ProCredit Bank

Serbia

Annual Report 2010

Key Figures

	EUR '000		RSD '000		Change
	2010	2009	2010	2009	RSD
Balance Sheet Data					
Total Assets	672,080	692,319	70,903,253	66,385,674	6.8%
Gross Loan Portfolio*	460,794	440,663	48,612,889	42,254,688	15.0%
Business Loan Portfolio	263,376	245,025	27,785,657	23,495,126	18.3%
EUR < 10,000	68,383	86,378	7,214,247	8,282,715	-12.9%
EUR > 10,000 < 30,000	63,127	51,820	6,659,830	4,968,997	34.0%
EUR > 30,000 < 150,000	72,192	65,948	7,616,109	6,323,645	20.4%
EUR > 150,000	59,674	40,878	6,295,472	3,919,770	60.6%
Agricultural Loan Portfolio	113,646	110,671	11,989,482	10,612,079	13.0%
Housing Improvement Loan Portfolio	39,138	41,600	4,129,017	3,989,006	3.5%
Other	44,633	43,368	4,708,733	4,158,476	13.2%
Allowance for Impairment on Loans	15,512	16,508	1,636,533	1,582,920	3.4%
Net Loan Portfolio	445,281	424,156	46,976,356	40,671,768	15.5%
Liabilities to Customers	351,975	392,592	37,132,726	37,645,140	-1.4%
Liabilities to Banks and Financial Institutions (excluding PCH)	231,593	203,517	24,432,607	19,515,039	25.2%
Total Equity	82,192	89,313	8,671,088	8,564,069	1.2%
Income Statement					
Operating Income	46,173	54,163	4,871,149	5,193,670	-6.2%
Operating Expenses	41,374	45,091	4,364,887	4,323,695	1.0%
Operating Profit Before Tax	4,799	9,073	506,261	869,974	-41.8%
Net Profit	4,220	8,421	445,172	807,518	-44.9%
Key Ratios					
Cost/Income Ratio	74.42%	71.26%			
ROE	5.17%	9.71%			
Capital Ratio	17.31%	19.42%			
Operational Statistics					
Number of Loans Outstanding	85,889	103,363			-16.9%
Number of Loans Disbursed within the Year	46,904	60,825			-22.9%
Number of Business and Agricultural Loans Outstanding	52,526	66,525			-21.0%
Number of Deposit Accounts	329,216	450,656			-26.9%
Number of Staff	1,299	1,864			-30.3%
Number of Branches and Outlets	57	79			-27.8%

* Total gross loan portfolio under management by ProCredit Bank Serbia including the securitised portfolio and cross-border loans as of 31 December 2010: EUR 510 million.

Exchange rate as of December 31:
2010: EUR 1 = RSD 105.4982
2009: EUR 1 = RSD 95.8888

Mission Statement

ProCredit Bank Serbia is a development-oriented full-service bank. We offer excellent customer service and a wide range of banking products. In our credit operations, we focus on lending to very small, small and medium-sized enterprises, as we are convinced that these businesses create the largest number of jobs and make a vital contribution to the economies in which they operate.

Unlike other banks, our bank does not promote consumer loans. Instead we focus on responsible banking, by building a savings culture and long-term partnerships with our customers.

Our shareholders expect a sustainable return on investment, but are not primarily interested in short-term profit maximisation. We invest extensively in the training of our staff in order to create an enjoyable and efficient working atmosphere, and to provide the friendliest and most competent service possible for our customers.

Letter from the Board of Directors

ProCredit Bank Serbia responded to the many challenges and instabilities in the macroeconomic environment during 2010 with unprecedented internal focus. The bank ended the year with all of its main performance indicators at healthy levels in line with banking sector averages, and most importantly with an innovative, more robust institutional structure, upon which it will continue to fulfil its vital role in the future.

Despite relatively high inflation and local currency depreciation, the real sector of Serbia's economy improved slightly in comparison to 2009. In this context, the bank succeeded in preserving its market share in lending by achieving reasonable loan portfolio growth, and thanks to its unrelenting commitment to rigorous risk management and responsible banking, the quality of the portfolio remained significantly higher than the sector average. Thus, ProCredit Bank is still the most recognisable partner of very small and small enterprises and the leading provider of financial support and services to individual agricultural producers. The stability of our overall level of deposits during the year reflected the strength of the bank's reputation as a reliable institution whose professional and courteous staff enable it to maintain long-term relationships with clients by providing excellent service.

These efforts to deliver the best possible service resulted in 17% growth in the gross loan portfolio, including cross-border loans, to RSD 55 billion (EUR 520.9 million). Total deposits slightly decreased by just 1% to RSD 37.1 billion (EUR 352 million). The bank's prudent risk policy was reflected in a portfolio at risk over 90 days of only 2.79%, contrasting starkly with the 12.84%[1] average for the Serbian banking sector. Our net profit for 2010 amounted to RSD 445.2 million (EUR 4.2 million), representing a sustainable return on equity of 5.17%. At the end of December, the bank's capital adequacy ratio was 17.45%, and it had a total of 227,263 clients on its books.

The year just ended saw the completion of the bank's most ambitious reorganisation to date, which has resulted in an improved business model that is more in tune with the needs of our clients. Core business processes were redesigned, far-reaching structural modifications were carried out, and significant changes were made to the branch network set-up, all of which culminated in a generally leaner organisation with the know-how and capacity to take on the challenges that lie ahead. Additionally, the bank invested significant effort in intensifying the use of automated processes, thus keeping abreast of the fast-paced market in which it operates.

Successful reorganisation has already led to greater efficiency, swifter management decision-making and streamlined execution of tasks, and will in future help to improve bank-client interaction and strengthen the bank's positioning as a reliable and flexible business partner for very small, small and medium-sized enterprises, as well as for agricultural producers and private individuals. Essentially, we are striving to become the house bank for very small and small businesses in Serbia. ProCredit Bank is fully aware that it can only achieve this goal by continuing to build fulfilling relationships with clients, which in turn is only possible through well-trained, professional and friendly staff. As in previous years, training was one of the top priorities in 2010, and was provided both locally and at the ProCredit Academies in Germany and Macedonia.

Thanks to the commitment, expertise and dedication of the staff and the management team, the bank's total assets increased by 6.81% to RSD 71 billion (EUR 672.1 million) by year-end. In 2011, ProCredit Bank Serbia will remain focused on further increasing business volumes in a prudent way as well as on continuing to offer a wide range of innovative, tailored products.

On behalf of the Board of Directors, I would like to express my gratitude to our shareholders for their continued support of our vision. I would also like to extend my appreciation to the staff and management of ProCredit Bank for their constant commitment and hard work. It is thanks to their dedication that we are able to present this encouraging report.

Borislav Kostadinov
Chairman of the Board of Directors

Members of the Board of Directors as of December 31, 2010:
Borislav Kostadinov (Chairperson)
Goran Živkov
Dr. Philipp Pott
Dr. Klaus Glaubitt
Rainer Ottenstein

Members of the Executive Board as of December 31, 2010:
Svetlana Tolmacheva
Mirjana Garapic-Zakanyi
Dejan Janjatović

[1] Credit bureau organised by the Serbian Bank Association; data are presented on bank's request.

The Bank and its Shareholders

ProCredit Bank Serbia is a member of the ProCredit group, which is led by its Frankfurt-based parent company, ProCredit Holding. ProCredit Holding is the majority owner of ProCredit Bank Serbia and holds 83.3% of the shares.

ProCredit Bank Serbia was founded in April 2001 as Micro Finance Bank by an alliance of international development-oriented investors, many of which are shareholders in ProCredit Holding today. Their goal was to establish a new kind of financial institution that would meet the demand of small and very small businesses in a socially responsible way. The primary aim was not short-term profit maximisation but rather to deepen the financial sector and contribute to long-term economic development while also achieving a sustainable return on investment.

Over the years, ProCredit Holding has consolidated the ownership and management structure of all the ProCredit banks to create a truly global group with a clear shareholder structure and to bring to each ProCredit institution all the best practice standards, synergies and benefits that this implies.

Today's shareholder structure of ProCredit Bank Serbia is outlined below. Its current share capital is EUR 82.2 million.

Shareholder (as of Dec. 31, 2010)	Sector	Headquarters	Share	Paid-in Capital (in EUR million)
ProCredit Holding	Investment	Germany	83.33%	68.5
Commerzbank AG	Banking	Germany	16.67%	13.7
Total Capital			**100%**	**82.2**

ProCredit Holding is the parent company of a global group of 21 ProCredit banks. ProCredit Holding was founded as Internationale Micro Investitionen AG (IMI) in 1998 by the pioneering development finance consultancy company IPC.

ProCredit Holding is committed to expanding access to financial services in developing countries and transition economies by building a group of banks that are the leading providers of fair, transparent financial services for very small, small and medium-sized businesses as well as the general population in their countries of operation. In addition to meeting the equity needs of its subsidiaries, ProCredit Holding guides the development of the ProCredit banks, provides their senior management, and supports the banks in all key areas of activity, including banking operations, human resources and risk management. It ensures that ProCredit corporate values, international best practice procedures and Basel II risk management principles are implemented groupwide in line with standards also set by the German supervisory authorities.

IPC is the leading shareholder and strategic investor in ProCredit Holding. IPC has been the driving entrepreneurial force behind the ProCredit group since the foundation of the banks.

ProCredit Holding is a public-private partnership. In addition to IPC and IPC Invest (the investment vehicle of the staff of IPC and ProCredit), the other private shareholders of ProCredit Holding include the Dutch DOEN Foundation, the US pension fund TIAA-CREF, the US Omidyar-Tufts Microfinance Fund and the Swiss investment fund responsAbility. The public shareholders of ProCredit Holding include KfW (the German promotional bank), IFC (the private sector arm of the World Bank), FMO (the Dutch development bank), BIO (the Belgian Investment Company for Developing Countries) and Proparco (the French Investment and Promotions company for Economic Cooperation).

ProCredit Holding has an investment grade rating (BBB-) from Fitch Ratings Agency. As of the end of 2010, the equity base of the ProCredit group is EUR 428 million. The total assets of the ProCredit group are EUR 5.2 billion.

COMMERZBANK

Commerzbank is Germany's leading bank for private and corporate customers. Following the merger of Dresdner Bank and Commerzbank in May 2009, its customers will in future have access to around 1,200 branches, the largest branch network of any German private bank. Commerzbank has approximately 15 million private and corporate customers worldwide, who can now enjoy a broad and attractive range of Commerzbank products and advisory services.

Commerzbank is a strong and reliable partner for corporate customers, particularly export-dependent small and medium-sized firms (SMEs). It also manages major corporate customers and institutions in Europe as well as multinational enterprises. In addition, Commerzbank is a leading export financier, supporting its customers in Germany and around the world.

Commerzbank AG is the parent company of a global financial services group. The group's operating business is organised into six segments providing each other with mutually beneficial synergies: Private Customers, Mittelstandsbank (SME bank), Central & Eastern Europe, Corporates & Markets, Asset Based Finance and Portfolio Restructuring Unit.

Today some 30% of German foreign trade is channelled through the new Commerzbank, the leading export financier for the German industry. The bank is directly represented in more than 50 countries as well as through a network of more than 6,000 banking relationships worldwide.

Commerzbank is well positioned in Central and Eastern Europe, serving more than 4 million customers in the region. In Poland the bank holds a 70% stake in BRE Bank, Poland's third-largest financial institution. In Ukraine it is the majority shareholder of Bank Forum – a universal bank with a nationwide network. Currently Commerzbank operates in more than ten countries in the region.

Special Feature

Pioneering Energy Efficiency Finance in Serbia

Energy costs account for more than 30% of production expenses at Serbian businesses. Private households also devote a significant portion of their budgets to energy. As energy costs in Serbia are currently subsidised, the situation will become even more challenging for both businesses and private households once real market prices have to be paid. In addition, because most energy in Serbia is supplied by fossil fuels, energy-efficient equipment and renewable energy sources are imperative for environmental protection and sustainable development.

Understanding that energy efficiency improvements can reduce costs significantly, contribute to environmental protection and enhance the quality of life, ProCredit Bank Serbia began to offer loans to promote energy efficiency back in 2007. These loans were intended for home improvement measures, such as installing double-glazed windows, insulation and more efficient heating and lighting systems. By the end of 2009, the bank had disbursed EUR 15 million using an IFC credit line; the repaid loan instalments were later disbursed again in a new loan cycle. The credit line was accompanied by a campaign to promote these loans and raise awareness about the importance and benefits of energy efficiency.

At the end of 2008, a new credit line agreement was signed with KfW, also in the amount of EUR 15 million, to be disbursed through ProCredit Leasing. Analyses were conducted throughout 2009 in order to develop and implement a range of sustainable leasing products for financing energy-efficient equipment and machinery that uses renewable energy technologies in the SME and agricultural production sectors. The analyses also included intensive market research aimed at establishing a base of potential suppliers of energy-efficient equipment. In addition to creating the relevant analysis forms and procedures, the bank conducted a series of staff trainings before the leasing products were launched at the beginning of 2010. This was followed by a marketing campaign consisting of educational sessions, direct promotions and other events.

At the same time, the bank's successful track record in providing financing for energy efficiency measures led to an additional agreement for two new credit lines from KfW for a total amount of EUR 30 million, part of which came from EU funds. The credit lines are slated to be disbursed as energy efficiency loans to households and SMEs.

The eligibility criteria for energy efficiency loans require a reduction of at least 20% in energy consumption or CO_2 emissions. Improvements financed by ProCredit Bank contributed to overall energy savings of 9 million kWh, while CO_2 emissions were reduced by 3200 tonnes by the end of 2010. Along with increasing awareness about the importance of energy efficiency for sustainable growth and environmental protection, the bank demonstrated both its commitment to development projects and its responsible approach to doing business.

Management Business Review

Management *from left to right:*

Mirjana Garapic-Zakanyi
Member of the Executive Board

Svetlana Tolmacheva
Chairperson of the Executive Board

Dejan Janjatović
Member of the Executive Board

Political and Economic Environment

In 2010 Serbia continued to make progress towards EU accession. EU officials recognised that the country had implemented significant reforms, that its co-operation with the International Criminal Tribunal for the former Yugoslavia in The Hague had improved, and that it was a factor for stability in the region. In November, the European Commission issued its Serbia 2010 Progress Report, confirming that the country had made political progress, and was on the road to economic recovery and GDP growth. However, it also mentioned that issues relating to the judiciary and to corruption still needed to be addressed. By December the Stabilisation and Association Agreement between the EU and Serbia had been ratified by 11 of the EU's 27 member countries.

The real economy showed signs of improvement. After a 3.1% decline in 2009,[1] GDP grew 1.7%[2] y-o-y, and this upward trend is expected to continue. Increased industrial output and rising exports aided by a competitive exchange rate helped to narrow the trade deficit, but it is still large and capital inflows are insufficient.

In the first six months, inflation was consistently below the NBS's target tolerance band of 6 ± 2%, but started to rise in the second half of the year, overshooting the tolerance band in October.[3] In response, the National Bank raised key interest rates and signalled a tightening of monetary policy. Price increases were due partly to food price shocks and partly to the depreciation of the local currency by approximately 11%. The value of the dinar against the euro dropped from a peak of RSD 95.9 in January to a low of RSD 107.5 in November.[4]

Fiscal performance remained on target. In November the Serbian parliament adopted a revised budget for 2010 with a deficit of RSD 148 billion (4.9% GDP), and the target for 2011 is a budget deficit of no more than 4.1% of GDP.[5]

Fitch Ratings revised Serbia's outlook from negative to stable and reaffirmed the country's long-term Issuer Default Rating of BB- for foreign currency debt. The government's commitment to comply with the IMF programme and the narrowing of the current account deficit were key factors behind the revision of Serbia's outlook.

IMF support for the balance of payments under a EUR 1.87 billion stand-by arrangement which runs until April 2011 has helped bolster reserves and investor confidence, while foreign-owned banks have maintained their exposure to Serbia.[6]

Financial Sector Development[7]

The banking sector in Serbia comprised 33 banks and 8 representative offices of foreign banks at the end of 2010. Two government-owned banks merged in September. Compared to 2009, total banking assets decreased to 1.56% in real terms to RSD 2,534 billion (EUR 24 billion). As in previous years, the top three banks accounted for approximately one third of total banking sector assets.

