,876**	**2,303**
Fee and commission income		238	292
Fee and commission expense		(68)	(69)
Net fee and commission income		**170**	**223**
Net gains/(losses) from foreign currencies	19	724	(151)
Net gains/(losses) from financial instruments at fair value through profit and loss			
Combined financial instruments		–	2,174
Net gains from investment securities available-for-sale	15	3,727	428
Income from lease of investment property	11	7,331	6,763
Income from sale of assets held for sale		75	–
Income from revaluation of investment property	11	1,615	1,755
Dividend income		182	–
Gain from bargain purchase	25	–	2,648
Other income		201	78
Net non-interest income		**13,855**	**13,695**
Operating income		**17,901**	**16,221**
Provision for impairment of other assets		(161)	(2)
General and administrative expenses	20	(13,503)	(12,865)
Other operating expenses		(1,343)	(1,488)
Operating expenses		**(15,007)**	**(14,355)**
Income from continuing operations before income tax benefit		**2,894**	**1,866**
Income tax benefit		2	–
Income from continuous operations after income tax		**2,896**	**1,866**
Income (loss) from discontinued operations after income tax	25	**(640)**	**513**
Net income for the year		**2,256**	**2,379**

The accompanying notes 1-25 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2012

(Thousands of Euros)

	2012	*2011*
Net income for the year	**2,256**	**2,379**
Other comprehensive income/(loss)		
Gains/(losses) from investment securities available-for-sale	6,691	(2,904)
Revaluation of property	2,284	3,246
Translation differences	(70)	70
Total other comprehensive income	**8,905**	**412**
Total comprehensive income for the year	**11,161**	**2,791**

The accompanying notes 1-25 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2012

(Thousands of Euros)

	Subscribed capital	*Callable capital*	*Revaluation reserve for investment securities available-for-sale*	*Revaluation reserve for property*	*Foreign currency translation reserve*	*Retained earnings*	*Total equity*
At 31 December 2010	**1,300,000**	**(1,085,505)**	**553**	**27,845**	**–**	**98,244**	**341,137**
Total comprehensive income/(loss)	–	–	(2,904)	3,246	70	2,379	2,791
At 31 December 2011	**1,300,000**	**(1,085,505)**	**(2,351)**	**31,091**	**70**	**100,623**	**343,928**
Total comprehensive income/(loss)	–	–	6,691	2,284	(70)	2,256	11,161
Withdrawal of the member countries (Note 15)	–	(49,247)	–	–	–	49,247	–
At 31 December 2012	**1,300,000**	**(1,134,752)**	**4,340**	**33,375**	**–**	**152,126**	**355,089**

The accompanying notes 1-25 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2012

(Thousands of Euros)

	Note	*2012*	*2011*
Cash flows from operating activities			
Interest, fees and commissions received from loans to customers and deposits with banks and other financial institutions		3,146	6,134
Interest received from combined financial instruments		–	757
Interest, fees and commissions paid		(96)	(116)
Net receipts from trading with foreign currencies		(160)	15
Cash flows from lease of investment property		7,331	6,763
Income from sale of assets held for sale		75	–
General and administrative expenses		(11,350)	(10,109)
Other operating expenses		(1,347)	(1,414)
Cash flows from operating activities before changes in operating assets and liabilities		**(2,401)**	**2,030**
Net (increase)/decrease in operating assets			
Deposits with banks and other financial institutions		19,893	(81,308)
Combined financial instruments		–	17,907
Loans to customers		(10,803)	(938)
Assets held for sale		–	(1,733)
Other assets		554	700
Net increase/(decrease) in operating liabilities			
Due to banks and other financial institutions		3,819	(1,017)
Current customer accounts		17	121
Other liabilities		(40)	(551)
Net cash flows from operating activities		**11,039**	**(64,789)**
Cash flows from investing activities			
Purchase of available-for-sale investment securities		(153,836)	(58,151)
Proceeds from sale and redemption of available-for-sale investment securities		138,776	49,314
Investment in investment property		(507)	(1,655)
Acquisition of property and equipment		(982)	(581)
Net cash flows from investing activities		**(16,549)**	**(11,073)**
Effect of exchange rate changes on cash and cash equivalents		16	40
Net decrease in cash and cash equivalents		**(5,494)**	**(75,822)**
Cash and cash equivalents, beginning		**13,901**	**89,723**
Cash and cash equivalents, ending	5	**8,407**	**13,901**

The accompanying notes 1-25 are an integral part of these consolidated financial statements.

(Thousands of Euros)

1. Principal activities

These consolidated financial statements include the financial statements of the International Investment Bank (the "Bank") and its subsidiaries. The Bank and its subsidiaries are hereinafter referred together as the "Group". The International Investment Bank is the parent company of the Group. The list of the Bank's subsidiaries is presented in Note 2.

The Bank was founded in 1970, has operated since 1 January 1971 and is an international institution operating on the basis of the Intergovernmental Agreement on the Establishment of the International Investment Bank (the "Agreement") and the Statutes. The Agreement was ratified by the member countries of the Bank and registered with the Secretariat of the United Nations in December 1971. The Bank is primarily engaged in commercial lending for the benefit of national investment projects in the member countries of the Bank and for other purposes defined by the Council of the Bank. The Bank also performs transactions with securities and foreign currency. The Bank operates from its office at 7 Mashi Poryvaevoi St., Moscow, Russia.

The Group had an average of 148 staff employees during 2012 (2011: 148).

At the 98th meeting of the Bank's Council on 28 November 2012, the heads of the member countries' delegations approved unanimously the IIB Relaunch Program proposed by IIB's Board designed to transform it into a dynamic full-service multilateral development bank. The Program includes the following elements:

- Change priorities in the IIB's lending policy - focus on offering credit products with a low risk level. Reduce the share of direct investment lending to ultimate borrowers in the loan portfolio and refocus to lending via partner banks (providing special purpose credit facilities for the development of the SME sector in the member countries, participating in syndicated lending);
- Improve the Bank's brand recognition and further develop partner relations in order to expand the Bank's lending operations;
- Obtain an international credit rating and enter global capital markets;
- Improve the Bank's risk management system in line with recommendations of the Basel Committee on Banking Supervision;
- Restructure the Bank's organization and employee motivation system, following best practices in place at leading multilateral development banks, to enhance the Bank's overall performance.

To carry out the above objectives, the Bank has approved a detailed business plan and financial model for 2013 through 2017.

After adopting the new development trajectory in 2012, the Bank has entered into agreements with the State Specialized Russian Export-Import Bank (Closed Joint-Stock Company), Bulgarian Development Bank and Slovenska Zarucna a Rozvojova Banka a.s.

To further step up its practical action, International Investment Bank has entered into a number of agreements as recently as 2013:

- Cooperation agreements with the four largest Vietnamese banks – JSC Bank for Investment and Development of Vietnam, Vietnam JSC Bank for Industry and Trade, Vietnam Bank for Agriculture and Rural Development, Ho Chi Minh City Development Joint Stock Commercial Bank;
- A cooperation agreement with Vietnam-Russia Joint Venture Bank;
- An agreement with Eurasian Development Bank on the general terms of interbank transactions in the currency and money markets;
- A cooperation agreement with Vnesheconombank and Belvnesheconombank Open Joint Stock Company;
- A memorandum of cooperation with VTB Bank.

These developments suggest improvements in the IIB's brand recognition, confidence in the Bank and, particularly important, willingness to develop working cooperation with the Bank on the part of potential borrowers and lenders, as well as readiness for broader cooperation on the part of leading multilateral financial institutions.

(Thousands of Euros)

1. Principal activities (continued)

Member countries of the Bank

The member countries of the Bank include (share in the paid-in capital of the Bank, %):

Member countries	*2012* %	*2011* %
Russian Federation	58.026	44.704
Czech Republic	12.587	9.697
Republic of Bulgaria	12.365	9.526
Romania	7.647	5.892
Slovak Republic	6.294	4.849
Republic of Cuba	2.222	1.711
Mongolia	0.435	0.335
Socialist Republic of Vietnam	0.424	0.327
Republic of Poland	–	13.590
Hungary	–	9.369
	100.000	**100.000**

In accordance with the Agreement, each member country of the Bank may withdraw from membership upon notice to the Council of the Bank at least six months in advance. In this case the Bank must settle all obligations to the relevant member country.

Republic of Poland and Republic of Hungary announced their withdrawal from membership in the Bank in 1999 and 2000, respectively, and are no longer full members of the Bank. In 2012, pursuant to the decision of the Council, the shares of the Republic of Poland and Hungary were classified as unallocated equity quota (Note 15).

The member countries of the Bank may vote at the annual and general meetings of the Council and each member country has one vote regardless of the size of its contribution to the Bank's capital.

Conditions of the Bank's financial and business operations in the member countries

In accordance with the Agreement, the Bank's assets, regardless of location, have immunity from any administrative or judicial interference.

In the member countries, the Bank is not subject to taxation and enjoys all privileges available to diplomatic representations.

The Bank is not subject to regulation by the Central Banks of the member countries, including the country of residence.

Business environment in the member countries

The member countries have experienced political and economic change, which has affected, and may continue to affect, the activities of enterprises operating in these countries. Consequently, operations in some member countries involve risks, which do not typically exist in developed markets.

The accompanying consolidated financial statements reflect the management's assessment of the impact of the member countries' business environment on the results of operations and financial position of the Group. Future evolution of the conditions in which the Group operates may differ from the assessment made by the management for the purposes of these financial statements.

2. Basis of preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), approved by the International Accounting Standards Board.

(Thousands of Euros)

2. Basis of preparation (continued)

Subsidiaries

On 2 July 2012, the Bank adopted the decision to establish CJSC IIB Capital (a 100% subsidiary).

As at 31 December 2011, the Bank controlled LLC StroyProektInvest as a holder of a 100% interest in the company's share capital. On 17 February 2012, the Bank sold a 100% interest in the share capital of LLC StroyProektInvest (Note 25).

Basis of measurement

These consolidated financial statements have been prepared under the historical cost convention with the exception of the financial instruments under fair value convention, the changes of which are translated through profit or loss account for the period, available-for-sale financial instruments also stated at fair value, and buildings and investment property are stated at revalued amounts.

Preparation and presentation of financial statements

The financial year of the Group begins on 1 January and ends on 31 December.

Functional and presentation currency

The management has determined the Group's functional and presentation currency to be the Euro ("EUR") as it reflects the economic substance of the underlying operations conducted by the Group and circumstances affecting its operations, because most financial assets and financial liabilities as well as income and expenses of the Group are denominated in EUR. The functional currency of the Group's subsidiaries is Russian ruble.