Lending was the main driver behind asset growth, continuing the trend of recovery that started in the last quarter of 2009. Total net lending amounted to RSD 1,685 billion (EUR 15.97 billion), an increase of RSD 285 billion (EUR 1.37 billion) or 9.38% compared to the end of 2009. Business loans again made up the largest share of bank lending, amounting to RSD 936 billion (EUR 8.87 billion) or 56% of the total, while loans to private households came to RSD 501 billion (EUR 4.75 billion) and loans to the public sector totalled RSD 209 billion (EUR 1.98 billion). Although foreign

1 National Bank of Serbia, Key macroeconomic indicators, www.nbs.rs/export/internet/english/80/index.html
2 National Bank of Serbia, http://www.nbs.rs/export/internet/english/15/konferencije_guvernera/attachment/20110315_DS_press_presentation.pdf
3 National Bank of Serbia, Target and actual inflation, www.nbs.rs/export/internet/english/30/30_9/kretanje_inflacije.html
4 National Bank of Serbia, Exchange rates
5 IMF Country Report Jan. 2011, http://www.imf.org/external/pubs/ft/scr/2011/cr1109.pdf
6 IMF Country Report Jan. 2011, http://www.imf.org/external/pubs/ft/scr/2011/cr1109.pdf
7 Unless otherwise stated, all figures in the Financial Sector Development section were taken from National Bank of Serbia, Banking Supervision, Fourth Quarter Report 2010

currency loans still accounted for a very high 68% of lending, their share was down from over 70% in 2009.

Government credit programmes contributed significantly to boosting GDP in 2010. Subsidised lending to businesses and private individuals amounted to around RSD 200 billion (EUR 1.9 billion)[8] to provide subsidised loans to businesses and private individuals. With credit markets functioning more normally, these programmes are being phased out.

Loan portfolio quality was once again the main factor influencing the profitability of the banking sector. Non-performing loans continued on their upward trend, rising to RSD 273 billion (EUR 2.6 billion) or 16.9% of the total loan portfolio, compared to 15.7% or RSD 202 billion (EUR 2.11 billion) at the end of 2009. The percentage of non-performing business loans increased to 21.8% (2009: 20.9%). At the same time, total provisions covered non-performing loans by a factor of 134%. The capital adequacy ratio of the Serbian banking sector remained high at 19.9%, well above the regulatory minimum of 12%.

Total deposits amounted to RSD 1,505 billion (EUR 14.3 billion) at the end of 2010, making up 59% of total liabilities. Private households accounted for 52%, followed by enterprises (24%) and non-residents (12%). 79% of total deposits were denominated in foreign currency (70% in EUR). Sight deposits and short-term savings continued to predominate.

Despite continuing recovery in banking sector profitability, 11 banks representing 17% of the sector's assets recorded losses totalling RSD 9.1 billion (EUR 86.3 million). The downward trend in banking staff numbers continued. Banks generally remained very liquid in 2010, and invested RSD 144 billion (EUR 1.36 billion) in government RSD securities with maturities of less than a year.

ProCredit Performance

Despite the unsettled macroeconomic environment, characterised by high inflation, sharp depreciation of the local currency and frequent changes in regulations, ProCredit Bank continued to support businesses in their efforts to recover from the impact of the financial crisis. The bank maintained its leading position in financing long-term investments by very small, small and medium-sized enterprises, especially through its participation in the government's anti-crisis programme. Within the framework of a strategic partnership with KfW, the bank drew on a new credit line set up to finance investments in energy efficiency, thus confirming its long-term commitment to supporting projects that contribute to development, undertaken not only by enterprises but also by private individuals and households. ProCredit Bank is still the market leader in providing financial services to individual agricultural producers, and will continue to focus on financing the advancement of Serbia's agricultural production.

In the year under review, the bank succeeded in retaining its market share in lending, while achieving a moderate increase in outstanding loan volume. Loan portfolio quality remained higher than the sector average. On the deposit side, the bank is recognised as the institution that offers its customers stability and long-term security for their savings, rather than trying to woo them with high interest rates. Our clients' confidence in the bank's strategic positioning and in its shareholders' solidity was demonstrated by the consistent level of deposits during the year.

In order to further enhance its quality of service, ProCredit Bank redesigned its business model based on a more comprehensive approach to meeting the different needs of each and every client. This necessitated a thoroughgoing reorganisation of its business processes and internal structures, including the creation of new departments and improvements to its branch network with a view to increasing efficiency. Following these important changes, the bank is now even better positioned to serve as a reliable and flexible business partner for very small, small and medium-sized enterprises, as well as agricultural producers and private individuals. By offering sophisticated, tailored services and sound advice, our highly trained professional

[8] Ministry of economy and regional development, Republic of Serbia, http://www.merr.gov.rs/sr/c/programi-i-projekti/krediti-ublazavanje-efekata-svetske-ekonomske-krize/106


ProCredit Bank
BANKOMAT

staff seek to build long-term relationships with our clients. Considerable effort was invested in better e-banking and card services, and in streamlining and automating processes, making it even more convenient for private individuals to do their banking business with ProCredit. We also staged a wide range of educational events designed to help customers of all types to manage their finances more effectively.

The bank is well capitalised and able to cover all of the risks to which it is exposed, a fact which represents an additional assurance to our clients that their money is safe. Despite all the current challenges, in a market where one third of all banks reported losses, ProCredit Bank achieved a moderate profit in 2010, an accomplishment which testifies to the soundness of our strategy of building long-term partnerships with clients.

Lending[9]

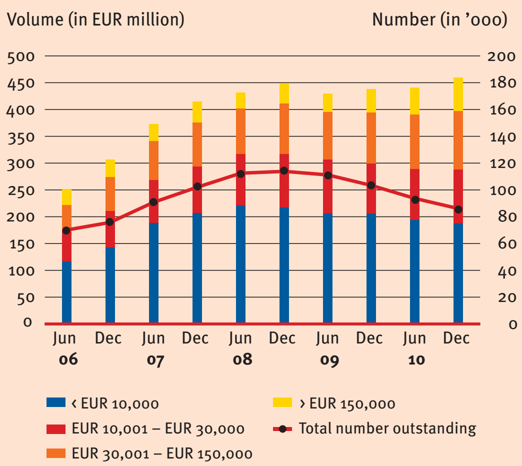
Many of our clients have adjusted to the new conditions created by the crisis, and have repositioned themselves in the market. This in turn has generated new demand for banking products, and has also made us reassess our approach toward specific groups of customers. One of the most important changes was the introduction of a minimum loan size of EUR 3,000 for clients in Belgrade and Novi Sad and EUR 2,000 for clients in all other cities, allowing us to focus our efforts on serving businesses with the potential to grow and create jobs.

On this basis, ProCredit Bank's loan portfolio grew by 4.6% to RSD 48.6 billion (EUR 460.8 million) spread across nearly 86,000 loans. We disbursed over 46,900 new loans with a combined volume of roughly RSD 36 billion (EUR 341.8 million). The bank continued to participate highly successfully in the lending programme organised by the Ministry of Economy and Regional Development. Of the 27 participating banks, ProCredit Bank took second place regarding the disbursement of investment loans, and fourth in terms of the total volume of subsidised loans disbursed, with RSD 15.7 billion (EUR 149.1 million).

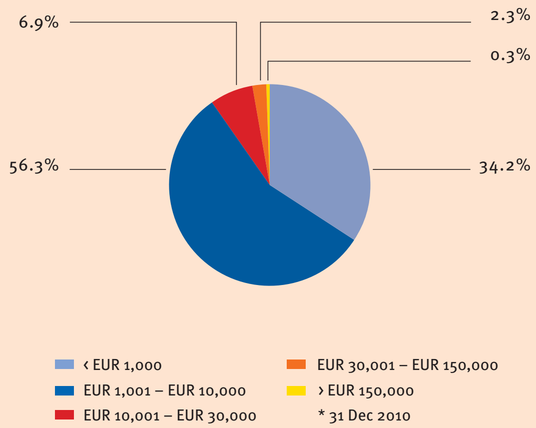
Loans to business clients (not including agricultural loans) accounted for 74.3% of all loans disbursed in 2010, and made up 57.2% of the year-end portfolio. Exposures up to EUR 10,000 represent 26% of the business loan portfolio (2009: 35.3%), while portfolio consisted of exposures from EUR 10,000 to EUR 50,000 accounted for 35.7% (2009: 31.3%). At the same time, loans from EUR 50,000 to EUR 150,000 made up 15.7% of the portfolio (2009: 16.8%) and esposures over EUR 150,000 amounted to 22.7% (2009: 16.7%).

Agriculture is a vital sector of the Serbian economy with a 10.8% share of GDP in 2009.[10] To support the operations of agricultural producers,

Loan Portfolio Development



Number of Loans Outstanding – Breakdown by Loan Size*



* 31 Dec 2010

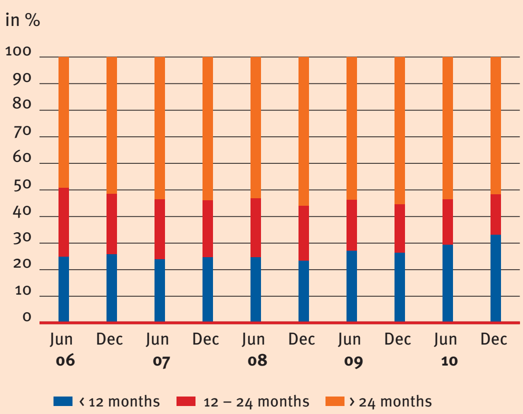
the bank offers loans for investments in modernisation and mechanisation, as well as for working capital. In 2010 we disbursed nearly 11,500 loans in this category with a combined volume of RSD 6 billion (EUR 56.9 million). Much of this was made possible by another government lending programme: according to the Ministry of Agriculture, ProCredit Bank accounted for almost 55.1% of the total volume of subsidised loans disbursed to the agricultural sector. The agricultural segment of the bank's portfolio grew by 2.7% to RSD 12 billion (EUR 113.6 million). The bank is the market leader with a 45.74% share of the number of agricultural loans disbursed, and 47.97% of the volume outstanding.

As a socially responsible institution, the bank provides financing to enable customers to make home improvements that enhance their quality of life, including energy efficiency loans to help

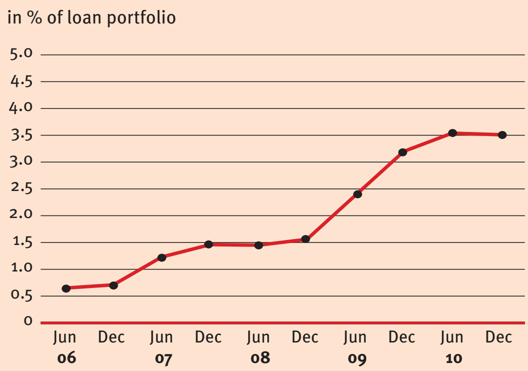
[9] The information provided in this section does not include ProCredit Bank's cross-border loans.

[10] Chamber of Commerce of the Republic of Serbia, http://www.pks.rs/PrivredauSrbiji/tabid/1788/language/sr-Latn-CS/Default.aspx

Business Loan Portfolio – Breakdown by Maturity



Loan Portfolio Quality (arrears >30 days)



Net write-offs:
in 2006: EUR 929,437
in 2007: EUR 2,169,502
in 2008: EUR 4,812,045
in 2009: EUR 2,674,104
in 2010: EUR 9,572,553

people overcome the rising cost of utilities. In total, we disbursed 1,836 housing improvement loans during the year; with RSD 4.1 billion (EUR 39.2 million) outstanding, this segment represents 8.5% of the overall year-end portfolio.

Deposits and Other Banking Services[11]

Turmoil in the banking sector and the many problems facing banks in Serbia have heightened clients' awareness of the importance of their bank's "family tree". Despite the ongoing financial crisis and the downward trend in interest rates on deposits, we managed to retain most of our depositors. Evidently, they appreciate the stability, safety and high level of professional service offered by ProCredit Bank, rather than seeking the highest interest rate on the market. Consequently, deposit volumes declined only slightly, by 2.02% to RSD 31.7 billion (EUR 300 million). Deposits from business customers grew by 5.1%, while deposits from private individuals decreased by 7.6%. Nevertheless, private individuals continued to hold the majority of customer deposits with a share of 52.8%. Reflecting the trust that our clients have in the long-term stability of the bank, term deposits made up the bulk of the total deposit base (61.2%), followed by current accounts (31%) and regular savings accounts (7.8%).

With regard to our other banking services, in 2010 we focused on improving quality rather than quantity. We analysed the utilisation of our ATMs, and started to relocate those that had been underused. We also installed nine new machines bringing the total number to 151. The bank also expanded its network of account statement printers to 42, and the number of POS terminals operated by our business customers rose to 538. At the end of the year, nearly 41,000 cards issued by ProCredit Bank were in circulation, 67.5% of which were being used at least once a month.

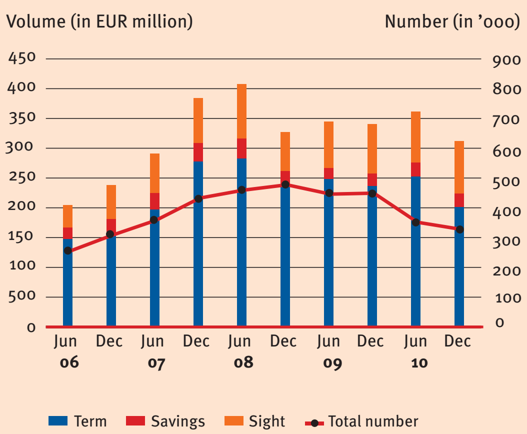
In its money transfer business, the bank carried out domestic transfers with a volume of RSD 425 billion (EUR 4.02 billion) in 2010, a decrease of 1.45%. However, the volume of international transfers increased by 6.0%, totalling RSD 48.2 billion (EUR 457 million).

Financial Results

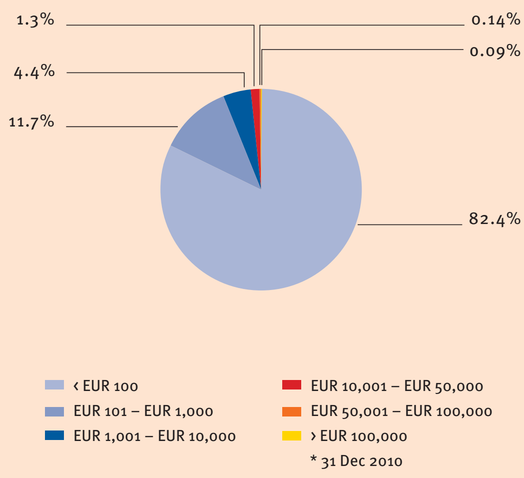
Despite the many constraining factors, ProCredit Bank's total assets increased by 6.81% to RSD 71 billion (EUR 672.1 million) in 2010. The large proportion of liquid assets – 30.7% of total assets – was mostly due to the high level of mandatory reserves that the bank is required to maintain at the central bank. The gross loan portfolio, including

[11] The information provided in this section does not include the deposits or collateral provided by ProCredit Holding.

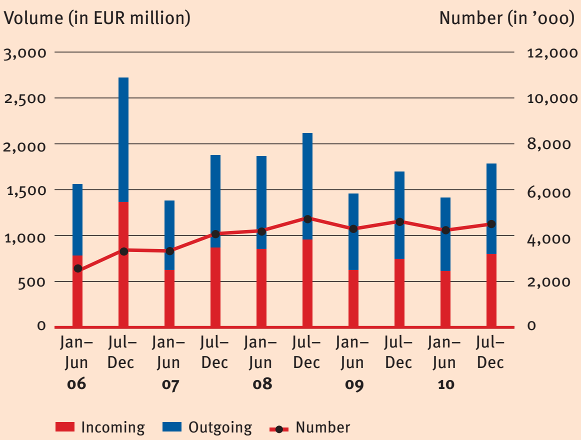
Customer Deposits



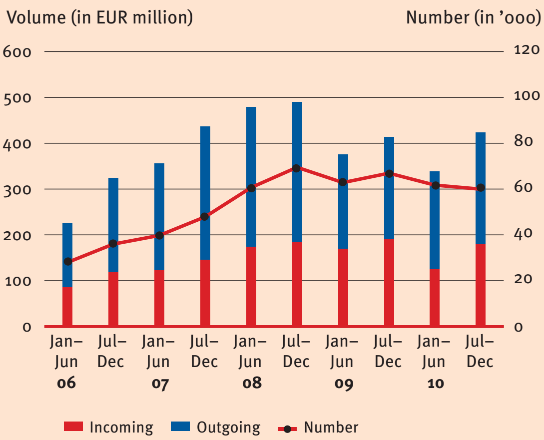
Number of Customer Deposits – Breakdown by Size*



Domestic Money Transfers



International Money Transfers



cross-border loans, grew to RSD 53.8 billion (EUR 509.6 million) as of year-end, having increased by 18.4% compared to end-2009. The bank maintained its strong efforts to keep portfolio quality under control and its conservative policy of setting aside adequate provisioning. Nevertheless, compared to the previous year loan loss provisions increased by 3.4% to RSD 1.6 billion (EUR 15.5 million).

With regard to liabilities, the bank took a strategic decision to optimise its funding structure by focusing on attracting depositors who attach particular value to a long-term banking relationship. As a consequence, total customer deposits at year-end stood at RSD 37.1 billion (EUR 352 million), only slightly below the previous year's figure. The deposit base accounted for 52.4% of total liabilities and was equivalent to 69.1% of the gross loan portfolio at year-end.

The bank's external funding amounted to RSD 21.3 billion (EUR 202 million), with injections during the year coming from our reliable long-term partners IFC, EFSE and KfW. ProCredit Holding's deposit exposure remained at the previous year's level of EUR 25 million.

Total operating income for the year was RSD 4.9 billion (EUR 46.2 million), of which net interest income contributed 93.8%. Compared to the previous year, interest income decreased by 9.5% to RSD 7.3 billion (EUR 69.3 million). This was a consequence of the bank's decision to introduce a minimum loan size of EUR 2,000, which meant discontinuing our lending operations in the smallest loan size range, where interest income was highest but operational expenses and risk were also highest. Interest expenses decreased by 21.2%, reflecting the success of the bank's efforts to access less expensive sources of funds.

Net fee and commission income, including the trading result, slightly decreased to RSD 1.2 billion (EUR 11.5 million). The operating result before tax amounted to RSD 506.3 billion (EUR 4.8 million), 41.8% short of the 2009 figure.

Operating expenses increased by 1% to RSD 4.4 billion (EUR 41.4 million) compared to the previous year, but this picture was slightly distorted by the one-time reorganisation expenses incurred in 2010. Without these costs, the decrease in operating expenses would have been more significant. The full effect of increased cost awareness among staff, coupled with the network reorganisation and optimisation undertaken in 2010, is expected to be reflected in cost savings in 2011. The cost-income ratio rose from 71.3% in 2009 to 74.4%.

The bank ended 2010 with a net profit of RSD 445.2 million (EUR 4.2 million), which, although 44.9% down on the previous year's result, nonetheless meant a sustainable return on equity of 5.17%. Shareholders' equity remains the strong foundation on which the bank's stability rests and its capital adequacy remained high at 17.31%, well above the local requirement of 12%.

Outlook

In 2011 Serbia is likely to face two main macroeconomic challenges: inflation, which rose above the target level in the second half of 2010 and is expected to remain high; and external financing shortfalls, as the current account deficit is expected to remain relatively high, requiring significant capital inflows to maintain external balance.

The NBS has already responded to rising inflation by tightening monetary policy – raising reference interest rates and mandatory reserve requirements – and will continue to pursue this course in 2011. GDP growth is projected at 3%,[11] while a budget deficit of about 4% of GDP is forecast.

The slow progress of growth-oriented structural reforms is an important issue for the authorities. With an eye to elections due to be held in 2012, the government's short-term plans are focused on restructuring the public utilities and on fiscal stabilisation.

The banking sector is still well capitalised, and should be able to absorb even a protracted corporate restructuring process. Many banks are expected to reorganise their processes: given that by the end of 2011 banks will be obligated to implement Basel II-compliant policies and procedures, risk management processes will be more comprehensive and demanding, and more stringent capital requirements will have to be met.

As ProCredit Bank has already completed its reorganisation, it will be in a strong position to take advantage of market opportunities and increase business volumes while remaining within the defined risk limits. Our strategy for 2011 is geared towards increasing market share in the Small business segment by offering a wide range of services, including financing, liquidity management, documentary business and transaction processing. Our aim is to be the leading bank for sustainable, growing enterprises. At the same time, we will continue to promote a culture of savings, emphasising the clarity, simplicity and security of our savings products. And in our transaction business, the focus will be on efficiency, convenience and the appropriate use of innovative technology. The bank is aware that it will need to continually adapt its business to fluctuating market conditions in order to achieve satisfactory financial performance.

[11] Republic of Serbia: Sixth review under the Stand-by Agreement, www.imf.org

Risk Management

In 2010, banking operations were still very strongly influenced by the financial crisis. At the same time, however, this situation has created opportunities for a bank that has consistently taken a rigorous approach to risk management. We believe that this has been one of the key factors behind ProCredit Bank's success in retaining the trust of our customers.

While ultimate responsibility for establishing and supervising the bank's risk management system lies with the Board of Directors, the Audit Board is charged with analysing and adopting draft policies and procedures regarding risk management and the system of internal controls, and monitors their implementation. The Executive Board is responsible for identifying and measuring risks to which the bank is exposed in its business activities, and for implementing the principles of risk management approved by the Board of Directors. At the operational level, the Risk Department develops and implements mechanisms to identify, assess, and mitigate the bank's exposure to risk. The Credit Risk Committee closely monitors current and future exposure to credit risk; the Assets and Liabilities Committee (ALCO) manages the short- and long-term liquidity position and also issues decisions on counterparty risk, country risk, interest rate risk, currency risk and the bank's risk-bearing capacity. The Operational Risk Committee manages exposures to operational risk and proposes measures to mitigate them, while information security issues are handled by a separate committee.

The risk management policies in effect at ProCredit Bank Serbia are based on the Group Handbook on Risk Management and Control, which in turn is based on the German Federal Financial Supervisory Authority's policy document "Minimum Requirements for Risk Management". ProCredit Bank Serbia reports its risk position to the Group Risk Management Committee (GRMC) at monthly intervals. In addition, the bank complies with National Bank of Serbia (NBS) regulations. The group's various risk management departments also monitor the bank's key risk indicators on an ongoing basis, providing guidance whenever required.

Risk management policies throughout the ProCredit group are based on the concept of "risk-bearing capacity", i.e. the principle that each bank's aggregated risk exposures must not exceed its capacity to bear risk, and that the resources available to cover risk are sufficient to absorb any losses that may arise and protect creditors' investments. Statistical models and other procedures are used to quantify the risks incurred, and thresholds and limits are set for each risk category and for the aggregate exposure.

ProCredit Bank's culture of internal and external transparency is crucial to our risk management efforts. Thanks to our clearly defined procedures and our encouragement of open communication, our well-trained staff are in a strong position to detect risks and take the steps necessary to mitigate them.

Credit Risk Management

Given that lending to small businesses is ProCredit Bank's main asset-side operation, it is not surprising that classical credit risk, i.e. the risk that borrowers will be unable to repay, accounts for the largest share of risk in this category.

ProCredit Bank Serbia has adopted the ProCredit Group Credit Risk Management Policy and the Group Collateral Valuation Policy, which together reflect the experience gained in more than two decades of successful lending operations in developing and transition economies. Credit decision-making authority at the bank is clearly defined; all decisions to issue a loan, or change its terms, are taken by a credit committee, and all credit risk assessments are carefully documented. Above all, the bank seeks to build and maintain long-term relationships with its customers, thus ensuring that it is fully aware of their financial situation, and great care is taken to avoid over-indebting them.

Credit risk is also mitigated by the fact that our portfolio is highly diversified. The businesses we serve operate in a wide range of sectors, and their exposure to global market fluctuations is very limited. Moreover, the vast majority of our credit exposures are relatively small. At the end of 2010, loans under EUR 30,000 accounted for 57% of the total outstanding portfolio, and the average amount outstanding was EUR 4,835, while the ten largest exposures accounted for only 6.24% of the portfolio.

As the vast majority of the bank's loans are repayable in monthly instalments, a borrower's failure to meet a payment deadline is treated as an initial sign of potential default and draws an immediate response from the bank. When a payment of interest or principal is overdue by more than 30 days, the loan in question is assigned to the portfolio at risk (PAR>30), which serves as the key indicator of classical credit risk.

As of year-end 2010 the bank's overall PAR>30 stood at 3.51% of the gross loan portfolio, while the portfolio of non-performing loans (over 90 days in arrears) amounted to 2.79% in volume terms. These arrears levels are higher than in 2009 due mainly to the general deterioration in the financial condition of local businesses. It should be noted that ProCredit Bank's PAR>90 is much better than the average for the Serbian banking sector as a whole, where 12.84% of credit exposures were still non-performing at the end of December (source: Credit bureau organised by the Serbian Bank Association; data are presented on bank's request).

One of the ways in which ProCredit Bank has met the challenge to portfolio quality posed by the financial crisis is to offer loan restructuring to those clients that are judged to have the potential to regain stability. Restructurings follow a thorough analysis of each client's changed payment capacity. The decision to restructure a credit exposure is always taken by a credit committee and aims at full recovery. As of end-2010, the total volume of restructured loans in the "watch" category came to EUR 2.79 million.

ProCredit Bank Serbia takes a conservative approach to loan loss provisioning. Impairment allowances for individually significant exposures are calculated on the basis of historical default rates. For all unimpaired credit exposures, portfolio-based allowances for impairment are made. At the end of the year the coverage ratio (loan loss provisions as a percentage of PAR>30) stood at 96.4%, and as a percentage of the total loan portfolio, provisions amounted to 2.94%.

Loans considered to be irrecoverable are consistently written off. Nonetheless, recovery efforts continue even after a loan has been written off, and collateral collection is rigorously enforced. In 2010 net write-offs totalled EUR 9.57 million, or 2.08% of the gross loan portfolio.

Counterparty and Issuer Risk Management

Counterparty and issuer risks evolve especially from the bank's need to invest excess liquidity, to conclude foreign exchange transactions, or to buy protection on specific risk positions.

The risk of incurring losses caused by the unwillingness or inability of a financial counterparty or issuer to fulfil its obligations is managed according to the ProCredit Group Counterparty Risk Management Policy, which defines the counterparty selection process and which sets limits on the size of exposures, and according to the Group Treasury Policy, which specifies the set of permissible transactions and the rules for their processing. As a matter of principle, only large international banks and local banks with a good reputation and financial standing are eligible counterparties. Exceptions to size limits are conditional on approval by the GRMC.

Country Risk Management

Given ProCredit Bank's focus on lending to businesses in the local market, it does not normally enter into cross-border transactions, and therefore its exposure to country risk is limited. However, the bank sometimes needs to exchanges currencies with other members of the ProCredit group. The group as a whole is exposed to country risk insofar as all ProCredit banks operate in transition economies or developing countries. However, over the years the ProCredit business model has proven to be relatively resistant to macroeconomic and political shocks.

Liquidity Risk Management

To determine the robustness of the bank's liquidity in the face of potential shocks, the bank performs regular stress tests based on scenarios defined as a group standard by the Group Liquidity Risk Management Policy. Whenever necessary to bridge liquidity shortages, ProCredit Bank Ser-

bia, like the other group banks, is able to obtain a standby line from ProCredit Holding.

Several factors inherent to the bank's business model offset liquidity risk. Firstly, the bank's diversified, high quality portfolio of loans means that incoming cash flows are highly predictable. Secondly, our customer deposits are spread across a large number of depositors each holding relatively small amounts. As of December 2010 the average balance in deposit accounts of all types came to EUR 946, and the ten largest depositors made up only 16.55% of the total deposit volume.

Currency Risk Management

ProCredit Bank Serbia has a low level of exposure to market risk because it does not trade in securities or in commodities, nor does it engage in derivative transactions except for hedging purposes. Currency risk is managed in accordance with the Group Foreign Currency Risk Management Policy. At the same time, the bank is in full compliance with NBS regulations.

The bank continuously monitors exchange rate movements and foreign currency markets, and determines its currency positions on a daily basis. Any exceptions to group policy or violations on group limits are subject to approval by the GRMC. Stress tests are regularly carried out to assess the impact of exchange rate movements on open currency positions (OCP) in each operating currency based on two scenarios: most probable and worst case.

Group policy forbids the bank to maintain OCPs for speculative purposes. However, FX derivatives may be used for hedging purposes to close certain positions, in which case they are closely monitored at both local and group level. As of end-2010, the bank had an OCP of 9.4%. During 2010 the Serbian dinar depreciated against the euro by 10.02%, mainly due to a reduced level of foreign direct investment coupled with higher public spending. The central bank responded by intervening in the interbank market, selling more than EUR 2.5 billion in an attempt to minimise the daily fluctuations in the value of the local currency.

Interest Rate Risk Management

The repo rate (the key local currency interest rate) initially decreased from 9.5% at the start of the year to 8% in April, but in August it began to rise again as a result of tightened monetary policy, returning to a level of 11.5% by year-end. Interest rates on EUR-denominated deposits decreased across the banking sector by between 1 and 1.5 percentage points, depending on the maturity (the longer the maturity, the smaller the decrease). 6-month EURIBOR increased during 2010 from 0.996% to 1.241%.

Maturity gap analysis and stress testing are used to measure and analyse the impact of interest rate shifts on interest income. A key policy measure undertaken so far to mitigate interest rate risk was the introduction of variable interest rates on loans, allowing the bank to raise (or lower) the rates it charges in line with shifts in the market interest rates. In 2010, the volume of outstanding loans subject to variable interest rates increased by EUR 32 million. The linking of interest rates to EURIBOR also stimulated portfolio growth. Another measure taken to reduce interest rate risk in 2010 was a revision of the interest rates paid on deposits, with the aim of encouraging longer maturities.

Operational Risk Management

The Group Operational Risk Policy is in full compliance with Basel II, German banking legislation. In addition ProCredit Bank Serbia also meets National Bank of Serbia regulations. To minimise operational risk, all processes are precisely documented and subject to effective control mechanisms. Job descriptions are comprehensive, duties are strictly segregated, and dependency on key individuals is avoided.

When recruiting, the bank pays close attention to personal integrity, a quality which is reinforced through the bank's strictly enforced code of conduct and through comprehensive training programmes designed to promote a culture of transparency and risk-awareness.

The group-wide Risk Event Database (RED) ensures that operational risks are addressed in a systematic and transparent manner, with all remedial and preventive action clearly documented and accessible to management control, both at bank level and at group level. Staff are required to report all events which represent an actual or potential loss exceeding EUR 100 using the RED interface. In the near future, all risk events will be entered directly in the RED by the process owner.

Furthermore, as part of their initial training, all new staff members are taught how to recognise and avoid operational risk and how to maintain information security. Additional training on these issues, and on how to use the RED, is given to the main users of the system, i.e. heads of departments and supervisors at head office level. In 2010, ProCredit Bank Serbia reported 100 risk events representing a total net risk amount of EUR 349,323. Typical events reported in RED include incorrectly processed payment orders, cash differences, and damage to vehicles or bank premises. In the majority of cases, losses of this kind are covered by compensation or by insurance. Every case of actual or attempted robbery or fraud is also reported, as is any potential risk that could be a source of loss in the future.

Every year the bank conducts a risk assessment procedure by completing a group-wide questionnaire on fraud risk and operational risk. Each of the risks described here must be mitigated by appropriate controls, the adequacy of which is the subject of the assessment. If the controls are judged to be insufficient, an action plan for remedying the situation is drawn up. The completed assessment is sent to the Group Operational Risk Management Department.

In 2010 the bank introduced the group-wide New Risk Approval (NRA) process, which is applied to all materially new or changed products, services or business processes. Only after the elimination of any obstacles or deficiencies revealed by the NRA process does management give its approval for the innovation to go ahead.

The bank's Business Continuity Policy ensures that the bank can maintain or restore its operations in a timely manner in the event of a serious disruption. As well as defining the steps to be taken to restore normal operations, the bank's Business Continuity Plan specifies the procedure for moving critical operations to temporary locations, the resources that need to be mobilised in each type of case and the expected cost of disruptions in specific areas. It also offers guidance on avoiding disruption in the first place. ProCredit Bank Serbia has a rigorous three-part Business Continuity Plan that addresses general emergency situations, power failures and IT system integrity.

Fraud has been recognised as the most significant source of operational risk, especially in the context of lending operations. To offset this risk, the bank has established clearly defined procedures and control mechanisms for loan approval, disbursement and monitoring. In addition, a dedicated fraud prevention team has been set up to address all fraud cases and propose countermeasures. The bank has since introduced a system for anonymous reporting of incidents and training courses aimed at raising fraud awareness.

Anti-Money Laundering

ProCredit Bank Serbia fully endorses the fight against money laundering and terrorist financing, and has implemented the Group Anti-Money Laundering Policy, which meets the requirements of Serbian, German and EU legislation. No customer is accepted and no transaction is executed unless the bank understands and agrees to the underlying purpose of the business relationship. The Group Anti-Money Laundering Department (Group AML) conducts an annual survey of all ProCredit banks and updates the policy accordingly. In addition, all ProCredit banks submit quarterly reports on their AML activities to Group AML.