These consolidated financial statements are presented in thousands of Euros ("Thousands of Euros" or "EUR thousand"), unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

The Group has adopted the following amended IFRS and new IFRIC Interpretations during the year. The principal effects of these changes are as follows:

Amendment to IFRS 7 Financial Instruments: Disclosures

The amendment was issued in October 2010 and is effective for annual periods beginning on 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred to enable the user of the Group's financial statements to assess the risks associated with those assets. The amendment affected disclosure only and had no impact on financial position or performance of the Group.

The following amended standards had no impact on accounting policies, financial position or performance of the Group:

- Amendment to IAS 12 *Income Taxes − Deferred Taxes: Recovery of Underlying Assets*;
- Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters.*

Foreign currency transactions

For the purposes of these consolidated financial statements, any currency other than the Euro is treated as a foreign currency. Foreign currency transactions are recorded in the functional currency at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the exchange rate ruling at the reporting date. Gains and losses arising from foreign exchange differences are recognized in the consolidated income statement as net gains/(losses) from foreign currencies. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated to the functional currency at the exchange rate ruling at the date of the initial transaction. Non-monetary assets and liabilities that are recorded at fair value in a foreign currency are translated to the euro at the exchange rate ruling at the date when their fair value was measured.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Foreign currency transactions (continued)

Differences between the contractual exchange rate of a transaction in a foreign currency and the Group's official exchange rate at the date of the transaction are included in net gains/(losses) from foreign currencies.

Basis of consolidation

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

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

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

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights or equity interest, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognized at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Group’s share of net assets of the associate. The Group’s share of its associates’ profits or losses is recognized in the consolidated income statement, and its share of movements in reserves is recognized in other comprehensive income. However, when the Group’s share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognize further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

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

Cash and cash equivalents

Cash and cash equivalents include cash on hand, Nostro accounts due from banks and other financial institutions and short-term deposits with banks, including reverse repurchase agreements, which mature within ninety days from the origination date and are free from contractual encumbrances.

Financial instruments

Recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value. In the case of investments not classified as financial assets at fair value through profit or loss, directly attributable transaction costs are added to their fair value. The Group determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Financial instruments (continued)

Financial assets and liabilities are recorded in the consolidated statement of financial position when the Group becomes a party to the contractual provisions of the instrument. All regular way purchases and sales of financial assets are recognized on the transaction date, i.e. the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

'Day 1' profit

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

Classification of financial instruments

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

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

The Group designates financial assets and liabilities at fair value through profit or loss if:

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

The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors.

Derivative financial instruments held for trading that are in a net receivable position (positive fair value) as well as option contracts acquired are reported as assets in the consolidated financial statements. Derivative financial instruments held for trading that are in a net payable position (negative fair value) as well as option contracts issued are reported as liabilities in the consolidated financial statements. Gains and losses resulting from these instruments are included in the consolidated income statement as net gains/(losses) from financial instruments at fair value through profit or loss.

An embedded derivative is separated from the host contract and it is accounted for as a derivative if, and only if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and the combined instrument is not measured at fair value with changes in fair value recognized in profit or loss for the period. Derivatives embedded in financial assets or financial liabilities at fair value through profit or loss are not separated.

Financial assets and liabilities at fair value through profit or loss in the consolidated income statement for the period are not reclassified after initial recognition. Interest income on financial assets at fair value through profit or loss is recognized in the consolidated income statement as interest income.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Financial instruments (continued)

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

- Held-to-maturity financial assets that the Group designates as at fair value through profit or loss upon initial recognition;
- Held-to-maturity financial assets that the Group designates as available for sale upon initial recognition; or
- Held-to-maturity financial assets that meet the definition of loans and accounts receivable.

Financial assets which the Group intends to hold for an undefined period are not included in this classification. Held-to-maturity financial assets are subsequently measured at amortized cost. Gains and losses are recognized in the consolidated income statement when the investments are impaired, as well as through the amortization process.

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

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

Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated income statement when such assets are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains and losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired, at which time the cumulative gains and losses previously recognized in other comprehensive income are reclassified to the consolidated income statement. However, interest calculated using the effective interest method is recognized in the consolidated income statement.

Fair value measurement principles

The fair value of financial instruments traded in an active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognized amounts, and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Financial instruments (continued)

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available-for-sale or held-to-maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value at the date of reclassification. Any gain or loss previously recognized in profit or loss is not reversed. The fair value of the financial asset at the date of reclassification becomes its new cost or amortized cost, as applicable.

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repo") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as cash equivalents, amounts due from credit institutions or loans to customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Securities lent to counterparties are retained in the consolidated statement of financial position. Securities borrowed are not recorded in the consolidated statement of financial position unless they are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the consolidated income statement. The obligation to return them is recorded at fair value as a trading liability.

Impairment of financial assets

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows from the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortized cost

For deposits with banks and other financial institutions, held-to-maturity investment securities, loans to customers that are carried at amortized cost the Group assesses individually whether objective evidence of impairment exists for the financial assets.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's amount recorded in the consolidated statement of financial position and the present value of estimated future cash flows (excluding expected future credit losses that have not yet been incurred). The amount of the asset recorded in the consolidated statement of financial position is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated income statement. Interest income continues to be accrued on the reduced carrying amount of the asset based on the original effective interest rate of the asset. Financial asset together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If earlier write-offs are later recovered, such the recovery is credited in the consolidated income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial instruments

For financial instruments available-for-sale, the Group assesses at each reporting date whether there is objective evidence that an instrument or a group of instruments is impaired.

In the case of equity investments classified as available for sale, objective evidence of impairment would include a significant or prolonged decline in the fair value of the investment below its acquisition cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the consolidated income statement – is reclassified from other comprehensive income to the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognized directly in other comprehensive income.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed, the old loan is derecognized and the new loan is recognized in the consolidated statement of financial position;
- If the loan restructuring is not caused by the financial difficulties of the borrower, the Group uses a similar approach as in respect of the derecognition of financial liabilities described below;
- If the loan restructuring is due to the financial difficulties of the borrower and the loan is deemed impaired after this restructuring, the Group recognizes the difference between the present value of the future cash flows discounted using the original effective interest rate and the carrying amount before the restructuring as an expense for impairment in the reporting period. If the loan is not impaired after the restructuring, the Group restates the effective interest rate. In case the loan is not impaired after restructuring, the Group recalculates the effective interest rate.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

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

Derecognition

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized in the consolidated statement of financial position where:

- The rights to receive cash flows from the asset have expired;
- The Group has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- The Group either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

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

Leases

Operating leases – Group as lessee

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

Operating leases – Group as lessor

The Group presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset. Lease income from operating leases is recognized in net non-interest income in the consolidated income statement on a straight-line basis over the lease term as income from lease of investment property. The aggregate cost of incentives provided to lessees is recognized as a reduction of a lease income on a straight-line basis over the lease term. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Investment property

Investment property is property that is not used in the Bank's operations and is held by the Group to earn rentals under operating lease or yield from an increase in its fair value. Investment property is carried at fair value with changes in its fair value recognized in the consolidated income statement. Gains and losses resulting from changes in the fair value of investment property are taken to the financial result and recorded as gains or losses from revaluation and disposal of investment property.

Subsequent costs are capitalized only when it is probable that future economic benefits will flow from the asset and its value can be measured reliably. If there is a change in use of an investment property, it is reclassified to property and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

Property and equipment

Property and equipment are carried in the consolidated financial statements at cost, less costs of day-to-day servicing, accumulated depreciation and accumulated impairment losses, excluding buildings that are recorded at revalued amounts, as described below. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying amount of property and equipment is reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

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

Buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations of buildings are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is recognized in other comprehensive income, except to the extent that it reverses a revaluation deficit of the same asset previously recognized in the consolidated income statement, in which case the increase is recognized in the consolidated income statement. A revaluation deficit is recognized in the consolidated income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation of property and equipment (including self-constructed property and equipment) is charged to the consolidated income statement on a straight-line basis over their estimated useful lives from the date when property and equipment become available for use.

Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	85
Equipment	3-7
Computers	3-6
Office furniture	5-10
Vehicles	4

The asset’s residual values, useful lives and depreciation methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Intangible assets

Intangible assets include computer software.

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

Amortization of intangible assets is charged to the consolidated income statement on a straight-line basis over the estimated useful lives of intangible assets.

	Years
Software	3

Assets classified as held for sale

The Group classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable.

The sale qualifies as highly probable if the Group's management is committed to a plan to sell the non-current asset and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as completed within one year from the date of classification of the non-current asset as held for sale.

The Group measures an asset classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The Group recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstances indicate that their carrying amount may be impaired.

Interest-bearing liabilities

Interest-bearing liabilities are initially recognized at cost being their initial amount less transaction costs incurred. Subsequently, interest-bearing liabilities are carried at amortized cost, recognizing the difference between the actual amount of funds raised and the price of settling the interest-bearing liability in the consolidated income statement over the period of such liability.

If a liability is redeemed or settled early, the difference between its amount in the consolidated statement of financial position and the price of settlement is recorded in the consolidated income statement.

Provisions

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

Equity

In accordance with amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation*, that were issued in February 2008, participants' shares are recognized in equity and not in liabilities.

Fiduciary assets

Assets held in a fiduciary capacity are not reported in the financial statements, as they are not the assets of the Group.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Recognition of income and expenses

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

Interest and similar income and expense

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

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

Fee and commission income

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

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

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

- *Other fee and commission income*

Fees earned for the provision of transaction services are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria.

Fee and commission expense

Fee and commission expenses comprise commissions on securities transactions and commissions on cash settlement transactions. Commissions paid on purchase of securities classified as financial instruments at fair value through profit or loss are recognized in the consolidated income statement at the purchase date. Commissions paid on all other purchases of securities are recognized as an adjustment to the carrying amount of the instrument with corresponding adjustment to its effective yield.

Commissions on cash settlement transactions are recorded in the consolidated income statement at the date when the relevant service is provided.

Dividend income

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

(Thousands of Euros)

3. Summary of accounting policies (continued)

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IFRS 9 Financial Instruments

IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 *Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets The Group will evaluate the impact of the application of the IFRS 9 final version, when issued, on the financial statements in conjunction with the other phases.