At ProCredit Bank Serbia, responsibility for AML activities is exercised by the Compliance and AML Unit, employing one compliance officer, two AML specialists and a unit supervisor. The Unit prepares daily reports on all cash transactions exceeding EUR 15,000. In addition, any attempt to execute a transaction that arouses suspicion of money laundering, terrorist financing or some other criminal activity must be reported, regardless of the amount. Front-office staff receive intensive training in how to recognise suspicious transactions. In cases of doubt, Group AML takes the final decision on how to handle the suspicious transactions and suspicious customers reported by the bank. In the near future, the bank plans to automate its AML screening process: the AML, Embargo and PEP modules of the specialist software package Siron are scheduled to be installed in the first quarter of 2011.

Capital Adequacy

The bank's capital adequacy is calculated on a monthly basis and reported both to the management and to the Group Risk Management Committee, together with rolling forecasts to ensure future compliance with capital adequacy requirements. Strong support from our shareholders once again enabled the bank to maintain a comfortable capital cushion. At year-end 2010 the capital adequacy ratio (tier 1 and tier 2 capital / risk-weighted assets) stood at 14.4%, well above the group-wide target of 12%. Capital adequacy according to local regulations was 17.45%, which is also significantly above the locally required minimum of 12%.

ProCredit Bank's ratings, issued by FitchRatings, remained unchanged in 2010. For foreign currency credit, its long-term Issuer Default Rating (IDR) was BB- and its short-term IDR was B; for local currency, its long-term and short-term ratings were BB and B, respectively.

Branch Network

At the end of 2010, ProCredit Bank Serbia had a total of 38 branches and 19 service points located in 38 different towns and cities across the country. In order to ensure efficient communication between the branches and the bank's headquarters, and to promote co-operation among branches in the same part of the country, the network is organised into four regions. The branches in the Northern Region cover Vojvodina province, Serbia's largest agricultural region, and therefore have a sizeable farming clientele. Two of the branches – Novi Sad NS in the heart of Vojvodina, and Kralja Petra in the Central Region – focus almost exclusively on agricultural lending.

In 2010, as part of our effort to respond in a more differentiated manner to our customers' needs, we made significant improvements to the structure of our branch network. Our lending business is now concentrated in a smaller number of specialised branches, where the majority of our business client advisers and credit analysts are now based. These branches provide not only credit products but also all of the bank's other services for business clients and private individuals, including various types of account services, foreign exchange, money transfers and utilities payments. A number of branches have been branded as Business Centres, which specifically aim to provide more complex services to larger small businesses and medium-sized enterprises.

In addition to these full-scale branches, the bank now also operates smaller service points in stra-

tegic, often densely populated neighbourhoods. The service points are designed to be convenient places for both private individuals and enterprises to do their day-to-day retail banking business, but do not process loan applications. Before deciding which branches should be converted into service points, the bank performed a careful analysis of the market potential and available resources in each location. During 2010, a total of 19 new service points were created, while 22 branches were closed in order to concentrate the available resources in locations where they could make the greatest impact on service quality.

Also in line with the shift towards a more pronounced customer focus, improvements were made to the interior design of the branches. Client advisers' desks are now located in areas separate from the front office, providing individual spaces for confidential negotiations. At the same time, separate cash booths have been abandoned in favour of a "one-stop" system, allowing customers to conduct both cash and non-cash transactions at a single front office desk, located conveniently near the entrance.

Our retail services include debit and credit cards, which both business clients and private individuals can use to withdraw cash at any of our 151 ATMs, nine of which were installed in 2010, or to make cashless purchases using POS terminals operated by local merchants. During 2010 we installed 76 new POS terminals at our business customers' premises, bringing the total to 538.

In 2011 we plan to continue to optimise the new branch network model by relocating several more branches to new locations better suited to their purpose and the scale of their business. We also expect to reinforce the image of the Business Centres as competence centres offering specialised services, such as EU credit programmes, energy efficiency lending, etc.

Organisation, Staff and Staff Development

In line with the group-wide focus on enhancing the quality of the relationship with our customers and improving service quality in 2010, the bank intensified its efforts to advance the professional and personal development of its staff. During the year, our employees participated in more than 600 internal training days, not including attendance at the international ProCredit Academies.

The bank's Training Department consists of eight full-time staff who are responsible for all aspects of training, from needs analysis, budgeting and design through delivery and evaluation. Reporting directly to the Executive Board, Training Department staff co-operate closely with other departments so that internal business trainers can provide optimal training for all employees. New employees receive tutoring for six months.

In 2010, the bank's training facilities were upgraded, including a simulation of the new branch layout and front office set-up. A small training centre was also set up in head office as a venue for special simulation trainings and workshops. In addition, a new e-learning platform was introduced that not only reduces costs, but also adds value to the way our employees develop: staff have easy access to knowledge and can absorb it at their own pace, which improves retention of the new information.

In the context of the ProCredit group's international initiative to raise the level of mathematical knowledge among its staff, ProCredit Bank Serbia hired a dedicated maths trainer who provided intermediate and advanced maths courses to more than 100 employees. Nearly 1,000 staff obtained maths training from material accessible via the bank's e-library. This combination of classroom instruction and self-guided learning bolstered the staff's maths skills, with 99% of employees passing the group-wide "Maths 1" examination in 2010.

A large proportion of the training provided to current and potential middle managers takes place outside Serbia at the international ProCredit Academies. In 2010, five colleagues from ProCredit Bank Serbia graduated from the ProCredit Regional Academy for Eastern Europe in Veles, Macedonia, while another 12 completed the first year of their six-block course. Three of the bank's staff earned their "ProCredit Banker" diploma, marking the successful completion of the highly intensive three-year programme offered at the central ProCredit Academy in Fürth, Germany.

The adoption of a new group-wide business strategy in 2010, with its increased emphasis on building long-term customer relationships, necessitated various changes to the bank's organisational structure. At head office level, several new departments were created to reflect the shift from a product-based to a client-based approach. For example, back-office credit operations were centralised, and a new operations support and development department now assists the branches in providing service to new customers.

The internal organisation of the branches was also revised, with separate front office areas for business clients and private individuals, respectively. In this context, various assessments were undertaken to ensure that staff had the requisite skills for their assignments within this modified structure. For example, the Business Client Advisers, who are responsible for advising clients on all of the bank's products and services and for acquiring new customers, were chosen for this new position on the strength of their communication skills. At the same time, experienced loan officers with the strongest analytical expertise were given the opportunity to focus on evaluating applications for credit services submitted by comparatively large, complex business clients. In all cases, intensive training was given to reassigned staff to prepare them for their new duties.

Given the bank's focus on consolidation and quality in 2010, recruitment of new personnel took place on a much more limited scale than in previous years. Nonetheless, 45 people joined the bank in 2010, bringing the total at year-end to 1,422 (including support staff and employees on maternity leave or other long-term leave). In line with the ProCredit group's new recruitment policy, all shortlisted applicants are now invited to take a "maths and logic" test, which is set by ProCredit Holding. Successful candidates then take part in group discussions and role plays, where among other things their interpersonal skills are assessed, followed by individual in-depth interviews with senior staff of the bank.

Another innovation in the year under review was the introduction in November of the ProCredit Stipend Course, which is offered to candidates who show potential but do not yet have the requisite qualifications for a full-time position. This six-month programme covers maths and basic accounting as well as banking-specific subjects.

ProCredit Bank Serbia understands that the key to providing high quality service lies in building a team of motivated, professionally competent staff who are jointly committed to the bank's mission and objectives, and who work well together on the basis of mutual trust and respect. For this reason, in addition to its substantial investment in training, the bank also approves an activities budget on a quarterly basis that managers can use for various team-building initiatives with their staff, such as sporting events, cultural outings, dining, etc.

Business Ethics and Environmental Standards

Part of the overall mission of the ProCredit group is to set standards in the financial sectors in which we operate. We want to make a difference not only in terms of the target groups we serve and the quality of the financial services we provide, but also with regard to business ethics. Our strong **corporate values** play a key role in this respect. Six essential principles guide the operations of the ProCredit institutions:

- **Transparency**: We adhere to the principle of providing transparent information both to our customers and the general public and to our employees, and our conduct is straightforward and open;
- **A culture of open communication**: We are open, fair and constructive in our communication with each other, and deal with conflicts at work in a professional manner, working together to find solutions;
- **Social responsibility and tolerance**: We offer our clients sound advice and assess their economic and financial situation, business potential and repayment capacity so that they can benefit from the most appropriate loan products. Promoting a savings culture is an important part of our mission, and we are committed to treating all customers and employees with fairness and respect, regardless of their origin, colour, language, gender or religious or political beliefs;
- **Service orientation**: Every client is served in a friendly, competent and courteous manner. Our employees are committed to providing excellent service to all customers, regardless of their background or the size of their business;

- **High professional standards**: Our employees take personal responsibility for the quality of their work and always strive to grow as professionals;
- **A high degree of personal commitment**: This goes hand-in-hand with integrity and honesty – traits which are required of all employees in the ProCredit group.

These six values represent the backbone of our corporate culture and are discussed and actively applied in our day-to-day operations. Moreover, they are reflected in the ProCredit Code of Conduct, which transforms the group's ethical principles into practical guidelines for all staff. To make sure that new employees fully understand all of the principles that have been defined, induction training includes sessions dedicated to the Code of Conduct and its significance for all members of our team. Regular refresher training sessions help to ensure that employees remain committed to our high ethical standards and are kept abreast of new issues and developments which have an ethical dimension for our institution. These events allow existing staff to analyse recent case studies and discuss any grey areas.

Another aspect of ensuring that our institution adheres to the highest ethical standards is our consistent application of best practice systems and procedures to protect ourselves from being used as a vehicle for money laundering or other illegal activities such as the financing of terrorist activities. An important focus here is to "know your customer", and, in line with this principle, to carry out sound reporting and comply with the applicable regulations. Updated anti-money laundering and fraud prevention policies are being introduced across the group to ensure compliance with German regulatory standards.

We also set standards regarding the impact of our lending operations on the environment. ProCredit Bank Serbia has implemented an environmental management system based on continuous assessment of the loan portfolio according to environmental criteria, an in-depth analysis of all economic activities which potentially involve environmental risks, and the rejection of loan applications from enterprises engaged in activities which are deemed environmentally hazardous and appear on our institution's exclusion list. By incorporating environmental issues into the loan approval process, ProCredit Bank Serbia is also able to raise its clients' overall level of environmental awareness. We also ensure that requests for loans are evaluated in terms of the applicant's compliance with ethical business practices. No loans are issued to enterprises or individuals if it is suspected that they are making use of unsafe or morally objectionable forms of labour, in particular child labour.

In addition, ProCredit Bank Serbia is actively involved in promoting energy efficiency and green initiatives amongst its staff and its clients. The bank aims to promote economic development that is as environmentally sustainable as possible. ProCredit Bank Serbia introduced a "Leasing for Energy Efficiency" programme for small businesses during 2010, under which 134 leasing contracts had been signed by the end of the year. In addition, the bank has drawn funds on a credit line set up by KfW to encourage lending to small and medium businesses for energy efficiency projects. The first disbursements under this line are expected to be made during 2011.

ProCredit Bank staff have been involved in a number of local environmental projects in 2010, including the government-supported "Clean up Serbia" initiative, in which nearly 500 employees took part, cleaning river banks, parks and other public spaces in a common effort to raise awareness and bring environmental issues to the attention of the general public. The bank also took an active role in the "Green Serbia" conference, held in April in Belgrade with the support of the Ministry of Ecology, which was also aimed at promoting environmental protection. Environmental issues are an essential component of the training provided to ProCredit Bank staff at the local, regional and international level.

The ProCredit Group: Responsible Neighbourhood Banks for Small Businesses and Ordinary People

The ProCredit group comprises 21 financial institutions providing banking services in transition economies and developing countries. ProCredit banks are responsible neighbourhood banks. This means, in the neighbourhoods in which we work, we aim to:

- be the house bank of choice for the very small, small and medium-sized enterprises which create jobs and drive economic development, and
- provide secure and transparent savings and banking services to ordinary people who are looking for an affordable bank they can trust.

At the end of 2010 our 15,600 employees, working in some 740 branches, were serving 3 million customers in Eastern Europe, Latin America and Africa.

The history of the ProCredit group is a rich one and forms the basis of what we are today. The first ProCredit banks were founded more than a decade ago with the aim of making a development impact by promoting the growth of small businesses. We sought to achieve this by providing loans tailored to their requirements and offering deposit facilities that would encourage low-income individuals and families to save. The group has grown strongly over the years, and today we are one of the leading providers of banking services to small business clients in most of the countries in which we operate.

Our origins lie in our pioneering microfinance positioning. This positioning has developed as our markets and our clients have developed so our socially responsible approach remains as relevant today as ever. Its importance has been underscored by the financial crisis and subsequent significant macroeconomic decline which most of our countries of operation experienced over the last two years. As enterprises adjust to and expand again in their new economic reality and ordinary people rebuild their trust in banks, it is clear that our customers need a reliable banking partner now more than ever. This has also given us the impetus to further strengthen our comprehensive customer-oriented approach with more highly specialised and well trained staff.

Unlike most other banks operating in our markets, we have always avoided aggressive consumer lending and speculative lines of business. Instead, the ProCredit banks work in close contact with their clients to gain a full understanding of the problems small businesses face and the opportunities that are available to them. Our credit technology, developed over many years with the support of the German consulting company IPC, relies on the careful individual analysis of credit risks. By making the effort to know our clients well and maintain long-term relationships based on trust and understanding, we are well positioned to support them not only when the economy is buoyant, but also during a downturn and recovery. Over the last two years, the ability of our loan officers to proactively make appropriate adaptations to payment plans where necessary to reflect clients' new and more challenging sales environments has played an important role in maintaining good loan portfolio quality.

We not only extend loans, but also offer our enterprise clients a broad range of other banking services such as cash management, domestic and international money transfers, payroll services, POS terminals and payment and credit cards. These services are geared towards assisting our business clients to operate more efficiently and more formally and thus help to strengthen the real economy and the banking sector as a whole. In these terms ProCredit has a “whole customer” focus rather than a simple product focus. Our staff and our branches are becoming more specialised and better equipped to cater to the needs of different client segments.

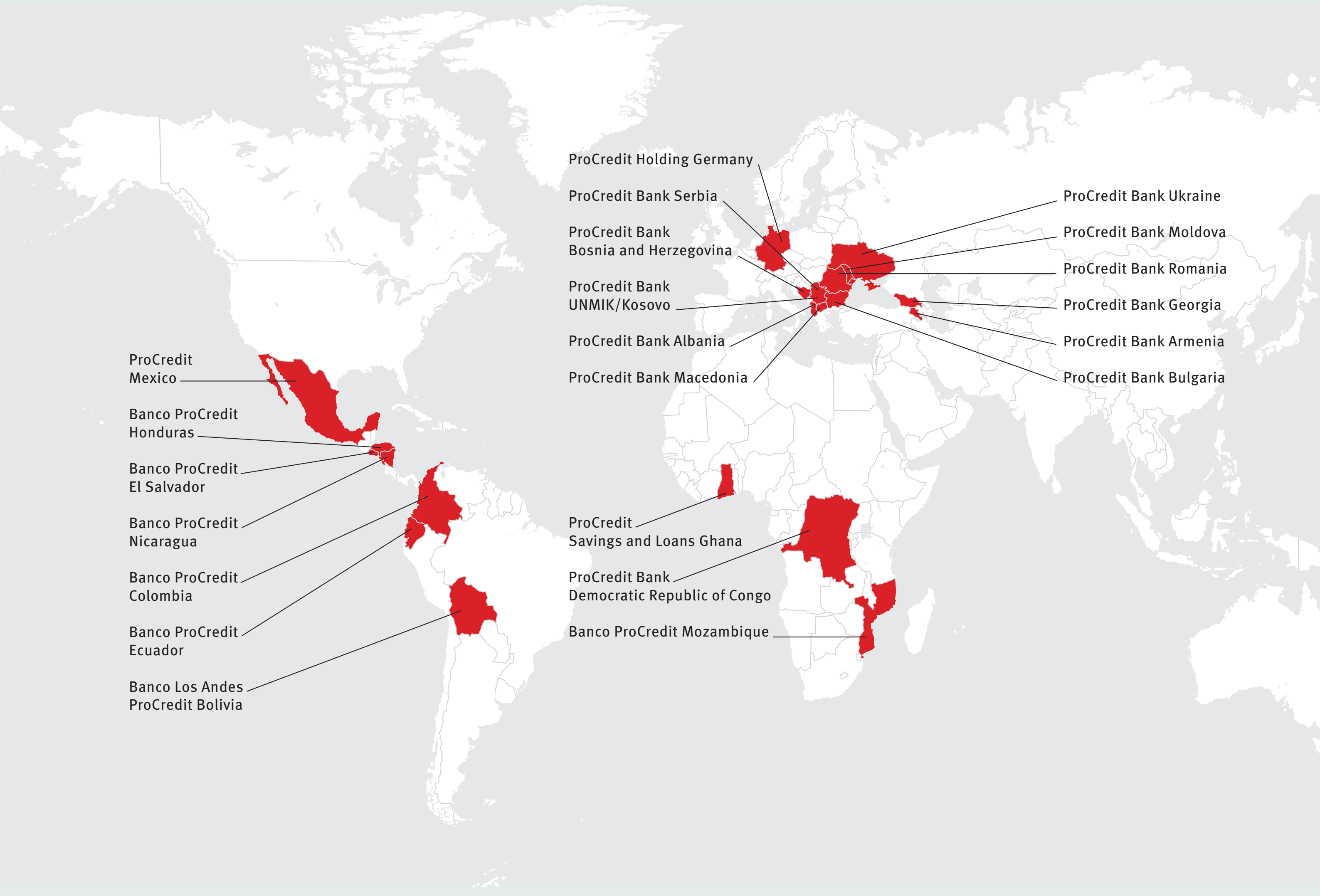
Today we have less of a focus on traditional “microfinance” than we did in the past. At the end of 2009, we increased the minimum loan size for enterprise clients to EUR/USD 2,000 in most countries since we found that below this limit there is such broad access to loans from consumer finance providers that “excess” had become more of a challenge for many clients than “access”. For these groups we prefer to offer deposit accounts and other banking services rather than credit.