IFRS 10 Consolidated Financial Statements

IFRS 10 *Consolidated Financial Statements*, establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. In addition IFRS 10 introduces specific application guidance for agency relationships. The standard also contains accounting requirements and consolidation procedures, which are carried over unchanged from IAS 27. IFRS 10 replaces the consolidation requirements in SIC-12 *Consolidation – Special Purpose Entities*, and IAS 27 *Consolidated and Separate Financial Statements*, and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently, the Group evaluates possible effect of the adoption of IFRS 10 on its financial position and performance.

IFRS 11 Joint Arrangements

IFRS 11 removes the option to account for jointly controlled entities using proportionate consolidation. Instead, jointly controlled entities that meet the definition of a joint venture must be accounted for using the equity method. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*, and becomes effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently, the Group evaluates possible effect of the adoption of IFRS 11 on its financial position and performance.

IFRS 12 Disclosure of Interests in Other Entities

The standard becomes effective for annual periods beginning on or after 1 January 2013. IFRS 12 contains all disclosure requirements that were previously included in IAS 27 related to consolidated financial statements, as well as all disclosure requirements that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required for such entities. The Group will need to disclose more information about the consolidated and unconsolidated structured entities with which it is involved or which it has sponsored. However, the standard will have no impact on financial position or performance of the Group.

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The standard becomes effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The adoption of IFRS 13 may have effect on the measurement of the Group's assets and liabilities accounted for at fair value. Currently, the Group evaluates possible effect of the adoption of IFRS 13 on its financial position and performance.

IAS 27 Separate Financial Statements (as revised in 2011)

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)

As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

Amendment to IAS 19 Employee Benefits

The amendment to IAS 19 becomes effective for annual periods beginning on or after 1 January 2013. The amendment introduces significant changes to the method of accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, the amendment limits changes in net pension assets (liabilities) recognized in profit and loss to net interest income (expense) and cost of services. The amendment will have no impact on the Group's financial position or performance.

Amendment to IAS 1 Presentation of Financial Statements – Presentation of Other Comprehensive Income

The amendment changes the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Group's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments will have no impact on the financial position or performance of the Group. The amendments become effective for annual periods beginning on or after 1 January 2013.

Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities

These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right to offset in the event of default.

The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. While many settlement systems are expected to meet the new criteria, some may not. As the impact of the adoption depends on the Group's examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects.

The amendments become effective for annual periods beginning on or after 1 January 2014.

Amendment to IFRS 1 Government Loans

These amendments require first-time adopters to apply the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to IFRS. The amendment will have no impact on the Group's financial statements.

(Thousands of Euros)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

Improvements to IFRS

The amendments become effective for annual periods beginning on or after 1 January 2013. These amendments will have no impact on the Group:

IFRS 1 First-time Adoption of International Financial Reporting Standards

This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.

IAS 1 Presentation of Financial Statements

This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.

IAS 16 Property, Plant and Equipment

This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.

IAS 32 Financial Instruments: Presentation

This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*.

IAS 34 Interim Financial Reporting

The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

4. Significant accounting judgments and estimates

Assumptions and estimation uncertainty

Management made a number of estimates and assumptions, which affect the consolidated reporting of assets and liabilities and the carrying value of assets and liabilities in the next financial year. Estimates and assumptions are continuously assessed and are based on the management experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In addition, management relies on judgments and assessments in applying the accounting policies. Most significant judgments which affect the amounts recorded in the consolidated financial statements, and estimates which may result in significant adjustment of the carrying value of assets and liabilities in the next financial year are presented below:

Allowance for loan impairment

The Group regularly reviews its loans to assess impairment. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgments as to whether there is any objective evidence indicating that there is a measurable decrease in the estimated future cash flows from a loan. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers or national or local economic conditions that correlate with defaults on liabilities. Impairment loss may be reversed only if a subsequent increase can be objectively related to an event occurring after the impairment loss was recognized. For uncollectible debt, the Group makes allowance in the amount equal to 100% of the amount of debt. Loans are written off at the decision of the Council of the Bank when no economic benefits are expected from them. Loans are recorded in the Group's consolidated statement of financial position less allowances for impairment.

(Thousands of Euros)

4. Significant accounting judgments and estimates (continued)

Assumptions and estimation uncertainty (continued)

Fair values of financial instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by the market price. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. The fair value of derivative financial instruments that are not quoted in an active market is determined using valuation methodologies. To the extent it is applicable, the models use only available market information, but certain areas require management estimates. Change in the assessment of these factors may affect fair value reflected in the financial statements. Management has used all available market information in estimating the fair value of financial instruments.

Fair values of buildings and investment property

As disclosed in Note 3, the Group applies the fair value model with regard to buildings and investment property.

As for buildings, the Group monitors the compliance of the value of buildings with their fair value and performs revaluation to ensure that the present value of buildings does not differ materially from their fair value. The Bank's building was revalued on 26 December 2012. Starting from 26 December 2012, the revalued building is depreciated in accordance with the remaining useful life. Changes in the fair value are recognized in other comprehensive income. For evaluating purposes the Group engages independent professional appraisers and applies an appropriate valuation methodology and information on transactions with similar real estate objects on the local market. However, valuation results based on the above valuation method may differ from the prices of actual transactions on the real estate market.

As for investment property, the Group monitors changes in its fair value at each reporting date to ensure that the current value of investment property does not differ materially from its fair value. The Group's investment property was revalued as at 26 December 2012. At 31 December 2012, there were no significant changes in the fair value. Changes in the fair value of investment property are recognized in the consolidated income statement. The Group determines the fair value of investment property by engaging independent professional appraisers and applying an appropriate valuation methodology and information on transactions with similar real estate objects on the local market. However, valuation results based on the above valuation method may differ from the prices of actual transactions on the real estate market.

Impairment of equity securities available for sale

The Group determines that available-for-sale equity investment securities are impaired when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is significant or prolonged requires judgment. In making this judgment, the Group evaluates, among other factors, the volatility of share prices. In addition, impairment may take place when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operating or financing cash flows.

In particular, information on significant areas of estimation uncertainty and critical judgments in applying accounting policies is presented in the following notes:

- Note 7 *Available-for-sale investment securities*
- Note 9 *Loans to customers*
- Note 11 *Investment property*
- Note 12 *Property and equipment*
- Note 16 *Contingencies and lending commitments*.

(Thousands of Euros)

4. Significant accounting judgments and estimates (continued)

Changes in accounting estimates

Initial valuation of assets held for sale

In June 2012, as a result of repayment of a portion of an impaired loan, the Group received equipment and recognized it as assets held for sale at the lower of cost and fair value less costs to sell (Note 10). In December 2012, based on the report of an independent appraiser, the Group reviewed its accounting estimates with regard to the fair value of the received equipment by decreasing the carrying value of the asset held for sale and recognizing the additional impairment of outstanding portion of the loan in the amount of EUR 977 thousand.

Useful life of buildings

On 1 January 2012, the Group reviewed its accounting estimates with regard to the useful life of buildings. The new useful life is 85 years (previously, 50 years). As at 1 January 2012 residual useful life of the building comprised 66 years. As a result of changes in the accounting estimates with regard to the useful life of a building, the annual depreciation costs of the Group decreased by EUR 580 thousand.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2012	*2011*
Cash on hand	**103**	**29**
Nostro accounts with banks and other financial institutions		
Credit rating AAA	820	449
Credit rating from A− to A+	1,513	317
Credit rating from BBB− to BBB+	51	11
No credit rating	4	4
Total Nostro accounts with banks and other financial institutions	**2,388**	**781**
Short-term deposits with banks:		
Term deposits with banks		
Credit rating from A− to A+	–	9,503
Credit rating from BBB− to BBB+	5,916	565
	5,916	**10,068**
Reverse repurchase agreements – *No credit rating*	–	3,023
Total short-term deposits with banks	**5,916**	**13,091**
Cash and cash equivalents	**8,407**	**13,901**

Cash and cash equivalents are neither impaired, nor past due.

As at 31 December 2011, the Group entered into reverse repurchase agreements with the Central Cooperative Bank, Sophia. The subject of these agreements was investment-rated sovereign Bulgarian Eurobonds. As at 31 December 2011, the fair value of the Eurobonds was EUR 3,358 thousand.

(intentionally blank)

(Thousands of Euros)

6. Deposits with banks and other financial institutions

Deposits with banks and other financial institutions comprise:

	2012	*2011*
Term deposits with banks		
Credit rating from A− to A+	10,017	71,146
Credit rating from BBB− to BBB+	25,069	40,098
Credit rating from BB− to BB+	25,085	–
Credit rating from B+	18,759	–
No credit rating	12,877	–
Deposits with banks and other financial institutions	**91,807**	**111,244**

Asat 31 December 2012, the Group placed deposits with banks in the Republic of Cuba made before 1990. These balances accounted for over 10% of the total deposits with banks and other financial institutions. The Group made a 100% allowance for impairment of these deposits.

	2012	*2011*
Term deposits with banks in the Republic of Cuba without credit rating	35,119	35,049
Less: allowance for impairment	(35,119)	(35,049)
Term deposits with banks in the Republic of Cuba	**–**	**–**

Information on change in the allowance for impairment of deposits with banks in the Republic of Cuba:

	2012	*2011*
At 1 January	**35,049**	**34,774**
Change in allowance resulting from changes in exchange rates	70	275
At 31 December	**35,119**	**35,049**

Repayment of the deposits with banks in the Republic of Cuba is a lasting process and the management believes that these receivables are deposits only formally and historically and are not relevant to the actual state of the Group's deposits. As a result, the Group does not include this debt (for which there is a 100% allowance) in the calculation of the quality and concentration of the Group's deposits.

As at 31 December 2012, the Group had no counterparties (2011: no counterparties) accounting for over 20% of the Group's total deposits with banks and other financial institutions, except for deposits with banks in the Republic of Cuba.

7. Available-for-sale investment securities

Available-for-sale investment securities comprise:

	2012	*2011*
Quoted debt securities		
Government bonds of member countries and municipal bonds:		
Eurobonds issued by governments of member countries	34,853	22,745
Bonds of local governments and municipal bonds	12,774	10,217
Government bonds of member countries and municipal bonds	**47,627**	**32,962**
Corporate bonds:		
Credit rating from A− to A+	3,877	–
Credit rating from BBB− to BBB+	41,959	34,759
Credit rating from BB− to BB+	4,258	1,115
Corporate bonds	**50,094**	**35,874**
Total quoted debt securities	**97,721**	**68,836**
Quoted equity instruments		
Credit rating from BB− to BB+	2,383	2,199
Total quoted equity instruments	**2,383**	**2,199**
Available-for-sale investment securities	**100,104**	**71,035**

(Thousands of Euros)

7. Available-for-sale investment securities (continued)

Government bonds of member countries represent EUR-denominated securities issued and guaranteed by the Ministries of Finance of these countries, maturing in 2015-2025 (2011: maturing in 2013-2025). The annual coupon rate for these bonds varies from 3.6% to 5.3% (2011: from 3.8% to 7.5%)

Bonds of local governments and municipal bonds represent EUR-denominated and RUR-denominated bonds issued by the city of Moscow, maturing in 2016 (2011: maturing in 2015-2016). The annual coupon rate for these bonds is 5.1% (2011: from 5.1% to 7.8%).

Corporate bonds are represented by the bonds issued by major companies and banks of member countries and EU countries, maturing in 2013-2022 (2011: maturing in 2011-2017). The annual coupon rate for these bonds varies from 4.3% to 8.5% (2011: from 4.5% to 10.81%).

Quoted equity securities are represented by shares of a major Russian company.

8. Held-to-maturity investment securities

As at 31 December 2011, held-to-maturity investment securities include quoted Eurobonds of Rosbank International Finance B.V. with the carrying amount of EUR 423 thousand. On 1 July 2012, the issuer redeemed these securities.

9. Loans to customers

The Group issued loans to customers operating in the following countries:

	2012	*2011*
Russian Federation	89,874	91,625
Mongolia	23,377	19,225
Slovak Republic	7,465	3,876
Republic of Bulgaria	6,153	2,930
Total loans to customers	**126,869**	**117,656**
Less: allowance for loan impairment	(77,764)	(73,404)
Loans to customers	**49,105**	**44,252**

	2012	*2011*
Loans to borrowers in the Republic of Cuba	44,117	45,173
Less: allowance for loan impairment	(44,117)	(45,173)
Loans to customers	–	–

Loans to borrowers in the Republic of Cuba originated during the period of 1985-1990. In December 1990, the Republic of Cuba discontinued payments to repay the debt. Due to the absence of collateral, delays for years and difficult economic conditions in Cuba, the Group made a 100% allowance for the debt.

Repayment of the loans issued to borrowers in the Republic of Cuba is a lasting process and the management believes that these receivables relate to the Group's loan portfolio just formally and historically and are not relevant to the actual state of the Group's loan portfolio. In view of the above, receivables relating to borrowers in the Republic of Cuba, for which a 100% allowance was made, are neither included in the calculation of the quality of the Group's loan portfolio nor reflected in the tables below.

(Thousands of Euros)

9. Loans to customers (continued)

Overdue loans

A summary of overdue loans as at 31 December 2012 and 2011 is presented below:

	2012	*2011*
Total loans for which the principal and/or interest is overdue	96,586	91,226
Less: allowance for loan impairment	(76,830)	(71,869)
Loans to customers	**19,756**	**19,357**

Allowance for loan impairment has been allocated to loans as follows:

	Russian Federation	*Mongolia*	*Republic of Bulgaria*	*Total*
At 1 January 2012	**67,878**	**5,526**	**–**	**73,404**
Net charge for the year	1,553	302	2,927	**4,782**
Interest accrued on impaired loans	(402)	–	–	**(402)**
Change in allowance resulting from changes in exchange rates	–	(20)	–	**(20)**
At 31 December 2012	**69,029**	**5,808**	**2,927**	**77,764**
Individual impairment	**69,029**	**5,808**	**2,927**	**77,764**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**89,874**	**11,790**	**2,927**	**104,591**

	Russian Federation	*Mongolia*	*Republic of Bulgaria*	*Total*
At 1 January 2011	**72,283**	**5,412**	**8**	**77,703**
Net charge for the year	6,084	82	(8)	**6,158**
Effect of acquisition of subsidiary, to which earlier a loan had been provided	(3,639)	–	–	**(3,639)**
Amounts written off	(7,004)	–	–	**(7,004)**
Change in allowance resulting from changes in exchange rates	154	32	–	**186**
At 31 December 2011	**67,878**	**5,526**	**–**	**73,404**
Individual impairment	**67,878**	**5,526**	**–**	**73,404**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**91,625**	**11,911**	**2,930**	**106,467**

As at 31 December 2012 and 2011 there were no overdue but not impaired loans in the Group's portfolio.

Change in these estimates may influence the size of allowance for loan impairment. For example, if the net present value of estimated future cash flows has increased/declined by 1%, allowance for impairment would have declined/increased by EUR 491 thousand as at 31 December 2012 (2011: by EUR 443 thousand).

Concentration of loans to customers

As at 31 December 2012, loans to two borrowers (2011: three) with the total amount of loans to each of the two borrowers exceeding 10% of total loans to customers were recorded on the Group's balance sheet. As at 31 December 2012, these loans total comprised EUR 38,252 thousand (2011: EUR 54,749 thousand) and an allowance of EUR 24,479 thousand (2011: EUR 32,778 thousand) has been made for them.

(Thousands of Euros)

9. Loans to customers (continued)

Analysis of collateral

The following table provides an analysis of the loan portfolio, net of allowance for impairment, by types of collateral as at 31 December 2012 and 2011:

	2012		*2011*	
	Loans net of allowance for impairment	***Share in the total loans, %***	***Loans net of allowance for impairment***	***Share in the total loans, %***
Pledge of real property (mortgage) and title	30,795	62.7	26,646	60.2
Pledge of equipment and goods in turnover	7,118	14.5	16,895	38.2
Pledge of rights of demand and construction	–	–	405	0.9
Other	286	0.6	306	0.7
Uncollateralised part of the loans	10,906	22.2	–	0.0
Total	**49,105**	**100.0**	**44,252**	**100.0**

The amounts shown in the table above represent the carrying value of the loan portfolio, and do not necessarily represent the fair value of the collateral.

As at 31 December 2012, fair value of collateral based on which impaired loans are provided for, amounted to EUR 27,908 thousand (2011: 24,894 thousand).

Analysis of loans by industry

The Group issued loans to borrowers operating in the following industries:

	2012	*2011*
Construction of buildings	50,816	31,378
Food and beverage	24,476	25,191
Production, transmission and distribution of electricity, gas and steam	22,893	32,551
Timber manufacturing	10,005	10,005
Mining	8,922	12,340
Specialized construction	7,465	3,876
Rubber and plastic manufacturing	1,365	1,368
Air transport	927	947
	126,869	**117,656**
Less: allowance for loan impairment	(77,764)	(73,404)
Loans to customers	**49,105**	**44,252**

10. Assets held for sale

Assets held for sale are represented by collateral received by the Bank from its debtors who failed to fulfill their obligations on the settlement of overdue loans. The Bank plans to realize these assets within 12 months and takes active actions for their further sale. Management believes that the assets received can be qualified as assets held for sale.

	2012	*2011*
Equipment	10,744	–
Property rights to participatory construction objects	–	1,719
Real estate	–	191
Assets held for sale	**10,744**	**1,910**

On 28 May 2012, real estate previously classified as an asset held for sale was sold to an independent purchaser.

In June 2012, as a result of repayment of a portion of an impaired loan, the Group received power equipment. The loan was issued to a borrower operating in the electric power industry.

In 2012, the Group could not realize property rights to participatory construction objects that were received in 2011, and reclassified those assets to other assets in the reporting period (Note 13).

(Thousands of Euros)

11. Investment property

In 2012 and 2011, the following changes occurred in the cost of property under operating lease:

	2012	*2011*
At 1 January	**50,287**	**47,951**
Inseparable improvements	507	581
Effect of revaluation	1,615	1,755
Carrying value as at 31 December	**52,409**	**50,287**

The Group rents buildings under operating lease agreements. In 2012 the Group's income from lease of investment property amounted to EUR 7,331 thousand (2011: EUR 6,763 thousand).

The Group engaged an independent appraiser to determine the fair value of its buildings. The valuation services were performed by an independent firm of professional appraisers which have acknowledged qualification and relevant professional experience in appraising real property of a similar category and in a similar location. Fair value is determined by reference to market-based evidence. The date of the revaluation was 26 December 2012. If the investment property was measured using the cost model, the carrying amounts as of 31 December 2012 would be as follows:

	2012	*2011*
Cost	29,055	28,791
Accumulated depreciation	(10,450)	(10,004)
Net book value	**18,605**	**18,787**

12. Property and equipment

The movements in property and equipment for the year ended 31 December 2012 were as follows:

	Buildings	*Equipment*	*Computers and software*	*Office furniture*	*Vehicles*	*Total*
Cost						
At 1 January 2012	**48,315**	**8,013**	**3,256**	**496**	**555**	**60,635**
Inseparable improvements	487	–	–	–	–	**487**
Additions	–	225	222	20	28	**495**
Disposals	–	(5)	–	(23)	–	**(28)**
Accounting for accumulated depreciation at revaluation	(732)	–	–	–	–	**(732)**
Effect of revaluation	2,284	–	–	–	–	**2,284**
At 31 December 2012	**50,354**	**8,233**	**3,478**	**493**	**583**	**63,141**
Accumulated depreciation						
At 1 January 2012	**–**	**(7,286)**	**(2,538)**	**(355)**	**(516)**	**(10,695)**
Charge for the year	(732)	(316)	(641)	(18)	(42)	**(1,749)**
Disposals	–	4	–	16	–	**20**
Accounting for accumulated depreciation at revaluation	732	–	–	–	–	**732**
At 31 December 2012	**–**	**(7,598)**	**(3,179)**	**(357)**	**(558)**	**(11,692)**
Net book value						
At 31 December 2011	**48,315**	**727**	**718**	**141**	**39**	**49,940**
At 31 December 2012	**50,354**	**635**	**299**	**136**	**25**	**51,449**

(Thousands of Euros)

12. Property and equipment (continued)

The movements in property and equipment for the year ended 31 December 2011 were as follows:

	Buildings	*Equipment*	*Computers and software*	*Office furniture*	*Vehicles*	*Total*
Cost						
At 1 January 2011	**46,070**	**7,688**	**2,700**	**502**	**553**	**57,513**
Additions	559	538	556	–	2	**1,655**
Disposals	–	(213)	–	(6)	–	**(219)**
Accounting for accumulated depreciation at revaluation	(1,560)	–	–	–	–	**(1,560)**
Effect of revaluation	3,246	–	–	–	–	**3,246**
At 31 December 2011	**48,315**	**8,013**	**3,256**	**496**	**555**	**60,635**
Accumulated depreciation						
At 1 January 2011	**(120)**	**(7,233)**	**(1,864)**	**(340)**	**(444)**	**(10,001)**
Charge for the year	(1,440)	(265)	(674)	(20)	(72)	**(2,471)**
Disposals	–	212	–	5	–	**217**
Transfers	–	–	–	–	–	–
Accounting for accumulated depreciation at revaluation	1,560	–	–	–	–	**1,560**
At 31 December 2011	**–**	**(7,286)**	**(2,538)**	**(355)**	**(516)**	**(10,695)**
Net book value						
At 31 December 2010	**45,950**	**455**	**836**	**162**	**109**	**47,512**
At 31 December 2011	**48,315**	**727**	**718**	**141**	**39**	**49,940**

As at 31 December 2012, the cost of fully depreciated property and equipment still used by the Group was EUR 10,056 thousand (2011: EUR 7,064 thousand).