Our targeted efforts to foster a savings culture in our countries of operation have enabled us to build a stable deposit base. ProCredit deposit facilities are appropriate for a broad range of lower- and middle-income customers. We place particular emphasis on working with the owners, employees and families associated with our core target group of very small, small and medium-sized businesses. ProCredit banks offer simple savings products and place great emphasis on promoting children's savings accounts and on running financial literacy campaigns in the broader community. In addition to deposit facilities, we offer our clients a full range of standard retail banking services. Over 2010 ProCredit institutions managed to maintain a high level of liquidity given the stability of their loyal retail deposit base.

The ProCredit group has a simple business model: providing banking services to a diverse range of enterprises and the ordinary people who live and work around our branches. As a result, our banks have a transparent, low-risk profile. We do not rely heavily on capital market funding and have no exposure to complex financial products. Furthermore, our staff are well trained, flexible and able to provide competent advice to clients, guiding them through difficult times as well as good times. Despite the turmoil of the global financial markets, the performance of the ProCredit group has been remarkably stable: we ended 2010 with a good liquidity position, comfortable capital adequacy, PAR over 30 days of 3.7%, and a modest profit. Given the very difficult macroeconomic situation in many of our countries of operation, this was a strong performance.

Our shareholders have always taken a conservative, long-term view of business development,

The international group of ProCredit institutions; see also ***www.procredit-holding.com***



aiming to strike the right balance between a shared developmental goal – reaching as many small enterprises and small savers as possible – and achieving commercial success.

Strong shareholders provide a solid foundation for the ProCredit group. It is led by ProCredit Holding AG, a German-based company that was founded by IPC in 1998. ProCredit Holding is a public-private partnership. The private shareholders include: IPC and IPC Invest, an investment vehicle set up by IPC and ProCredit staff members; the Dutch DOEN Foundation; the US pension fund TIAA-CREF; the US Omidyar-Tufts Microfinance Fund; and the Swiss investment fund responsAbility. The public shareholders include the German KfW Bankengruppe (KfW banking group); IFC, the private sector arm of the World Bank; the Dutch development bank FMO; the Belgian Investment Company for Developing Countries (BIO) and Proparco, the French Investment and Promotions Company for Economic Co-operation. The group also receives strong support from the EBRD and Commerzbank, our minority shareholders in Eastern Europe, and from the Inter-American Development Bank (IDB) in Latin America. With the strong support of its shareholders and other partners, the ProCredit group ended the year with a total capital adequacy ratio of 16.5% – a figure that reflects their confidence in the group.

ProCredit Holding is not only a source of equity for its subsidiaries, but also a guide for the development of the ProCredit banks, providing the personnel for their senior management and offering support in all key areas of activity. The holding company ensures the implementation of ProCredit corporate values, best practice banking operations and Basel II risk management principles across the group. The group's business is run in accordance with the rigorous regulatory standards imposed by the German banking supervisory authority (BaFin).

ProCredit Holding and the ProCredit group place a strong emphasis on human resource management. Our "neighbourhood bank" concept is not limited to our target customers and how we reach them; it also concerns the way in which we work with our staff and how we encourage them to work with their customers. The strength of our relationships with our customers will continue to be central to working with them effectively in 2010 and achieving steady business results. In 2010 there was a strong focus on staff quality and efficiency, which resulted in a 20% reduction in the number of staff over the year. This focus has been supported by the introduction of a new group-wide recruitment policy and a demanding training programme for all staff. This is complemented by a six month stipend or intern programme provided by ProCredit banks for new entrants into the banking sector which symbolises our commitment to skill development in all our countries of operation.

A responsible approach to neighbourhood banking requires a decentralised decision-making process and a high level of judgment and adaptability from all staff members, especially our branch managers. Our corporate values embed principles such as open communication, transparency and professionalism into our day-to-day business. Key to our success is therefore the recruitment and training of dedicated staff. We maintain a corporate culture that promotes the professional development of our employees while fostering a deep sense of personal and social responsibility. This entails not only intensive training in technical and management skills, but also frequent staff exchanges between our member institutions. In this way, we take full advantage of the opportunities for staff development that are created by the existence of a truly international group.

A central plank in our approach to training is the ProCredit Academy in Germany, which provides a part-time "ProCredit Banker" training programme over a period of three years for high-potential staff from each of the ProCredit institutions. The curriculum includes intensive technical training and also exposes participants to subjects such as anthropology, history, philosophy and ethics in an open and multicultural learning environment. Our goal in covering such varied topics is to give our future managers the opportunity to develop their knowledge and views of the world. At the same time, we aim to improve their communication and staff management skills. The group also operates three Regional Academies in Latin America, Africa and Eastern Europe to support the professional development of middle managers at the local level.

The group's strategy for 2011 focuses on two key interrelated themes "high quality customer relations" and "efficiency". We will further expand our business as the "house bank" of choice for small and very small enterprises, offering tailored loans and other banking services. At the same time we will continue to improve the speed and convenience of our services for all clients.

Strong investment in our staff will also remain a key priority since it is their skills which enable us to build strong, broad-based relationships with our clients, which are a particularly important factor of success in volatile macroeconomic conditions. As a group of responsible banks for ordinary people with prudent policies and well-trained staff to ensure our steady performance, we look forward to consolidating our position as a "house bank" for small businesses, their employees, and the ordinary people who live and work in the neighbourhoods around our branches.

ProCredit in Eastern Europe

ProCredit operates in 11 countries across Eastern Europe. It is a leading provider of banking services to very small, small and medium-sized businesses in the region. ProCredit banks provide a high standard of transparent, professional services to all their clients – the ordinary people who live and work in the vicinity of the 457 ProCredit branches across the region.

2010 proved to be another challenging year for the South Eastern and Eastern European countries in which ProCredit works. Most countries in South Eastern Europe experienced no GDP growth or GDP decline over the year as they continued to adjust to the fallout of the financial sector crisis. Only Albania and the more eastern countries (Armenia, Georgia, Moldova and Ukraine) experienced more steady GDP growth of 4-5%. The development of banking sectors in the region also continued to be depressed as non-performing loans (NPLs, i.e. loans more than 90 days overdue) that were originally disbursed in the pre-crisis boom years now work their way through the system. In most markets, sector NPLs were over 10% at the end of 2010.

Macroeconomic stability and signs of recovery are currently being driven above all by strong commodity prices. However, government spending remained very tight, consumer confidence low and activity in the small and medium enterprise sector depressed in 2010. Prospects for 2011 are somewhat more encouraging and ProCredit banks are working closely with their enterprise clients to support their ability to respond to gradually emerging opportunities. Indeed, more widely, the role of ProCredit banks against this still vulnerable economic backdrop is a valuable one as our clients and the financial markets in which we operate adjust to the new economic reality in the region.

For the financial sectors in which we work, ProCredit banks have represented consistency, good risk management and a high degree of financial transparency throughout the past two unsettled years. ProCredit banks have been notable in continuing to lend steadily and responsibly to support small businesses whilst banking sectors as a whole have tended to be restrictive or erratic.

For our enterprise clients, ProCredit banks remain a reliable and responsible partner. We specialise in working with very small, small and medium enterprises, because these segments are central to developing the economy and employment opportunities. Our approach is based on building strong relationships with our clients and a thorough understanding of their business.

This means we disburse loans which help a business to develop and are in line with a company's ability to repay. It also allows us, for example, where necessary to appropriately adapt loan repayment schedules if the sales pattern of a business has changed significantly. This has helped some of our clients endure through the crisis and has meant that arrears and write-off figures for the ProCredit banks in Eastern Europe are relatively low. The combined PAR (Portfolio at Risk > 30 days) for the Eastern European institutions as a percentage of their loan portfolio was 4.1% at the end of 2010 (PAR>90 days stood at 3.0%). Write-offs for the group in the region amounted to 1.2% of the loan portfolio.

Asset quality decline amongst the Eastern European institutions was concentrated in Bosnia, Bulgaria, Romania and Ukraine, countries in which the pre-crisis boom in consumer lending was most extreme and the level of overindebtedness in the banking sector as a whole therefore most marked. The performance of ProCredit banks across the region and in these countries remains very strong when compared to the market as a whole. In these terms ProCredit continues to demonstrate that with a responsible approach to lending, based on a thorough understanding of the real situation of an enterprise, a high degree of financial stability can be achieved for clients and in bank performance.

At the same time our enterprise loan portfolio grew over 2010. The outstanding loan portfolio of the 11 ProCredit banks in Eastern Europe stood at EUR 2.7 billion at the end of 2010 (an increase of 6.9% from the end of 2009). In 2010, ProCredit staff have been proactive in acquiring new clients and serving existing clients, especially supporting responsible investment opportunities as well as good management of working capital,

liquidity and receivables. Our lending activities aim in particular to foster local production and service industries, and include the provision of agricultural loans. We are keen to support a sector that has been particularly neglected by other banks and that is vital for employment and social cohesion outside the main urban areas.

In 2010, in addition to developing their core segments (very small and small enterprises taking loans with a volume of less than EUR 150,000), ProCredit banks also grew with clients in the "medium enterprise" segment (defined as clients taking loans above EUR 150,000) by some 20%, illustrating a need from such businesses for capital which was not being provided by other banks. For very small and small businesses in the region, ProCredit banks remain the leading bank group specialised in meeting their needs. These businesses are still relatively informal, but are operating in steadily formalising markets which are becoming more competitive. It takes a focused bank with well trained staff to work sustainably with this segment. In summary, ProCredit banks have firmly established themselves as broad-based enterprise banks able to cover the full spectrum of demand.

For our private person clients, ProCredit banks have also been a symbol of stability and transparency in turbulent years. ProCredit has focused for many years on promoting a savings culture because setting money aside can help clients build a buffer against the vagaries of life, and the ratio of deposits to GDP in Eastern European countries is still well below Western European levels.

We offer simple and reliable retail banking services. Our belief in transparent, direct communication is particularly important in fostering clients' trust in these difficult times. We understand that our clients want to know in simple language how to save safely; they also want to access their money when they need it and they want access to convenient and efficient transaction services. In 2010, as in 2009, our experience confirmed that our clients appreciate the transparent, responsible approach we take.

ProCredit banks fund most of their lending activities from local savings. The ratio of deposits to loans in the ProCredit banks in the region is close to 90%. Not only did we not have to rely on unpredictable capital markets for funds in 2010, but ProCredit banks in the region remained highly

liquid throughout the year and our cost of funds declined.

Looking forward, in addition to the savings services they provide, ProCredit banks will continue to be very conservative with consumer loans for their private person clients, but will expand their provision of convenient banking services, such as e-banking and direct debit, and will continue to provide responsible housing improvement, energy efficiency and other loans which help build a family's assets.

For our staff, ProCredit banks offer unique opportunities for professional development and job satisfaction given our strong client orientation, open communication culture and unusual commitment to staff training. In terms of institution building activities, ProCredit banks in Eastern Europe were, like the rest of the ProCredit group, focused above all on quality and efficiency rather than quantity in 2010. The pre-crisis boom years in Eastern Europe encouraged all banks, including ProCredit banks, to invest heavily in staff numbers and branch infrastructure, which needed to be brought back in line with prevailing economic conditions. This has provided the context for ProCredit banks to also review staff standards and our training efforts as well as bank processes and procedures – to ensure our institutions are ideally aligned with demand and the efficient services required by our clients. As a result, branch infrastructure has been reviewed, staff numbers reduced and greater job specialisation implemented.

Our staff is the key element in our approach to being a stable, down-to-earth and personal banking partner. The ProCredit group invests a lot to achieve high standards in staff recruitment and development. Staff exchanges, cross-border training programmes and regional workshops are an important part of our approach. To complement the international academy in Germany, we have an Eastern European Academy, located near Skopje in Macedonia, which is dedicated to the training of ProCredit middle managers. The regional academy is an important channel for rapid and consistent communication region-wide and one that helps us adapt quickly to face new challenges. A language centre at the academy also provides residential English courses, maximising the potential for international exchange within the group. Investment in our staff is an ongoing commitment and will remain a central plank in the ProCredit Bank approach. A qualified, motivated and professional team lies at the root of our lasting success across Eastern Europe.

Name	Highlights*	Contact
ProCredit Bank Albania	Founded in October 1998 40 branches 29,791 loans / EUR 172.1 million in loans 195,053 deposit accounts / EUR 242.0 million 672 employees	Legal address: Sami Frashëri St., Tirana Mailing address: Dritan Hoxha St., Tirana P.O. Box 2395 Tel./Fax: +355 4 2 389 300 / 22 33 918 info@procreditbank.com.al www.procreditbank.com.al
ProCredit Bank Armenia	Founded in December 2007 9 branches 4,512 loans / EUR 39.0 million in loans 18,116 deposit accounts / EUR 19.4 million 240 employees	105/1 Teryan St., area 11 0009 Yerevan Tel./Fax: + 374 10 514 860 / 853 info@procreditbank.am www.procreditbank.am
ProCredit Bank Bosnia and Herzegovina	Founded in October 1997 26 branches 20,746 loans / EUR 119.2 million in loans 97,249 deposit accounts / EUR 111.7 million 460 employees	8 Emerika Bluma 71000 Sarajevo Tel./Fax: +387 33 250 950 / 971 info@procreditbank.ba www.procreditbank.ba
ProCredit Bank Bulgaria	Founded in October 2001 75 branches 42,286 loans / EUR 562.5 million in loans 220,971 deposit accounts / EUR 373.5 million 1,268 employees	26 Todor Aleksandrov Blvd. 1303 Sofia Tel./Fax: +359 2 813 5100 / 5110 contact@procreditbank.bg www.procreditbank.bg
ProCredit Bank Georgia	Founded in May 1999 58 branches 49,060 loans / EUR 250.7 million in loans 436,898 deposit accounts / EUR 202.4 million 1,640 employees	154 D. Agmashenebeli Ave. 0112 Tbilisi Tel./Fax: +995 32 202222 / 202223 info@procreditbank.ge www.procreditbank.ge
ProCredit Bank UNMIK/Kosovo	Founded in January 2000 62 branches 93,510 loans / EUR 494.8 million in loans 409,502 deposit accounts / EUR 676.1 million 1,107 employees	16 “Mother Tereze” Boulevard 10000 Prishtina Tel./Fax: +381 38 555 777 / 248 777 info@procreditbank-kos.com www.procreditbank-kos.com
ProCredit Bank Macedonia	Founded in July 2003 30 branches 26,790 loans / EUR 148.5 million in loans 118,067 deposit accounts / EUR 139.2 million 541 employees	109a Jane Sandanski Blvd. 1000 Skopje Tel./Fax: +389 2 321 99 00 / 01 info@procreditbank.com.mk www.procreditbank.com.mk
ProCredit Bank Moldova**	Founded in December 2007 23 branches 11,249 loans / EUR 61.4 million in loans 38,802 deposit accounts / EUR 24.7 million 454 employees	65 Stefan cel Mare Ave. office 901, Chisinau Tel./Fax: +373 22 836555 / 273488 office@procreditbank.md www.procreditbank.md
ProCredit Bank Romania	Founded in May 2002 37 branches 28,900 loans / EUR 180.8 million in loans 118,147 deposit accounts / EUR 133.5 million 830 employees	62-64 Buzesti St., Sector 1 011017 Bucharest Tel./Fax: +40 21 201 6000 / 305 5663 headoffice@procreditbank.ro www.procreditbank.ro
ProCredit Bank Serbia	Founded in April 2001 57 branches 95,198 loans / EUR 507.2 million in loans 329,216 deposit accounts / EUR 316.2 million 1,299 employees	17 Milutina Milankovica 11070 Belgrade Tel./Fax: +381 11 20 77 906 / 905 info@procreditbank.rs www.procreditbank.rs
ProCredit Bank Ukraine	Founded in January 2001 40 branches 17,089 loans / EUR 190.3 million in loans 125,129 deposit accounts / EUR 130.0 million 1,017 employees	107a Peremohy Ave. 03115 Kyiv Tel./Fax: +380 44 590 10 17 / 01 info@procreditbank.com.ua www.procreditbank.com.ua

* The figures in this section have been compiled on the basis of the financial and operational reporting performed in accordance with group-wide standards; they may differ from the figures reported in the bank’s local statements.