The Group engaged an independent appraiser to determine the fair value of its buildings. The valuation services were performed by an independent firm of professional appraisers which have acknowledged qualification and relevant professional experience in appraising real property of a similar category and in a similar location. Fair value is determined by reference to market-based evidence as at 26 December 2012.

If the buildings were measured using the cost model, the carrying amounts as of 31 December 2012 would be as follows:

	2012	*2011*
Cost	28,123	27,801
Accumulated depreciation	(10,022)	(9,612)
Net book value	**18,101**	**18,189**

13. Other assets and liabilities

Other assets comprise:

	2012	*2011*
Property rights to participatory construction objects	1,811	–
Advance payments and future period expenses	1,026	1,565
Other accounts receivable	492	6
Deferred income tax assets	2	–
	3,331	**1,571**
Less: provision for impairment of accounts receivable	(280)	(120)
Other assets	**3,051**	**1,451**

(Thousands of Euros)

13. Other assets and liabilities (continued)

Other liabilities comprise:

	2012	*2011*
Other accounts payable	3,098	3,210
Provision for potential VAT payments related to income from leases	1,962	1,895
Settlements with employees	621	544
Other	122	124
Other liabilities	**5,803**	**5,773**

14. Due to banks and other financial institutions

Due to banks and other financial institutions comprise:

	2012	*2011*
Correspondent accounts of banks without rating	1	1
Term deposits of banks without rating	3,787	–
Due to banks and other financial institutions	**3,788**	**1**

15. Equity

Equity

The Bank's subscribed capital amounts to EUR 1,300,000 thousand which represents the Bank's equity stated in the Agreement. The Bank's member countries make contributions to the Bank's equity pursuant to their shares stipulated in the Agreement.

In 2012, based on the Council's decision, the Bank's paid-in share capital decreased by EUR 49,247 thousand (shares of the Republic of Poland and Hungary). The Bank had no liabilities to the Republic of Poland and Hungary, because per Bank’s estimates the net assets of the International Investment Bank were negative as of the date the countries applied for withdrawal. Therefore, the Bank deems liabilities to the Republic of Poland and Hungary as settled. The shares were transferred from the Bank's paid-in capital to retained earnings as the shares unallocated between the member countries.

Callable capital is the amount of contributions by the Bank's member countries which have not been made yet and the amount of unallocated equity contributions totaling EUR 296,900 thousand as at 31 December 2012.

Revaluation reserve for available-for-sale investment securities, revaluation reserve for property and equipment and revaluation reserve for currencies

The movements in the revaluation reserve for available-for-sale investment securities, revaluation reserve for property and equipment and revaluation reserve for currencies were as follows:

	Revaluation reserve for available-for-sale investment securities	*Revaluation reserve for property and equipment*	*Revaluation reserve for currencies*
At 1 January 2011	**553**	**27,845**	**–**
Net unrealized losses on available-for-sale investments securities	(2,476)	–	–
Realized gains on available-for-sale investment securities reclassified to the income statement	(428)	–	–
Revaluation of buildings	–	3,246	–
Revaluation of currencies	–	–	70
At 31 December 2011	**(2,351)**	**31,091**	**70**
Net unrealized gains on available-for-sale investment securities	10,418	–	–
Realized gains on available-for-sale investment securities reclassified to the income statement	(3,727)	–	–
Revaluation of buildings	–	2,284	–
Disposal of currency revaluation	–	–	(70)
At 31 December 2012	**4,340**	**33,375**	**–**

(Thousands of Euros)

15. Equity (continued)

Revaluation reserve for available-for-sale investment securities

The revaluation reserve for available-for-sale investment securities records fair value changes of available-for-sale investments.

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment is used to record increases in the fair value of buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity.

Revaluation reserve for currencies

Revaluation reserve for currencies is used to record the subsidiary's assets and liabilities translated to the functional currency of the Group.

16. Contingencies and loan commitments

Legal

In accordance with the Agreement on the establishment of the Bank, its assets (irrespective of their location) enjoy immunities from any administrative and legal claims

In the ordinary course of business, the Group acts as a plaintiff in a number of court proceedings against its borrowers. The Group takes all necessary legal and other actions to collect the bad debt and to realize respective repossession rights. When the estimated amount of costs resulting from the Group's further actions to collect bad debt and/or realize respective repossession rights is higher than the amount collected and also when the Group holds necessary and sufficient documents and/or regulations issued by the governmental authorities, it decides to write off such bad debt against the respective provision.

Insurance

The Group obtained insurance coverage for a group of buildings, equipment and car park as well as liability insurance against damages caused by operating assets of a hazardous nature. However, the Group did not obtain insurance coverage related to temporarily discontinued operations or the Group's obligations to third parties.

Commitments and contingencies

At any time the Group has outstanding commitments to extend loans. These commitments take the form of approved loan agreements.

The contractual amounts of off-balance sheet commitments are set out in the table below. The amounts reflected in the table for commitments assume that amounts are fully advanced.

As at 31 December, the Group’s commitments and contingencies comprised the following:

	2012	***2011***
Credit related commitments		
Undrawn loan facilities	20,419	22,539
Commitments and contingencies	**20,419**	**22,539**

17. Leases

Group as lessor

The Group provides its real estate for operating leases. The Group's non-cancelable operating lease rentals are receivable as follows:

	2012	***2011***
Less than 1 year	7,292	5,131
Leases	**7,292**	**5,131**

(Thousands of Euros)

18. Interest income and interest expense

Net interest income comprises:

	2012	*2011*
Loans to customers	3,600	3,216
Available-for-sale investment securities and held-to-maturity investment securities	3,366	2,865
Deposits with banks and other financial institutions	1,724	1,678
	8,690	**7,759**
Combined financial instruments	–	757
Interest income	**8,690**	**8,516**
Due to banks and other financial institutions	(2)	(34)
Current customer accounts	(30)	(21)
Interest expenses	**(32)**	**(55)**
Net interest income	**8,658**	**8,461**

As at 31 December 2012, interest income accrued on impaired loans to customers amounted to EUR 1,615 thousand (2011: EUR 2,254 thousand).

19. Net gain/(loss) from foreign currencies

Net gains less losses from foreign currencies comprise:

	2012	*2011*
Net gain/(loss) from revaluation of assets and liabilities in foreign currencies	884	(166)
Net (loss)/gain from trading in foreign currencies	(160)	15
Net gain/(loss) from foreign currencies	**724**	**(151)**

20. General and administrative expenses

General and administrative expenses comprise:

	2012	*2011*
Employee compensations and employment taxes	7,620	7,121
Depreciation charge	1,749	2,471
IT-expenses, inventory and occupancy expenses	1,473	1,118
Expenses related to business travel, representative and accommodation expenses	1,291	997
Consulting and audit expenses	466	261
Other	904	897
General and administrative expenses	**13,503**	**12,865**

21. Risk management

The Group classifies risks inherent in its various activities into three main groups:

- financial risks;
- operational risks;
- business risks.

(Thousands of Euros)

21. Risk management (continued)

Risk management framework

The Group's risk management policy is based on the conservative assessments and is mainly aimed at mitigation of adverse impact of risks on the Group's results, i.e. on the safety and reliability of fund allocation while maintaining the reasonable level of profitability.

The conservative assessment assumes that the Group does not enter into potential transactions with high or undeterminable risk level, regardless of profitability.

The Group's risk management activities are intended to:

- identify, analyze and manage risks faced by the Group;
- establish ratios and limits that restrict level of the appropriate types of risks;
- monitor the level of the risk and its compliance with established limits;
- develop and implement regulative and methodological documents as well as software applications that ensure the professional risk management for the bank transactions.

Risk management policies and procedures are reviewed regularly to reflect changing situation on the financial markets.

Risk management system

For the purposes of risk management, the Group applies risk management system which ensures cooperation in the area of risk management among all management bodies, business units and committees of the Group in accordance with the existing regulatory documents. The main components of the risk management system include the Council, the Audit Committee, the Board, the Asset, Liability and Risk Committee (ALRCO), the Credit Committee and the Risk Management Department.

The Council is the supreme management body of the Bank responsible for its overall management, approval of the Main Risk Management Principles as well as approval of its key risk ratios.

The Audit Committee appointed by the Council audits the Group's operations considering all the risk factors stipulated by the Regulation on the Audit Committee of the Bank.

The Board is the executive body of the Bank, which is responsible for compliance with risk management policies and procedures as well as ratios and limits established by the Council. The Board ensures co-operation among all business units and committees of the Group with regard to risk management.

ALRCO is the Management Board's collegial body responsible for development and implementation of the risk management policy in the course of interbank and security transactions.

The Credit Committee is the Management Board's collegial body responsible for lending and assessment of risks arising from loans, guarantees and other types of credit-related transactions.

Committees meet on a regularly basis and provide to the Management Board their recommendations to improve risk management policies and procedures as well as information on significant transactions.

The Risk Management Department collects and analyzes information related to all types of bank risks, performs their qualitative and quantitative assessment, prepares recommendations for the Management Board and committees of the Group to mitigate risk impact on the Group's performance.

Risk identification

The Group identifies and manages both external and internal risk factors throughout its organizational structure. As a result of regular analysis of the Group's exposure to different types of risks performed by the Risk Management Department, the Group identifies factors leading to the increase of the risk level and determines the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Management Department monitors financial and non-financial risks influencing the results of banking transactions. Current risks exposures and their projected changes are discussed during the meetings of ALRCO and also communicated to the Management Board along with the recommendations on possible risk mitigation measures.

(Thousands of Euros)

21. Risk management (continued)

Risk assessment, management and control

The Group's risk assessment, reporting and control procedures vary by risk type, but are based on a common methodology developed and updated by the Risk Management Department.

Credit risk

Credit risk is the risk that the Group will incur a loss because its counterparty fails to discharge its contractual financial obligations to the Group, or discharged them in an untimely fashion or not in full. Credit risk arises principally from loans and advances to customers and other banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual borrower or counterparty default risk, geographical and industry risk.

For risk management purposes, credit risk arising from financial instruments at fair value through profit or loss is managed and reported as a market risk exposure.

System of credit risk management

Upon preparation of a transaction by the initiating unit it is approved by the Credit Committee, and then – the Management Board. The Management Board is responsible for all direct credit risk exposures up to EUR 15,000 thousand and up to 7 years. Direct credit risks exposures of over EUR 15,000 thousand or above 7 years should be approved by the Council of the Bank.

The objective of credit risk management is to decrease its possible adverse effect on the Group's performance based on the maintenance of potential losses resulted from credit risk within established limits.

To mitigate credit risk, the Group limits concentrations of exposure to individual customers, counterparties and issuers (for securities), groups of related customers, counterparties and issuers as well as by industry/sector, credit rating (for securities). Credit risk management process is based on regular analysis of the creditworthiness the borrowers and their ability to repay interest and principal of debt, and on correspondent limits modification (if necessary).

The Group's regulatory documents establish the following:

- procedures to review and approve loan/credit applications;
- methodology for the credit assessment of borrowers, counterparties, issuers and insurance companies;
- valuation approaches with regard to collateral offered;
- requirements to the credit documentation;
- procedures for the ongoing monitoring of loans and other credit exposures.

The corporate loan/credit application and appropriate project documents are reviewed by the Credit Department. In case of a positive decision, the set of documents from the Credit Department required for reviewing the loan/credit application shall be analyzed by the Legal Department, Risk Management Department, Security Department, Strategic Planning and Analysis Department, and Internal Control and Compliance Department. For the purpose of comprehensive analysis of the loan/credit application received from the Credit Department, the Legal Department and Risk Management Department jointly prepare Description of the Investment Transaction. The loan/credit application is subject to review by the Credit Committee based on the Description of the Investment Transaction, report of the Security Department and Strategic Planning and Analysis Department, report on risks of the Risk Management Department and compulsory judgment of the Legal Department in respect of the legal compliance of the proposed transaction. The procedure of making lending decisions comprises the following steps: Step 1 includes reviewing application by the Credit Committee; Step 2 includes making decision by the Management Board of the Bank (if such issue falls within its competence); Step 3 includes sending a set of respective documents approved by the Management Board of the Bank to the member countries in order to obtain the final approval from the country of origin of the borrower; Step 4 includes making decision by the Council of the Bank (if such issue falls within its competence).

Apart from individual customer analysis, the Risk Management Department assesses the whole loan portfolio with regard to credit concentration and market risks. Based on the Group's internal rating model to determine borrower's default probability and recovery estimates, the Group classifies all loans and other credit related products by the respective groups of risks.

(Thousands of Euros)

21. Risk management (continued)

Credit risk (continued)

The Group continuously monitors the quality of individual credit exposures and regularly reassesses the creditworthiness of its customers. The revaluation is based on the customer's most recent financial statements, past-due status, performance of its business plan and other information submitted by the borrower, or otherwise obtained by the Group. Based on this information, the borrower's internal credit rating (class of the loan) may be revised and, accordingly, the appropriate loan impairment provision may be created or changed.

Collateral and other credit enhancements

Credit risk is also managed by obtaining pledge of real estate, assets and securities, and other collateral, including corporate and personal guarantees, as well as monitoring availability and value of collateral.

As availability of collateral is important to mitigate credit risk, this factor is a priority for the Group when reviewing loan/credit applications if their terms and conditions are similar. To ensure recovery of its resources associated with conducting lending and project-financing transactions, the Group applies the following types of collateral for recovery of loans and fulfillment of obligations:

- pledge of equipment and goods in turnover;
- pledge of real property (mortgage) and title;
- pledge of rights of demand and construction.

Analysis of the Group's loan portfolio, net of impairment allowance, by types of collateral is provided in Note 9.

Collateral is not generally held over loans and deposits, except where securities are held as collateral in reverse repurchase agreements. Collateral is not required against exposures to securities.

Quality of the collateral provided is assessed by the following criteria: safety, adequacy and liquidity.

The Group assumes that the fair value of the collateral is its value estimate recognized by the Group to calculate the discounted impairment allowance based on its liquidity and possibility of selling such property in the event of borrower's default considering the time needed for such sale, litigation and other costs.

Current market value of the collateral, if necessary, is assessed by accredited appraisers or based on the Group's internal expert estimate, or carrying amount of the collateral including adjustment coefficient (discount). The Group's internal expert opinion on the fair value of the collateral and feasibility of the adjustment coefficient (discount), which adjusts the market value, shall be approved/ reconciled with the Risk Management Department. The adjustment coefficient (discount) is established based on the table of recommended discounts "Regulations on lending operations" as at initial measurement of the collateral value. Where the market value of the collateral is assessed as impaired, the clients are usually required to provide additional collateral.

Allowance for loan impairment

The Group creates allowance for loan impairment that represents its estimate of losses incurred in its loan portfolio. The Group writes off a loan balance against related allowances for loan losses only subject to the approval of the Council and where the loan is determined as uncollectible and when all necessary steps to collect the loan are completed. Such decision is made after consideration of the information on significant changes in the client's financial position such as inability to repay the loan, and when proceedings from disposal of the collateral are insufficient to cover the debt amount in full. Generally, overdue loans are written off when overdue more than five years or if the debtor is declared bankrupt.

(intentionally blank)

21. Risk management (continued)

Credit risk (continued)

Maximum exposure to credit risk

Maximum credit risk exposure of the Group as related to financial assets is recorded in their carrying amount.

Credit risk for off balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same procedures and methodologies, as defined by the Group's credit policy, for approving credit related commitments (undrawn loan commitments, letters of credit and guarantees) as it does for on balance sheet credit obligations (loans). Maximum credit risk exposure by credit related commitment represents all the amount of these commitments (Note 16).

Concentration of credit risk

The Group monitors credit risk concentrations by industry and geographic location. Analysis of credit risk concentration by industry is presented in Note 9.

The table below shows information on credit risk geographical concentration as of 31 December 2012 and 2011:

	2012								
	Russian Federation	*Czech Republic*	*Republic of Bulgaria*	*Romania*	*Slovak Republic*	*Republic of Cuba*	*Mongolia*	*Other countries*	*Total*
Assets									
Cash and cash equivalents	6,073	–	–	–	–	–	–	2,334	**8,407**
Deposits with banks and other financial institutions	37,962	–	15,033	–	10,018	–	18,759	10,035	**91,807**
Available-for-sale investment securities	46,934	15,078	3,326	10,915	12,267	–	1,168	8,033	**97,721**
Loans to customers	20,845	–	3,226	–	7,465	–	17,569	–	**49,105**
Other assets	1,217	–	–	–	–	22	–	–	**1,239**
Total	**113,031**	**15,078**	**21,585**	**10,915**	**29,750**	**22**	**37,496**	**20,402**	**248,279**

	2011								
	Russian Federation	*Czech Republic*	*Republic of Bulgaria*	*Romania*	*Slovak Republic*	*Republic of Cuba*	*Mongolia*	*Other countries*	*Total*
Assets									
Cash and cash equivalents	611	9,503	3,023	–	–	–	–	764	**13,901**
Deposits with banks and other financial institutions	10,036	6,005	10,044	–	10,032	–	–	75,127	**111,244**
Available-for-sale investment securities	40,869	4,106	4,878	4,093	5,881	–	1,115	7,894	**68,836**
Held-to-maturity investment securities	423	–	–	–	–	–	–	–	**423**
Loans to customers	23,747	–	2,930	–	3,876	–	13,699	–	**44,252**
Other assets	1,427	–	–	–	–	22	–	2	**1,451**
Total	**77,113**	**19,614**	**20,875**	**4,093**	**19,789**	**22**	**14,814**	**83,787**	**240,107**

Other countries include members of the Organization for Economic Development (OECD).

The assessment of credit quality of assets is based on the qualitative and quantitative assessment of credit risk.

Deposit contracts with banks and other financial institutions are concluded with first-class counterparties with high credit ratings assigned by such internationally recognized rating agencies as Standard & Poor's, Fitch and Moody's.

Assessment of credit quality of loans is based on a 5 grade system of risk factor categories: standard, sub-standard, doubtful, impaired and uncollectible. The risk factor category is assigned on the basis of the assessment of the client's financial position, payment discipline, credit history, compliance with business plan and production discipline, additional characteristics such as management quality, compliance with other terms and conditions of the loan agreement, strength of positions in the market, competitive potential, administrative resources, industry specifics and country rating.

(Thousands of Euros)

21. Risk management (continued)

Credit risk (continued)

The following table provides information on the credit quality of the loans issued and included in the Group's loan portfolio as of 31 December 2012:

	Loan amount	*Impairment*	*Loan amount, including impairment*	*Impairment to loan amount ratio, %*
Loans without any signs of impairment identified				
Standard loans				
- *Mongolia*	11,586	–	11,586	–
- *Slovak Republic*	7,465	–	7,465	–
- *Republic of Bulgaria*	3,226	–	3,226	–
Impaired loans				
Loans not past due				
- *Russian Federation*	8,005	(933)	7,072	12
Loans overdue less than 30 days				
- *Mongolia*	10,864	(4,881)	5,983	45
Uncollectible loans				
- *Russian Federation*	81,869	(68,096)	13,773	83
- *Republic of Bulgaria*	2,927	(2,927)	–	100
- *Mongolia*	927	(927)	–	100
Total loans to customers	**126,869**	**(77,764)**	**49,105**	**61**

The following table provides information on the credit quality of the loans issued and included in the Group's loan portfolio as of 31 December 2011:

	Loan amount	*Impairment*	*Loan amount, including impairment*	*Impairment to loan amount ratio, %*
Loans without any signs of impairment identified				
Standard loans				
- *Mongolia*	7,314	–	7,314	–
- *Slovak Republic*	3,876	–	3,876	–
Impaired loans				
Loans not past due				
- *Russian Federation*	15,240	(1,535)	13,705	10
Loans overdue from 90 days to 1 year				
- *Russian Federation*	17,311	(9,045)	8,266	52
Uncollectible loans				
- *Russian Federation*	59,074	(57,298)	1,776	97
- *Mongolia*	11,911	(5,526)	6,385	46
- *Republic of Bulgaria*	2,930	–	2,930	–
Total loans to customers	**117,656**	**(73,404)**	**44,252**	**62**

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Renegotiated structured loans are continuously reviewed to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual impairment assessment, calculated using the loan's original effective interest rate.