** Not including finance company ProCredit Moldova.

Our Clients

Jovan Velja, 58, is a technology engineer specialised in chemical production and has immense experience in this field. He founded his company, Hemodom, 22 years ago near Novi Sad in northern Serbia as a small family enterprise that produced detergents and tools for maintaining hygiene in industrial facilities. Today the company has 14 employees and a range of over 50 products. Operating countrywide, Hemodom cleans the production lines of various businesses in the metal, milk, meat and beverage industries.

Looking for a reliable source of financing for his small family business, Mr. Velja made inquiries at several banks. After deciding that ProCredit had the most professional service, he began a long-term business relationship with the bank, taking out and repaying four different loans by 2009.

“Some of the banks I worked with treated me well, but others lacked professionalism and failed to understand my needs,”
he says of his experiences with local banks.

In 2009, Hemodom was the first company in Serbia to obtain a government-subsidised investment loan. ProCredit Bank and the client pioneered the procedure for this type of loan and Mr. Velja used the funds he received to build new production premises.

“ProCredit Bank’s professionalism led me to choose it as my main bank. Most of all, I appreciate the precise information they give me and the fact that they honour our agreements. ProCredit also takes a proactive approach to serving its clients, both through its daily activities and by holding events such as education seminars.”

Impressed by ProCredit’s customer outreach, Mr. Velja agreed to speak at a seminar held by the bank in May 2010 for dozens of journalists. He gave an inspiring and insightful presentation about the issues that SMEs in Serbia face today.

With a view to passing on his business to the next generation of his family, Mr. Velja hopes to continue working with the bank.

“Two of my four sons are already in the business and I want to help them to secure their future. If the professionalism and readiness for co-operation I have experienced so far continues, I will count on ProCredit Bank’s support to further develop Hemodom as a family company.”

Katalin Muzlai, Cattle Breeder

Katalin Muzlai, 50, has been a successful farmer and cattle breeder all her life. Today, she grows corn, wheat, soy and sunflowers on her own 40 hectares and rents 170 more near the village of Backo Gradiste in northern Serbia. Her average crop yields are among the highest in the nation, and each of her 92 cows produces more than 6,000 litres of milk a year, making Ms. Muzlai one of the leading milk producers in the Vojvodina region. She has long-term contracts with a number of well-known buyers, mainly large dairy producers.

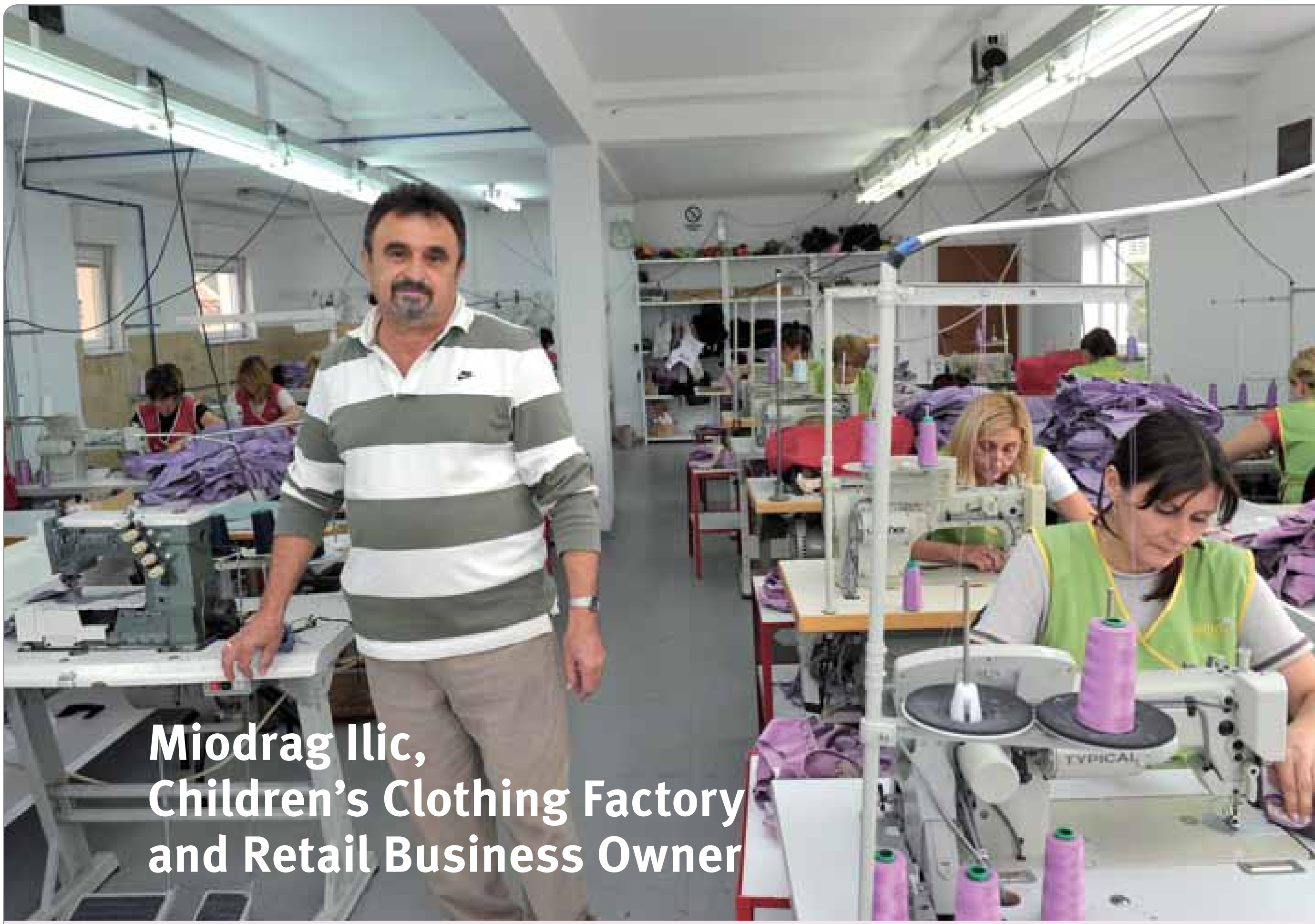
Ms. Muzlai first started using ProCredit's services in 2006 and has never looked back. She has taken out four loans and also uses the bank's money transfer services. Her most recent loan was spent on watering equipment, and her two sons, who also own agricultural enterprises, use ProCredit's services as well.

"After 5 years with ProCredit Bank, I can say that I am truly pleased with the way it has supported me. In addition to offering tailor-made products and services, ProCredit gives me advice that I can rely on. The bank's staff understand my needs, and that makes everything a lot easier."

Ms. Muzlai's commitment to improving and upgrading her business was recognised by ProCredit Bank's "ProAgro Leader" contest jury, which selected her as the winner in 2010. This award honours outstanding rural producers in Serbia who boost productivity and modernise their operations through careful investment.

"I plan to upgrade my production capacities and modernise my equipment in the near future. More importantly, I want to invest in training the people who work on my farm; improving their skills is the key to ensuring the ongoing success of my business. I am counting on ProCredit Bank's continuing support and professionalism to achieve these goals,"
Ms. Muzlai explains.

In addition, having decided that energy efficiency measures and renewable energy sources are the next step in improving her business and quality of life, Ms. Muzlai recently started using biomass to heat her living and production premises. Here again, she knows that ProCredit will support her every step of the way.



Miodrag Ilic, Children's Clothing Factory and Retail Business Owner

Miodrag Ilic, 57, is a technology engineer. In 1985 he left his job in Kragujevac as a lecturer on textile technology to start a children's clothing business. His company, "Kolibri", started out as a small production facility in central Serbia that produced just enough clothing for Mr. Ilic's retail shop.

"I started using the bank's services as soon as it opened in Kragujevac in 2001. As domestic money transfer services had been discontinued in Serbia, I immediately entrusted my transfers to ProCredit,"

he explains.

Business has grown since then and today the company employs 29 people, with Mr. Ilic in charge of production. All Kolibri employees receive their salaries through the current accounts at ProCredit Bank, and the company has been using e-banking services since they were first introduced in 2002. Over the years, Mr. Ilic has taken out 8 loans for a total of more than EUR 75,000, with the first loan being used to implement new production technologies. As a result of his determination and sound management of the company, along with the ongoing support provided by ProCredit over the years, Kolibri is now able to produce more than 35,000 garments annually in a 580 m² facility.

With high-quality, well-designed clothing made of select materials, Kolibri is firmly established in the local market; Mr. Ilic is now taking steps to export his products to surrounding countries. His further development plans include expanding the production process and making technological improvements. Purchasing new equipment for printing and washing his materials is high on the agenda, and once again Mr. Ilic is counting on the bank's support to achieve his goals.

"I appreciate the bank's professionalism and also the kindness of the employees. It means a lot to us to be able to conduct our financing and banking business quickly and accurately. I know I can continue to rely on ProCredit in my efforts to overcome the current crisis and further develop Kolibri."

Aleksandra Zoric Krzic, Savings Client

Aleksandra Zoric Krzic, 40, lives in Belgrade and works as a project manager and adviser. During the 1990s, a time characterised by mistrust of banks and a deregulated market, many people – including Aleksandra – preferred to keep their savings at home. In 2003, she decided that it was time to put her money in a bank. After examining the market and making inquiries at several banks, she found that ProCredit offered the services she wanted.

"Although the ProCredit's interest rates were similar to those of the other banks I had used, the efficiency and courtesy of the staff really won me over. In addition, the fact that the bank doesn't have the standard protective glass between tellers and customers made everything feel more personal and direct. All of these factors convinced me that ProCredit was the right bank."

Soon after making her first deposit, Aleksandra opened a savings account at ProCredit Bank for her 6-year-old daughter. Aleksandra's father Sava, a retired physician, followed in his daughter's footsteps and also transferred his savings to the bank in 2007.

"After four years of reliable, high-quality banking and excellent customer service at ProCredit Bank, I arranged to have my salary deposited directly into my current account and I also applied for a housing loan – which was recently approved! A long-term loan means a long-term business relationship with the bank, so it was extremely important to ensure that I would be obtaining good service. I have been very satisfied so far."

In addition to taking advantage of the bank's credit products, salary deposit services and savings options, Aleksandra uses ProCredit's e-banking services and has debit and credit cards issued by ProCredit Bank, thus using almost the complete spectrum of the bank's products and services for private individuals.

Financial Statements

For the year ended 31 December 2010.
Prepared in accordance with International Financial Reporting Standards.

pwc

Independent auditor's report

To the Shareholder's of ProCredit Bank a.d. Belgrade

We have audited the accompanying financial statements of ProCredit Bank a.d. Belgrade and its subsidiaries, which comprise the consolidated balance sheet as at 31 December 2010 and the consolidated statements of comprehensive income, changes in equity and 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.

Auditor's 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 ProCredit Bank a.d. Belgrade and its subsidiaries as at 31 December 2010, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers doo

PricewaterhouseCoopers d.o.o. Belgrade
16 March 2011
Belgrade, Serbia

PricewaterhouseCoopers d.o.o., Omladinskih brigada 88a, 11070 Belgrade, Republic of Serbia
T: +381 11 3302 100, F:+381 11 3302 101, www.pwc.rs

Business Registration Agency of Republic of Serbia
Company ID Number: 17147862, Number of Registration: 709, PIB: 100148170
Bank Account No: 275-0000220018415-04 kept with Societe Generale Banka Srbija AD Bank, Bulevar Zorana Đinđića 50a Street, 11070 Belgrade
Wholly Owned Company, Subscribed and paid capital: In Money 3,270,316.68 EUR, In Kind: 56,171.20 EUR

Consolidated Income Statement

For the year ended 31 December 2010

in thousands of dinars	Notes	Year ended 31 Dec 2010	Year ended 31 Dec 2009
Interest and similar income		7,308,677	8,073,500
Interest expense and similar charges		(2,740,493)	(3,478,264)
Net interest income	4	**4,568,184**	**4,595,236**
Allowance for impairment losses on loans and advances	5	(994,356)	(874,067)
Net interest income after allowances		**3,573,828**	**3,721,169**
Fee and commission income		1,196,778	1,213,677
Fee and commission expense		(160,339)	(158,277)
Net fee and commission income	6	**1,036,439**	**1,055,400**
Net trading income	7	172,406	283,901
Net result from financial assets at fair value through profit or loss	8	11,909	(19,437)
Operating income	9	76,567	152,637
Operating income		**260,882**	**417,101**
Personnel expenses		2,493,498	2,410,537
Other administrative expenses		1,871,389	1,913,158
Operating expenses	10	**4,364,887**	**4,323,695**
Operating result		**506,261**	**869,974**
Tax expenses	11	(61,089)	(62,456)
Profit for the year		**445,172**	**807,518**

Consolidated Statement of Comprehensive Income

	2010	2009
Profit for the year	445,172	807,518
Change in revaluation reserve from available-for-sale financial assets	(2,825	4,873
Change in deferred tax on revaluation reserve from available for sale assets	283	(487)
Total other recognized income and expense	(2,542)	4,386
Total recognized income and expense	**442,630**	**811,904**

The accompanying notes on pages 50 to 83 form an integral part of these consolidated financial statements.

ProCredit Bank a.d. Belgrade
Consolidated Financial Statements for the year ended 31 December 2010
(All amounts expressed in thousand of Dinars unless otherwise stated)

Consolidated balance sheet

	Note	As of 31 December	
		2010	2009
ASSETS			
Cash and balances with the Central Bank	12	21,025,345	22,366.213
Loans and advances to banks	13	713,645	780,898
Loans and advances to customers	14	46,976,356	40,671,768
Derivative financial assets	15	105	4
Available-for-sale financial assets	16	13,618	13,973
Other financial investments	17	7,924	7,924
Intangible assets	18	220,676	251,010
Property and equipment	19	1,316,447	1,483,578
Deferred income tax assets	20	251,489	270,891
Current Tax assets	21	1,855	-
Other assets	22	375,794	539,415
Total assets		**70,903,254**	**66,385,674**
LIABILITIES			
Deposits from banks	23	2,195,180	349,697
Derivative financial liabilities	24	5,649	4,832
Due to customers	25	37,132,726	37,645,140
Other borrowed funds	26	19,350,784	16,543,430
Subordinated debt	27	2,886,643	2,621,912
Tax liabilities	28	-	10.814
Provisions	29	92,232	84,148
Other liabilities	30	568,952	561,632
Total liabilities		**62,232,166**	**57,821,605**
EQUITY			
Share capital	31	3,663,012	3,663,012
Share premium	31	2,776,745	2,776,745
Retained earnings		584,625	773,336
Revaluation reserve on property and equipment		2,842	5,384
Special banking risk reserves	32	1,643,864	1,345,592
Total equity		**8,671,088**	**8,564,069**
Total equity and liabilities		**70,903,254**	**66,385,674**

The accompanying notes on pages 6 to 75 form an integral part of these consolidated financial statements.