(Thousands of Euros)

21. Risk management (continued)

Liquidity risk

Liquidity risk is the risk of loss resulting from the Group's inability to meet its payment obligations in full. Liquidity risk results from improper balance between the Group's financial assets and financial liabilities by period and amount (including due to untimely discharge of its financial obligations by one or several counteragents of the Group) and/or an unforeseen need of immediate and simultaneous discharge of its financial obligations.

The Group’s approach to management of liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its obligations when due, under both normal and stressed conditions, without incurring unacceptable losses or taking risk of damage to the Group’s reputation.

In the course of liquidity management the Group's management relies on the following principles:

- liquidity has priority over return;
- continuous liquidity management;
- distribution of authorities between management bodies and divisions;
- planning and limitation of liquidity consistent with the size, nature of business and financial position of the Group;
- forecasting of cash flows.

Liquidity risk is managed to ensure the Group's ability to meet its financial obligations in full and on a timely basis. For this purpose the Group:

- determines an acceptable liquidity level;
- continuously monitors liquidity;
- takes measures to maintain liquidity at the acceptable level;
- in case of liquidity crisis performs a set of procedures for its recovery.

The Group manages its liquidity in two areas: the Treasury Department manages the liquidity, and Risk Management Department performs control over risk liquidity.

The Treasury Department receives on a weekly basis information from business units regarding the liquidity profile of their financial assets and liabilities and forecasts of projected cash flows arising from projected future business. Further, the Treasury Department manages the Group's liquidity in accordance with the existing regulatory documents of the Group and ALRCO's decisions.

The Risk Management Department performs control on a weekly basis over actual values of the current and overall liquidity and compares these values with standards. In case of non-compliance of these standards, the Risk Management Department immediately notifies ALRCO about it in order to develop and perform activities for recovering liquidity.

Due to the fact that all the Group's liabilities are short-term with maturity "on demand" or "less than 1 month", the Group does not estimate non-discounted cash flows since the expected cash outflow will not be significantly different from the carrying value of the Group's financial liabilities as of 31 December 2011 and 31 December 2010.

(intentionally blank)

(Thousands of Euros)

21. Risk management (continued)

Liquidity risk (continued)

The following tables provide an analysis of assets and liabilities on the basis of the remaining period from the balance sheet date to the contractual maturity date (liquidity gap).

	2012							
	Less than 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*Over 5 years*	*No stated maturity*	*Past due*	*Total*
Assets								
Cash and cash equivalents	8,407	–	–	–	–	–	–	**8,407**
Deposits with banks and other financial institutions	12,877	53,845	25,085	–	–	–	–	**91,807**
Available-for-sale investment securities	–	830	2,091	42,048	52,752	2,383	–	**100,104**
Loans to customers less allowance for impairment	–	1,026	7,100	10,573	10,650	–	19,756	**49,105**
Other assets	1,053	6	178	2	–	–	–	**1,239**
	22,337	**55,707**	**34,454**	**52,623**	**63,402**	**2,383**	**19,756**	**250,662**
Liabilities								
Due to banks and other financial institutions	3,788	–	–	–	–	–	–	**3,788**
Current customer accounts	2,396	–	–	–	–	–	–	**2,396**
Other liabilities	2,418	215	3,170	–	–	–	–	**5,803**
	8,602	**215**	**3,170**	**–**	**–**	**–**	**–**	**11,987**
Net position	**13,735**	**55,492**	**31,284**	**52,623**	**63,402**	**2,383**	**19,756**	**238,675**
Accumulated net position	**13,735**	**69,227**	**100,511**	**153,134**	**216,536**	**218,919**	**238,675**	

	2011							
	Less than 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*Over 5 years*	*No stated maturity*	*Past due*	*Total*
Assets								
Cash and cash equivalents	8,899	5,002	–	–	–	–	–	**13,901**
Deposits with banks and other financial institutions	30,111	81,133	–	–	–	–	–	**111,244**
Available-for-sale investment securities	314	812	14,487	35,964	17,259	2,199	–	**71,035**
Held-to-maturity investment securities	20	–	403	–	–	–	–	**423**
Loans to customers less allowance for impairment	–	445	1,898	19,917	2,635	–	19,357	**44,252**
Other assets	588	173	690	–	–	–	–	**1,451**
	39,932	**87,565**	**17,478**	**55,881**	**19,894**	**2,199**	**19,357**	**242,306**
Liabilities								
Due to banks and other financial institutions	1	–	–	–	–	–	–	**1**
Current customer accounts	2,382	–	–	–	–	–	–	**2,382**
Other liabilities	2,067	196	3,510	–	–	–	–	**5,773**
	4,450	**196**	**3,510**	**–**	**–**	**–**	**–**	**8,156**
Net position	**35,482**	**87,369**	**13,968**	**55,881**	**19,894**	**2,199**	**19,357**	**234,150**
Accumulated net position	**35,482**	**122,851**	**136,819**	**192,700**	**212,594**	**214,793**	**234,150**	

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.

	Less than 3 months	*3 to 12 months*	*Total*
2012	2,997	17,422	**20,419**
2011	14,139	10,000	**24,139**

21. Risk management (continued)

Liquidity risk (continued)

The Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

Market risk is the risk that the Group may incur losses due to adverse changes in the market situation expressed in changes in interest rates, exchange rates and value of equity instruments. Market risk is divided into interest rate, currency and equity risks. Market risk is connected to fluctuations on the three main economic markets: debt securities market, equities market, FX and commodities markets, which are subject to general and specific market movements.

The Board of the Bank performs overall management of market risk in line with the General Risk Management Policies approved by the Bank's Council.

ALCO, led by the Deputy Chairman of the Bank's Management Board, coordinates the Group's market risk management policy, considers and provides to the Management Board recommendations on management of market risks, as well as assets and liabilities.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimizing the return on risk. In stressed market conditions caused by the global economic crisis these activities on market risk management shall be hardened.

Therefore, the regulatory base is enhanced, including setting new stop-out and stop-loss limits and sublimits, subject to positions taken and the limit of overall portfolio losses.

The market risk is mainly managed through daily reassessment of market price positions; optimization of the maturities and raising funds ensuring a stable interest margin; hedging changes in foreign currency position through use of derivative instruments; setting and complying with respective limits which restrict exposure to equity, interest and currency risks.

Currency risk

Foreign currency risk is the risk of loss resulting from adverse changes in exchange rates with respect to the Group's open positions in foreign currencies.

The currency risk is analyzed through regular estimation of the open currency position with breakdown by currencies and certain balance sheet positions with consideration of maturities/terms of borrowings denominated in foreign currencies.

The currency risk is monitored through regular preparation of analytical materials related to currency and finance markets of the countries of placements and borrowings, which includes required information on quotes, interest rates, exchange rates and trends of their movements.

If necessary, the Group makes adjustments to the asset and liability currency structure to minimize the currency risk. The currency risk is managed through:

- establishing of and compliance with the limits of two levels, including limits of the open currency position and limits for currency operations performed by officials and business units of the Group (operational limits).

The table below indicates the currencies to which the Group had significant exposure at 31 December 2012 and 31 December 2011 on its non-trading monetary assets and liabilities and its projected cash flows. The analysis calculates the effect of a reasonably possible change of the currency rate against the euro on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on the equity does not differ from the effect on the income statement. All other variables are held constant. A negative amount in the table reflects a potential net reduction in the income statement or equity, while a positive amount reflects a net potential increase.

Currency	*Change in currency rate in % 2012*	*Effect on profit 2012*	*Change in currency rate in % 2011*	*Effect on profit 2011*
RUB	+10/-10	1,749/(1,431)	+12/-12	1,412/(1,110)
USD	+11/-11	1,925/(2,401)	+13/-13	527/(406)

(Thousands of Euros)

21. Risk management (continued)

Currency risk (continued)

The Group's exposure to currency risk is presented below:

	2012					*2011*				
	EUR	*USD*	*RUB*	*Other currencies*	*Total*	*EUR*	*USD*	*RUB*	*Other currencies*	*Total*
Assets										
Cash and cash equivalents	1,010	1,321	5,944	132	**8,407**	13,062	253	575	11	**13,901**
Deposits with banks and other financial institutions	91,807	–	–	–	**91,807**	111,244	–	–	–	**111,244**
Available-for-sale investment securities	77,961	22,143	–	–	**100,104**	57,345	3,314	10,376	–	**71,035**
Held-to-maturity investment securities	–	–	–	–	**–**	–	423	–	–	**423**
Loans to customers less allowance for impairment	49,105	–	–	–	**49,105**	44,252	–	–	–	**44,252**
Other assets	332	173	734	–	**1,239**	245	43	1,163	–	**1,451**
	220,215	**23,637**	**6,678**	**132**	**250,662**	**226,148**	**4,033**	**12,114**	**11**	**242,306**
Liabilities										
Due to banks and other financial institutions	–	3,788	–	–	**3,788**	–	1	–	–	**1**
Current customer accounts	2,247	149	–	–	**2,396**	2,182	200	–	–	**2,382**
Other liabilities	2,033	275	3,495	–	**5,803**	1,801	305	3,667	–	**5,773**
	4,280	**4,212**	**3,495**	**–**	**11,987**	**3,983**	**506**	**3,667**	**–**	**8,156**
Net balance sheet position	**215,935**	**19,425**	**3,182**	**132**	**238,674**	**222,165**	**3,527**	**8,447**	**11**	**234,150**

Interest rate risk

The interest rate risk is the risk of financial losses due to adverse changes in the interest rates of the Group's assets, liabilities and off-balance sheet instruments.

The Group is exposed to the effects of fluctuations in the prevailing levels of market interest rates in its financial position and cash flows. Interest margins may increase as a result of such changes but may also reduce or create losses in the event that unexpected movements arise. The Management Board is responsible for overall management of the Group's assets and liabilities. Due to insignificant amount of borrowings, currently the effect of the interest rate risk is not material.