These consolidated financial statements have been approved by Executive Board on 15 March 2011 and signed on their behalf by:

Svetlana Tolmacheva
Chairperson of the Executive Board

ProCredit Bank a.d. Beograd

Dejan Janjatovic
Member of the Executive Board

Consolidated Statement of Changes in Equity

For the year ended 31 December 2010

in thousands of dinars	Notes	Share Capital	Share Premium	Retained earnings	Revaluation reserve on available for sale (Restated)	Special banking risk reserves	Total
At 01 January 2009		**3,663,012**	**2,776,745**	**545,328**	**998**	**1,076,186**	**8,062,269**
Total comprehensive income		–	–	807,518	4,386	–	811,904
Transfer to special banking risk reserves	32	–	–	(269,407)	–	269,407	–
Distributed dividends				(310,103)	–		(310,103)
At 31 December 2009		**3,663,012**	**2,776,745**	**773,336**	**5,384**	**1,345,592**	**8,564,069**
Total comprehensive income		–	–	445,172	(2,542)	–	442,630
Transfer to special banking risk reserves	32	–	–	(298,272)	–	298,272	–
Distributed dividends		–	–	(335,611)	–	–	(335,611)
At 31 December 2010		**3,663,012**	**2,776,745**	**584,625**	**2,842**	**1,643,864**	**8,671,088**

The accompanying notes on pages 50 to 83 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2010

in thousands of dinars	Notes	Year ended 31 Dec 2010	Year ended 31 Dec 2009
Cash flow from operating activities:			
Profit before tax		506,261	869,974
(Decrease)/Tax liabilities		(10,814)	–
Adjustments for non-cash items:			
Impairment loss		994,356	803,140
Depreciation and amortization		304,629	370,787
Unrealized gains on foreign currency revaluation		9,495	(42,939)
Provisions		8,084	(90,534)
Net cash flow from operating activities before changes in operating assets and liabilities		**1,812,011**	**1,910,428**
Changes in operating assets:			
(Increase)/decrease in derivative financial assets		(101)	(4)
(Increase) in loans and advances to customers		(6,398,669)	(2,238,539)
(Increase) in other assets		163,621	(215,488)
		(6,235,149)	**(2,454,031)**
Changes in operating liabilities:			
(Decrease)/ increase in deposits from banks		1,845,483	(2,854,303)
Increase/(Decrease) in due to customers		(512,414)	7,222,375
Increase in other liabilities		7,320	199,799
		1,340,389	**4,567,871**
Net cash from/ (used in) operating activities		**(3,082,749)**	**4,022,942**
Cash flow from investing activities:			
Proceeds from disposal of property and equipment		3,393	125
Purchase of property and equipment and intangible assets		(151,608)	(480,969)
Net cash (used in) investment activity		**(148,215)**	**(480,844)**
Cash flow from financing activities:			
Increase in other borrowed funds		12,522,895	4,966,498
Repayments of other borrowed funds		(10,364,441)	(9,525,054)
Paid dividends		(335,611)	(398,940)
Net cash (used in)/from financing activities		**1,822,843**	**(4,957,496)**
Net (decrease) in cash and cash equivalent		**(1,408,121)**	**(1,415,134)**
Cash and cash equivalents as at 1 January		**23,147,111**	**24,562,245**
Cash and cash equivalents as at 31 December	33	**21,738,990**	**23,147,111**

The accompanying notes on pages 50 to 83 form an integral part of these consolidated financial statements.

Notes to the Financial Statements

For the year ended 31 December 2010

All amounts expressed in thousands of Dinars unless otherwise stated

1. General information

ProCredit Bank a.d. Beograd (the "Bank") was established in 2001 as a Joint Stock Company. The National Bank of Yugoslavia (the Central Bank) issued the Bank with a banking license on 5 April 2001.
In 2003, the Bank changed its name from Micro Finance Bank a.d. Beograd to ProCredit Bank a.d., Beograd.
As at 31 December 2010 the Bank's shares are owned by two shareholders: ProCredit Holding AG Frankfurt am Main, with holdings of 83.33 percent and Commerzbank AG Frankfurt am Main of 16.67%.
The Bank is licensed in the Republic of Serbia to perform payment transfers, credit and deposit activities in the country and abroad, and in accordance with the Republic of Serbia law, is to operate on principles of liquidity, security of placements and profitability.
The Bank established ProCredit Leasing d.o.o. as Limited Liability Company. The ProCredit Leasing d.o.o. is registered with the Agency for legal entities Belgrade under register number 1973/2005 as of 17th February 2005. The Bank is 100% owner of ProCredit Leasing.
The Group consists of the Bank and its subsidiary ProCredit Leasing d.o.o.
The Group is controlled by ProCredit Holding AG, Germany, which owns 83.33% of shares. The remaining 16.67% is owned by Commerzbank AG. The ultimate parent of the group is ProCredit Holding AG.
On 31 December 2010, the Group has head office located in Belgrade, Milutina Milankovica 17 and 57 branches throughout Serbia.
These consolidated financial statements have been approved for issue by the Executive Board on April, 15 2011.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

A) Basis of preparation

The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared under the historical cost convention, except for available for sale financial assets, all derivative financial instruments which have been measured at fair value.
The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the consolidated financial statements are disclosed in Note 2Z.
The consolidated financial statements are presented in RSD, which is the Group's presentational currency. The figures shown in the consolidated financial statements are stated in RSD thousand.

(a) Standards effective for annual periods beginning on or after 1 January 2010
The following new standards and interpretations became effective for the Group from 1 January 2010:

IFRIC 17, Distributions of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets should be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 did not have an impact on these financial statements.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 did not have an impact on these financial statements.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 requires an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interest") even if this results in the non-controlling interests having a deficit balance (the previous standard required the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary has to be measured at its fair value.

The Group has changed its accounting policy for the accounting for loss of control or significant influence from 1 January 2010.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 allows entities to choose to measure non-controlling interests using the previous IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer has to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. Acquisition-related costs are accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer has to recognise a liability for any contingent purchase consideration at the acquisition date. Changes in the value of that liability after the acquisition date are recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The revised IFRS 3 did not have a material impact on these financial statements.

Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2, Share-based Payment (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard. The amendments did not have a material impact on these financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment did not have a material impact on these financial statements.

IFRS 1, First-time Adoption of International Financial Reporting Standards (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The revised standard did not have a material impact on these financial statements.

Additional Exemptions for First-time Adopters - Amendments to IFRS 1, First-time Adoption of IFRS (effective for annual periods beginning on or after 1 January 2010). The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments did not have a material impact on these financial statements.

Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. In addition, the amendments clarifying classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary published as part of the Annual Improvements to International Financial Reporting Standards, which were issued in May 2008, are effective for annual periods beginning on or after 1 July 2009. The amendments did not have a material impact on these financial statements.

Unless otherwise stated above, the amendments and interpretations did not have any significant effect on the Group's consolidated financial statements.

B) Consolidation

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights.
The Bank has only one 100% owned subsidiary – ProCredit Leasing d.o.o.
Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

C) Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Serbian Dinars (RSD), which is the functional and presentation currency of the Group entities.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

D) Financial assets

The Group classifies its financial assets in the following categories: loans and receivables and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

Classes of financial assets

The Group classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table below:

Category of financial assets per IAS39	Class determined by the Bank	Subclass
Financial assets at fair value through profit and loss	Derivative financial assets	Derivatives – non-hedging
Loans and receivables	Loans and advances to banks	Banks within the Group
Loans and receivables	Loans and advances to banks	OECD banks
Loans and receivables	Loans and advances to banks	Domestic and non-OECD banks
Loans and receivables	Loans and advances to customers	Business
Loans and receivables	Loans and advances to customers	Agricultural
Loans and receivables	Loans and advances to customers	Housing
Loans and receivables	Loans and advances to customers	Finance leases
Loans and receivables	Loans and advances to customers	Consumer
Loans and receivables	Loans and advances to customers	Other
Available for sale financial assets	Available for sale financial assets	Listed
Available for sale financial assets	Other financial instruments	Unlisted

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

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception.
A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if it is 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. Derivatives are also categorized as held for trading unless they are designated as hedging instruments.

Financial assets and financial liabilities are designated at fair value through profit or loss when:

- Doing so significantly reduces measurement inconsistencies that would arise if the related derivatives were treated as held for trading and the underlying financial instruments were carried at amortized cost for loans and advances to customers or banks and debt securities in issue'
- Certain investments, such as equity investments, are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis are designated at fair value through profit and loss; and
- Financial instruments, such as debt securities held, containing one or more embedded derivatives significantly modify the cash flows, are designated at fair value through profit and loss.

Gains and losses arising from changes in fair value are included directly in the consolidated income statement and are reported as 'Net trading income'. Interest income and expense and dividend income and expenses on financial assets held for trading are included in 'Net interest income' or 'Dividend income', respectively.

Gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in "Net result from financial assets through profit and loss".

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. All loans and advances are initially recognized at fair value. All loans and advances are recognized when cash is advanced to borrowers. After initial recognition, these are subsequently measured at amortized costs using the effective interest rate method. Amortized cost is calculated by taking into account any issue costs and any discount or premium on settlement.

(c) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available for sale. The Group did not classify any financial asset as held-to-maturity during reporting period.

(d) Available-for-sale financial assets

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.
Regular-way purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognized on trade-date – the date on which the Group commits to purchase or sell the asset.
Financial assets are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the income statement. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortized cost using the effective interest method.

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognized directly in other comprehensive income until the financial asset is derecognized or impaired. At this time, the cumulative gain or loss previously recognized in other comprehensive income is recognized in profit or loss. However, interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available for sale is recognized in the income statement.
The fair value of investments quoted in an active market is based on current supply (financial assets) or demand (financial liabilities). If the market of a financial asset is inactive, the bank shall determine fair value by using valuation techniques. This includes application of recent transactions among independent parties, analysis of discounted cash flows and other valuation techniques used by market participants. The valuation models reflect current market conditions on the date of valuation, whereby such conditions are not necessarily applicable for the period before or after the valuation date. On the balance sheet date, management of the bank revises those models to make sure they faithfully represent current market conditions, including relative market liquidity and interest margins.
Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost.

E) Financial Liabilities

Financial liabilities that are not classified as at fair value through profit or loss fall into category. Other liabilities and are measured at amortised cost. Financial liabilities measured at amortised cost are deposits from banks or customers, convertible bonds and subordinated debts.

The Group classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table below:

Category per IAS39		Class determined by the Bank
Financial liabilities	Financial liabilities at fair value through profit and loss	Derivative financial liabilities
Financial liabilities	Financial liabilities at amortized cost	Deposits from banks
Financial liabilities	Financial liabilities at amortized cost	Due to customers
Financial liabilities	Financial liabilities at amortized cost	Other borrowed funds
Financial liabilities	Financial liabilities at amortized cost	Subordinated debt
Off-balance sheet exposure	Loan commitments	Loan commitments
Off-balance sheet exposure	Guarantees, acceptances and other financial liabilities	Guarantees, acceptances and other financial liabilities

F) Offsetting financial instruments

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

G) Derivative financial instruments and hedge accounting

Derivatives are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Gains and losses arising from changes in fair value of derivatives are included in "Net trading income". However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with financial assets or financial liabilities designated at fair value are included in 'Net result from financial assets at fair value through profit or loss'.
The Group had only economic hedging transactions during the reporting period.

Embedded derivatives
The Bank negotiates a currency clause with the beneficiaries of the loans.. Foreign-currency clause is an embedded derivative that is not accounted for separately from the host contract since the economic characteristics and risks of the embedded derivative are closely related to the host contract. Gains/losses arising on this basis are recorded in the income statement within "Net trading income".

H) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognized within 'interest income' and 'interest expense' in the income statement using the effective interest method.
The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.
Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

I) Fee and commission income

Fees and commissions are generally recognized on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognized as an adjustment to the effective interest rate on the loan.

J) Sale and repurchase agreements

Securities purchased under agreements to resell ('reverse repos') are recorded as Cash and balances with Central Bank. Reverse repos are included in cash and cash equivalents if they have a maturity less than three months from the date of acquisition. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

K) Impairment of financial assets carried at amortized cost

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

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:
- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Downgrading below investment grade level.

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between three months and 12 months; in exceptional cases, longer periods are warranted.
The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.
The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement.
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.
For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.
Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.
Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.
When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.
If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the income statement in impairment charge for credit losses.

L) Impairment of financial assets classified as available for sale

The Group assesses at each date of the consolidated statement of financial position whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the consolidated income statement. Impairment losses recognised in the consolidated income statement on equity instruments are not reversed through the consolidated income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the consolidated income statement.

M) Intangible assets

Acquired computer software licences are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized on the basis of the expected useful lives and the period licences are issued for. Software has a maximum expected useful life of 5 years. Cost associated with developing or maintaining computer software programs are recognized as an expense as incurred.

N) Property and equipment

Premises are stated at historical cost less accumulated depreciation and provision for impairment, where required. Equipment is stated at cost, less accumulated depreciation and provision for impairment, where required.
As at 31 December 2008 the Group performed a revaluation of its Head Office building in accordance with IAS 16. The valuation was performed by an independent valuer. The building value was determined by the valuer using the Comparative Market Price Method. The Group has recorded in revaluation reserves within Other comprehensive income the amount of RSD 579,995 thousand, net of related deferred tax.
In 2009 the Group changed accounting policy and all premises are stated at historical cost less accumulated depreciation and provision for impairment, where required (Note 2Y).
Historical cost includes expenditure that is directly attributable to acquisition of the items.
Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to other operating expenses during the financial period in which they are incurred.
Depreciation of fixed assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings – 40 years,
- Leasehold improvements – shortest of 10 years or leasehold contract duration,
- Motor vehicles – 5 years,
- Furniture – 10 years,
- Computers – 5 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.
Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in other operating expenses in the income statement.

O) Impairment of non-financial assets

Assets that are subject to amortization and depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

P) Leases

(a) A group company is the lessee

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases.
The leases entered into by the Group are primarily operating leases. The total payments made under operating leases are charged to other operating expenses in the income statement on a straight-line basis over the period of the lease.
When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized as an expense in the period in which termination takes place.

(b) A group company is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognized as a receivable. The difference between the gross receivable and the present value of the receivable is recognized as unearned finance income. Lease income is recognized over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

Q) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than a three-month maturity from the date of acquisition, including cash and non-restricted balances with Central Bank, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks and short-term government securities.

R) Provisions

Provisions for legal claims are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.
Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any item included in the same class of obligations may be small.
Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

S) Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.
Financial guarantees are initially recognized in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortization calculated to recognize in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of Management.
Any increase in the liability relating to guarantees is taken to the income statement under other operating expenses.

T) Employee benefits

(a) Pension obligations

The Group operates a defined contribution pension plan. The Group companies pay contributions to publicly administered pension insurance plans on a mandatory basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

(b) Other employee benefits

The Group companies provide termination benefits, as required by the Labour Code in Serbia. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and/or the completion of a minimum service period and is calculated as three monthly average salaries in Serbia in the month before employee retirement. The expected costs of these benefits are accrued over the period of employment. The defined benefit obligation is valued annually by independent qualified actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

The assumptions used by actuary in calculation of the retirement benefits are as follows:
- Three average salaries in December 2010 per economy;
- Estimated annual increase in salaries of 3%; and
- Discounting rate of 8%.

U) Current and deferred income tax

a) Current income tax

Income tax presents the amount calculated and paid to the tax authorities based on legislations of Republic of Serbia. Estimated monthly installments are calculated by the Tax authority and paid in advance on a monthly basis.
Income tax at the rate of 10% is payable based on the profit disclosed in the Tax return. In order to arrive at the taxable profit, the accounting profit is adjusted for certain permanent differences and reduced for certain investments made during the year. Tax return is submitted to tax authorities 10 days after submission of the financial statements, i.e. until the 10 March of the following year.
According to Serbian tax law, the Group is entitled to use tax credits based on the amounts invested in property and equipment and number of new employees hired and to reduce the current income tax liability. Tax credits on new employees hired can be used by the Group only in the year when declared. Tax credit on new investments in property and equipment can be carried forward for a period on 10 years. In order to be eligible to use these investment tax credits, the Group should not dispose related property and equipment items during a period of three years from the year when tax credit was declared. Tax credit calculation is open to tax audit by Tax Administration in a period of 5 years from the year when the tax become due for payment.

b) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.
Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.
The principal temporary differences arise from depreciation of property and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and tax losses carried forward. The rates enacted or substantively enacted at the balance sheet date are used to determine deferred income tax.
Deferred tax assets are recognized for all deductible temporary differences, unused tax assets and unused tax losses, to the extent that it is probable that future taxable profits will be sufficient to enable realization (utilization) of deductible temporary differences, unused tax assets and unused tax liabilities.
Deferred tax related to fair value re-measurement of available-for-sale investments, which are charged or credited directly to other comprehensive income is also credited or charged directly to other comprehensive income and subsequently recognized in the income statement together with the deferred gain or loss.