The Group performs sensitivity analysis of equity using the interest rate gap method for the purpose of controlling financial losses arising from unfavorable changes in interest rates. The interest rate gap method is used to assess changes in equity by using data on mismatch of claims and obligations sensitive to interest rate changes aggregated at given maturity intervals.

The sensitivity of equity (as a result of change in fair value of available-for-sale equity instruments with fixed rates as at 31 December 2012 and 31 December 2011) due to a reasonably possible change in equity indices is presented below. The effect of revaluation of financial assets was calculated based on the assumption that there are parallel shifts in the yield curve.

Country	*Currency*	*Market index*	*Index change 2012*	*Effect on equity 2012*	*Index change 2011*	*Effect on equity 2011*
EU	EUR	Ger Gov	+0.3%/-0.1%	1,118/(235)	+0.4%/-0.1%	824/(206)
USA	USD	US Treas	+0.5%/-0.2%	452/(175)	+0.6%/-0.2%	11/(4)
Russia	RUB	OFZ	–/–	–/–	+5.5%/-2.0%	1,189/(432)

Equity risk

Equity risk is the risk of losses due to adverse changes in the market prices for equity instruments (securities) and derivatives that were acquired by the Group, caused by factors related both to issuers and overall fluctuations in the equity market.

(Thousands of Euros)

21. Risk management (continued)

Equity risk (continued)

The equity risk is managed through strict compliance with the established limits. To minimize the equity risk, in the course of its activity the Group may establish the following limits: limit on overall securities portfolio; limit on non-investment grade securities; maximum limit on trading and investment securities portfolio; limit on combined financial instruments portfolio; industry limits; limits by counterparty and issuer; stop-out and stop-loss limits and sublimits on the overall portfolio and individual portfolios. The equity risk is also minimized by hedging changes in the market value of securities through use of derivatives, as well as by using the delivery-versus-payment principle in settlements under securities transactions.

The effect on equity (as a result of change in fair value of equity instruments recognized as available for sale as at 31 December 2012 and 31 December 2011) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

Market index	*Index change 2012*	*Effect on equity 2012*	*Index change 2011*	*Effect on equity 2011*
Index S&P 500	+18	552	+30	456
Index S&P 500	-18	(552)	-30	(456)

Business risks

The Group's business risks include strategic, legal and reputation risks.

Strategic risk is a risk of losses which the Group may incur as result of mistakes in making decisions, defining the Group's business and development strategy, and is expressed in the following:

- Inadequate accounting for potential threats to the Group's operation;
- Incorrect or insufficiently reasoned definition of perspective business areas;
- Lack or insufficient resources required (financial, material and technical, human resources) and organizational activities (management decisions).

Legal risk is a risk of losses which the Group may incur due to:

- The Group's non-compliance with the legislation and other regulations of the country of residence and country of placement of funds, and agreements entered into;
- Lack of diligence and due care exercised by the Group's lawyers in the course of preparation of contractual documents failing to provide full protection of the Group's interests;
- Misconduct of counterparties to the agreements entered into;
- Untimely or unqualified protection of the Group's interest in court;
- Untimely or unqualified preparation and codification of the Group's regulations, including those related to risk management.

Risk of the Group's business reputation loss (reputation risk) is a risk of loss arising from deterioration of the public opinion related to the Group's financial stability, quality of its services and nature of its business in general resulting in loss of clients (counterparties).

The Group has developed special procedures and takes measures to minimize adverse effect of business risks for the Group.

(intentionally blank)

(Thousands of Euros)

22. Fair values of financial instruments

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

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. While Management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realized in the current circumstances.

Deposits with banks and other financial institutions and cash and cash equivalents. Management has estimated that at 31 December 2012 and 31 December 2011 the fair value of deposits with banks and other financial institutions and cash and cash equivalents was not materially different from their respective carrying amount. This is due to the fact that it is practice to renegotiate interest rates to reflect current market conditions and, therefore, a majority of balances carry interest at rates approximating market interest rates.

Loans to customers. Management has estimated that at 31 December 2012 and 31 December 2011 the fair values of loans to customers were not materially different from their respective carrying amounts. Fair values of loans to customers were calculated based on the respective market interest rates at 31 December 2012 and 31 December 2011.

Set out below is a comparison of the carrying amounts and fair values of the Group’s financial instruments that are carried in the financial statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying amount 2012	*Fair value 2012*	*Unrecognized gain/(loss) 2012*	*Carrying amount 2011*	*Fair value 2011*	*Unrecognized gain/(loss) 2011*
Financial assets						
Cash and cash equivalents	8,407	8,407	–	13,901	13,901	–
Deposits with banks and other financial institutions	91,807	91,807	–	111,244	111,244	–
Investment securities held-to-maturity	–	–	–	423	363	(60)
Loans to customers	49,105	48,037	(1,068)	44,252	44,252	–
Financial liabilities						
Due to banks and other financial institutions	3,788	3,788	–	1	1	–
Current customer accounts	2,396	2,396	–	2,382	2,382	–
Total unrecognized change in unrealized fair value			**(1,068)**			**(60)**

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

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity and variable rate financial instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortized cost is estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing loans and deposits with banks is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity.

(Thousands of Euros)

22. Fair values of financial instruments (continued)

Financial instruments recorded at fair value

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

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

	Level 1 2012	*Level 2 2012*	*Level 3 2012*	*Total 2012*
Financial assets				
Available-for-sale investment securities	98,936	1,168	–	**100,104**

	Level 1 2011	*Level 2 2011*	*Level 3 2011*	*Total 2011*
Financial assets				
Available-for-sale investment securities	71,035	–	–	**71,035**

23. Related party disclosures

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 *Related Party Disclosures*. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Transactions and settlements with related parties were carried out on conditions similar to those, which prevail in transactions between independent parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for 2012 and 2011 are as follows:

		2012		*2011*	
	Related party	*Carrying amount*	*Average interest rate, %*	*Carrying amount*	*Average interest rate, %*
Balance sheet					
Current customer accounts	Key management personnel	75	1.5	149	1.0

		2012	*2011*
	Related party	*Income/ (expense)*	*Income/ (expense)*
Income statement			
Interest expense on current customer accounts	Key management personnel	(6)	(5)
Employee benefits	Key management personnel	(744)	(670)
Compensation for travel expenses and medical insurance	Key management personnel	(106)	(51)
		(856)	**(726)**

(Thousands of Euros)

24. Capital adequacy

Capital adequacy ratio is the most important financial indicator characterizing credibility of the credit institutions and is estimated as ratio of capital base to risk weighted assets expressed as a percentage. Approval of the capital adequacy ratio is the sole power of the Bank's Council.

The Basel Committee on Banking Regulations recommends maintaining the ratio of capital to risk weighted assets ("statutory capital ratio") above the prescribed minimum level. As at 31 December 2012, this minimum level was 8% (2011: 8%).

Taking into account the Bank's status, the structure of the Bank's member countries and respective decision of the Council, the Group maintains the capital adequacy ratio at the level not less than 25% as of 31 December 2012 (2011: 25%).

Therefore, the Group monitors the capital adequacy ratio, computed in accordance with the Basel Capital Accord (commonly known as Basel I) as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998) and Amendment to the Capital Accord to incorporate market risks (updated November 2007).

The following table shows the composition of the Group's capital position computed in accordance with the Basel Accord, as of 31 December 2012 and 2011.

	31 December 2012	***31 December 2011***
Tier 1 capital		
Paid-in capital	165,248	214,495
Retained earnings	152,126	100,623
Total tier 1 capital	**317,374**	**315,118**
Tier 2 capital		
Revaluation reserve for available-for-sale investment securities	4,340	(2,351)
Revaluation reserve for property and equipment	33,375	31,091
Total tier 2 capital	**37,715**	**28,740**
Total regulatory capital	**355,089**	**343,858**
Risk-weighted assets:		
Banking book	186,778	172,857
Trading book	114,127	51,757
Total risk-weighted assets	**300,905**	**224,614**
Total capital expressed as a percentage of risk-weighted assets, % ("capital adequacy ratio")	**118.01%**	**153.09%**
Total tier 1 capital expressed as a percentage of risk-weighted assets, % ("tier 1 capital ratio")	**105.47%**	**140.29%**

25. Discontinued operations

On 24 June 2011, the Bank purchased a 100% interest in LLC StroyProektInvest as part of bad debt workout. LLC StroyProektInvest is a limited liability company operating in accordance with the laws and regulations of the Russian Federation. The company is principally engaged in engineering works.

Management of the Group had an intention to sell its share in LLC StroyProektInvest within one year after purchase; therefore, the identifiable assets and liabilities of the subsidiary were classified as disposed operation and on acquisition were recognized at the lower of their fair value and carrying amount.

25. Discontinued operations (continued)

The carrying amount and the fair value of identifiable assets and liabilities acquired and the effect of excess of net assets over the acquisition cost as of the date of purchase were as follows:

The carrying amount and the fair value of identifiable assets and liabilities acquired and the effect of excess of net assets over the acquisition cost as of the date of purchase were as follows:

	Fair value at the date of acquisition	*Carrying amount at the date of acquisition*
Assets	12,236	10,078
Liabilities	2,772	5,211
Total identifiable net assets		**7,306**
Effect of the excess of net assets over the cost of acquisition		(2,648)
Compensation transferred upon acquisition of control		**4,658**

As of the date of acquisition, the Bank recognized in its financial statements a loan issued to LLC StroyProektInvest. LLC StroyProektInvest recognized the loan totaling EUR 8,534 thousand in amounts due to credit institution. The fair value of the above liabilities of LLC StroyProektInvest approximated EUR 4,658 thousand. These transactions are represented by the relations between the Group entities, which were established before and eliminated in the process of accounting for the business combination. The loan raised was eliminated from the identifiable liabilities of LLC StroyProektInvest. The compensation transferred upon acquisition was increased by the fair value of these liabilities.

In February 2012, the Group sold its 100% interest in LLC StroyProektInvest to independent purchasers for EUR 0.25 thousand paid in cash and amount of the loan with fair value of EUR 6,707 thousand. The excess of the current carrying amount of liabilities less current carrying amount of assets of LLC StroyProektInvest over the compensation paid in cash and the fair value of newly recognized loan amounted to EUR 640 thousand as of the acquisition date. This excess was recognized in the consolidated income statement as a result of discontinued operation.

	Carrying value as of the disposal date
Assets	10,121
Liabilities	2,774
Total net assets	**7,347**
Compensation received upon disposal of control	(6,707)
Loss from discontinued operations after income tax	**640**