V) Borrowings

Borrowings are recognized initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between proceeds net of transaction costs and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

W) Share capital

(a) Share issue costs

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognized in equity in the period in which they are approved by the Bank’s shareholders.
Dividends for the year that are declared after the balance sheet date are dealt with in the subsequent events note.

X) Repossessed property

In certain circumstances, property is repossessed following the foreclosure on loans that are in default. Repossessed properties are measured at the lower of carrying amount and fair value less costs to sell and reported within ‘Other assets’.

Y) Comparatives

Where necessary, comparative figures have been reclassified to conform with changes in presentation in the current year. Reclassifications in Balance sheet were made.

a) Adjustment of opening balance and comparatives

Balance Sheet	Effect on 2008
Property and equipment as at 31 December 2008	**2,347,528**
Reversal of revaluation	(644,439)
Restated Property and equipment as at 31 December 2008	**1,703,089**
Revaluation reserves as at 31 December 2008	**580,993**
Reversal of revaluation	(579,995)
Restated Revaluation reserves as at 31 December 2008	**998**
Deferred tax liability as at 31 December 2008	**64,444**
Reversal of deferred tax	(64,444)
Restated Deferred tax liability as at 31 December 2008	–

As at 31 December 2008 the Group performed a revaluation of its Head Office building in accordance with IAS 16. The Group has recorded in revaluation reserves within Other comprehensive income the amount of RSD 579,995 thousand, net of related deferred tax. In 2009 the Group changed accounting policy and all premises are stated at historical cost less accumulated depreciation and provision for impairment, where required.

Z) Critical accounting estimates and judgments

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment losses on loans and advances

The Group reviews its loan portfolio to assess impairment at least on a monthly basis. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Provisions

Provisions in general are highly judgmental, especially in the cases of legal disputes. The Group assesses the probability of an adverse event as a result of a past event to happen and if the probability is evaluated to be more than fifty percent, the Group fully provides for the total amount of the liability. The Group is rather prudent in these assessments, but due to the high level of uncertainty, in some cases the evaluation may not prove to be in line with the eventual outcome of the case.

3. Financial risk management

The Group's activities are exposed to a variety of financial risks. This exposure demands organized activities related to analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects of risks on the Group's financial performance.
The Group's risk management procedures are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Group regularly reviews its risk management procedures and systems to reflect changes in markets, products, legislature and emerging best practice.
Risk management is carried out by a Group's Risk Department and specialized Risk Committees under procedures approved by the Board of Directors. The Risk Department identifies, evaluates financial risks and makes proposals to Risk Committees to hedge those risks in close co-operation with the Group's business units. The Board of Directors provides principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments. In addition, internal audit is responsible for the independent review of risk management and the control environment. The most important types of risk are:

- Credit risk,
- Liquidity and funding risk,
- Market risks (including currency risk, interest rate and other market price related risks),
- Operational and other risks.

Impact of the Crisis to Operations of the Group

The world financial crisis triggered by sub-prime mortgage crisis in the United States of America, during 2008 led to global financial instability, decline in investment levels in the global capital market, slowdown in bank lending, and substantial fluctuations in the securities market. In the second half of 2008 it led to recession in the majority of developed countries. Consequently, the crisis spread from the financial sector to the real economy.
During 2008 and 2009, the majority of developed countries adopted a package of measures aimed at mitigating effects of the world crisis and boosting the economy for the purpose of economic recovery and job protection. The package of measures was expanded with participation of the National Bank of Serbia that in October 2008 annulled the liability of required reserves on credit funds from abroad, and simultaneously froze the level of required reserves for the liabilities originating from the period before 30 September 2008. NBS subsequently introduced some short-term or long-term stimulating measures by creating new or amending the existing by-laws. At the beginning of 2009 the Government of the Republic of Serbia adopted a package of measures as a support to economy and revitalization of bank lending activities. In the course of 2010 the Government of the Republic of Serbia resumed its stimulating measures through various programs and mechanisms, including subsidized lending program.
After the decline of 0.6% in 2009, world economy showed large growth percentage in 2010 of 5% which is above expectations. However, this is the result of the envisaged growth in China of 10.3%, while eurozone showed growth of just 1.8% while Central and Eastern Europe had growth of 4.3% during 2010. Projections for 2011 assess growth of world economy on the lower level than in 2010 (4.4%).
At the same time, during 2010 Serbia recorded growth in GDP of 1.5%, following the decline of 3.5% in 2009. MMF forecast for 2011 assess increase in gross domestic product of 3%.
The Bank's clients – borrowers were faced in 2009 and 2010 with decrease in liquidity, which can also be expected in 2011, and which may have implications on their capacity to duly service the liabilities arising from disbursed loans and other placements. Likewise, aggravation of borrowers' business conditions may exert adverse impact on cash flows projected by the Bank's management, as well as on our estimate of impairment of financial and non-financial assets. Pursuant to information availability, the management accurately gave projections for the future cash flows in terms of assessment of impairment.
Lack of liquidity in the Serbian market also has unfavourable impact on the fair value of collateral the Bank keeps as pledge for loans and other placements. Such an adverse effect is reflected on marketability and real market value of most collateral items, including residential, commercial immovable assets, as well as different types of movable pledge. Precisely this fall in fair value of collateral items may lead to increase in the assumed credit risk, and subsequently trigger losses.
Taking into account the above-mentioned situation and its potential effects, the Bank put extra efforts into keeping the adverse effects of the crisis under control during 2009 and 2010. To that end, the Bank invested additional efforts to minimize the crisis effects on the Bank's exposure to market risk, financial risk and credit risk, as well as general economic situation. This includes a set of measures, processes and activities in the area of monitoring loan borrowers, receivable collection, change of lending conditions and required pledge, training and recruitment of employees in the domain of financial analysis and outstanding debt recovery. The Bank places special emphasis on exposure to particular client categories, i.e. business activities subject to significant influence of the crisis.

A) Management of the Overall Risk Profile

The Group is not allowed to take on more risk than it is capable of bearing. This rule is put into operation using specified limits for all types of risks and a risk bearing capacity model, which stipulates that at all times the predefined economic Tier I + II capital has to be available to cover potential losses. This model was further developed in the course of 2009 and 2010. Results are presented below.

The capital management of the Group has the following objectives:
- Full compliance with external capital requirements set by the regulators of the banking sectors in the jurisdictions where the group entities operate.
- Meeting the internally defined minimum capital adequacy requirements.
- Enabling the Group to implement its plans for continued growth while following its business strategy as a "neighbourhood bank".

The capital management of the ProCredit Banks is ruled by the Group Policy on Capital Management and the Group Policy on Risk Bearing Capacity. To ensure that the above stated objectives are met at all times, the Bank uses four indicators. Aside from regulatory and Basel II capital ratios, the leverage ratio and risk bearing capacity are monitored on a monthly basis by ALCO.

A.1. Capital Adequacy
External minimum capital requirements are imposed and monitored by the local banking supervision authorities – the National Bank of Serbia. Local supervision is based on stand-alone financial statements according to local accounting rules.

During the reporting period, all regulatory capital requirements have been met at all times.
The Group's objectives when managing capital can be set down as following demands:
- To comply with the capital requirements set by the National Bank of Serbia
- To comply with the capital requirements set by International Financial Institutions according to long term loans contracts
- To ensure expected stability of growth and development and strong basis for further progress of Group's business

Capital adequacy is planned in detail in the process of business planning. The National Bank of Serbia is informed of achieved capital adequacy ratio on a quarterly basis.
The National Bank of Serbia requires that every bank, at any moment, has minimum of EUR 10 million of share capital in nominal amount and capital adequacy ratio of minimum 12%.

The Bank's capital consists of 3 parts:
- Tier 1 capital, which consists of share capital, share premium, reserves, retained earnings, profit/loss from buying own shares, deducted by non-material investments;
- Tier 2 capital, which consists of subordinated loan capital and reserves from profit for general banking risks up to 1.25% of risk weighted assets, preferential shares, emission premium based on preferential shares, revalorization reserves based on investments in fixed assets and subordinated liabilities of the bank up to 50% of core capital;
- Deductable items, which consist of collective impairment allowances, share in capital of banks or other financial institutions exceeding 10% of capital of the organisation that is invested into, and 10% of the investing bank capital and the amount of the tier 2 capital of the bank which exceeds its tier 1 capital.

Table below shows capital elements and calculation of capital adequacy as per IFRS standards for the years ended on 31 December.

	2010	2009
Tier 1 capital		
Share capital	3,663,012	3,663,012
Share premium	2,776,745	2,776,745
Legal reserves	1,345,592	1,345,592
Retained earnings	773,336	773,336
Intangible assets	(214,157)	(251,010)
Total qualifying Tier 1 capital	**8,344,528**	**8,307,675**
Tier 2 capital	**2,276,198**	**1,649,627**
Deductions from equity	**(335,611)**	**(335,611)**
Total regulatory capital	**10,285,115**	**9,621,691**
Risk weighted assets		
Assets weighted by credit risk	62,547,387	55,213,836
Open currency position	985,118	506,163
Total risk weighted assets	**63,532,505**	**55,719,999**
Capital adequacy ratio	**16.19%**	**17.27%**

During the year 2010 there were no additional increases of capital compared to end of 2009.

A.2. Risk Bearing Capacity

In addition to regulatory capital ratios, the Group assesses its capital adequacy by using the concept of risk bearing capacity to reflect the specific risk profile of the Group, i.e. comparing the potential losses arising from its operation with the bank's risk bearing capacity.

The risk taking potential of the bank is defined as the equity (net of intangibles) plus subordinated debt, which amounted to RSD 11,298,414 thousands as of the end of December 2010. The Resources Available to Cover Risk (hereinafter: RAtCR) were set at 60% of the risk-taking potential, i.e RSD 6,779,048 thousands. The table below shows risk bearing capacity limit and the level of utilisation as of the end of December 2010 and 2009.

	Limit *in %*	**Actual** *in %*	**Limit**	**Actual**
2010	60.0	36.7	11,298,414	4,146,018
2009	60.0	30.2	10,902,057	3,295,909

As the above table indicates, the Group showed a modest level of utilisation of its RAtCR as of end of December 2010. All risks combined, as quantified by the methods established in the group's policies, are considerably below the 60% of the group's total risk-bearing potential as defined. Further information on the methods of quantifying the various risk categories is given in the following chapters.

B) Credit risk

The Group takes exposure to credit risk which is the risk that a counterparty will be unable or unwilling to pay the debt amounts in full when due. The Group's primary exposure to credit risk arises through its loans to customers.

In order to keep the credit risks on acceptable level the Group:

- Evaluates creditworthiness of each client individually including his/her exposure to loans and off balance liabilities;
- Analyzes risks arising from the investment which is the loan purpose;
- Determines limits of credit exposure to its clients;
- Approves loans only to creditworthy clients and gathers appropriate means of collateral;
- Separates process of maintaining client relationship from the process of assessing client's creditworthiness, which applies to all loans to medium clients;
- Takes mandatory down-payment of 20% to 30% for each financial leasing contract with the client as the cushion against the depreciation of the value of the subject of leasing.

B.1. Policy of Loan Approvals

To control the credit risk exposure, the bank has defined a prudent lending policy. The clients that are subjects of the lending process are carefully analyzed. The decisions on loan approval are made on the basis of client's loan repayment capability and appropriate means of collateral as loan coverage. All clients must fulfil the following criteria:

- To have stable and profitable business (in case of legal entities, entrepreneurs and agriculture producers),
- Appropriate capability for future loan repayment (applies to all clients),
- In case that the bank identifies maturity mismatches between certain types of assets and liabilities in client's balance sheet, this mismatch has to be justifiable (in case of legal entities, entrepreneurs and agriculture producers),
- Cash flow does not indicate potential problems (in case of legal entities, entrepreneurs and agriculture producers),
- Good credit history and repayment behaviour in ProCredit Bank and/or other banks (applies to all clients),
- To provide adequate collateral (applies to all clients),
- To have adequate management and organization of business (in case of legal entities, entrepreneurs and agriculture producers).

In the light of the impact of the global financial crisis on the liquidity and financial position of the Group's borrowers, the Group has tightened the level of creditworthiness of clients. Maximum exposure which includes all loan instalments versus client's monthly profitability (net cash flow) was changed and now is on the level of 50 to 70%.

B.2. Loan Loss Classification

The Group has developed procedures for classification of loans and off balance claims of the bank, with regards to the degree of credit risk associated with the client. At the same time two methodologies of loan loss classification standards were developed to satisfy the requirements of:

1. Laws and regulations enacted by the National Bank of Serbia (NBS); and
2. Internal loan loss provisioning policy.

Calculation of allowances for impairment – provisions against potential losses for ProCredit Bank

The Bank calculates allowances for loan impairment at the monthly level for the portfolio for which group provisioning is formed in the course of automatic processing, and minimum once per year for individual impairments – impairments determined at the level of individual client for clients who meet specific conditions defined in the text below (quarterly formation of an individual impairment is also possible if there are indications of a change in claim value).

In case of group provisioning (provisions at the portfolio level) a general weight for each risk class is applied through automatic processing on the calculated basis, whereas in case of calculation of individual impairment, impairment at the client level is individually determined in accordance with the risk level the Bank is exposed to.

Total impairment of balance sheet assets is the sum, the product of risk class weight and the calculated basis for accounts receivable

in the given risk class (calculated provisions), as well as the sum of individual impairments for clients with provisions at the individual level. In case of provisions at the portfolio level, risk weight defined by this document for each risk class is applied.
With respect to off-balance sheet items the Bank does not have provisions for liabilities, pursuant to internal methodology, but solely equity provisions on the basis of criteria defined by the National Bank of Serbia.
On the occasion of loan approval, the loan will according to PCB classification be classified in class I (loan is not in arrears on the occasion of approval). Credit rules and Credit risk management policy allow lending exclusively to clients with good business results who satisfy strict eligibility criteria defined by the Bank and its shareholders, ensuring thus ex-ante rigid and prudent credit risk assessment for all clients.
All balance sheet items, which should according to the general rules change the risk class in respect of the number of days in arrears, will not be reclassified if the amount in arrears is less than EUR 2.00 (31 December 2010:1 EUR = 105.4982 RSD).

Group /individual provisioning

With regards to group provisioning, provisions are calculated by applying general weight for internal risk class for the respective client and related parties with the respect of contamination principle for the outstanding amount, while in case of individual provisions the individual provisioning amount is specified for the client who meets the prescribed criteria.

Group provisioning

On a group basis loans are classified in specific internal risk classes for the party, according to the number of days in arrears, and the provisions are formed by applying general weight for a certain risk class of the party onto the basis, which is defined hereinafter. General weight is defined by internal methodology based on the migration analysis which represents historical development of the portfolio on the basis of which weights that present likelihood for a certain party to be in the status of liability non-settlement are defined in compliance with the internal policy. General provisioning weight in the preceding period and the equivalent of the Bank's average historical losses is the weight in use for a large number of parties, namely it is defined as average volume at the portfolio level.

Rules for calculation of the provisioning basis

Provisions for losses are pursuant to the internal policy allocated for loans, credit cards and authorized current account overdrafts, bill of exchange protests, private individual account fees, account transaction fees, i.e. for balance sheet assets of the bank exposed to credit risk.

The provisioning basis includes:

- Principal amount undue
- Due principal and interest, booked penalty interest
- Authorized current account overdraft – used portion of the approved limit (receivables on the balance sheet), as well as unauthorized overdraft amount
- Credit cards – used portion of the approved limit (receivables on the balance sheet), as well as unauthorized overdraft amount
- Receivables on the balance sheet originating from off-balance sheet assets, bill of exchange protests and paid letters of credit
- Account transaction fees, and private individual account fees

Receivables as the basis for calculation of provisions against loan losses are reduced by the deposit amount.

Rules for classification

Classification of the party/client relies on the following principles:

- The principle of the number of days in arrears per client's party
- Contamination principle, i.e. the party/client and all parties of related persons are monitored, and then all parties are given the lowest risk class a party has. If the client can be found in more than one group of related parties, the client will have the lowest class a party in any one of the groups of related parties has, but will not transfer this class to the party which is not in the group in which the party on the basis of which the relevant party has been allocated a lower class is located (e.g. A related to B, and A related to C, A will therefore define the class B, but B will not define the class C in cases when A has the worst class among all 3 clients).
- The portfolio of reprogrammed loans has a classification that differs from the rest of the portfolio. The breakdown of reprogrammed loans includes following categories: Standard, Watch and Impaired, depending on the criteria defined by a special document Rules for reprogrammed credit exposure. A reprogrammed loan from the category Watch (a loan in arrears over 30 days at the moment of reprogramming) will have a different risk class compared to the class defined as standard for the rest of the portfolio. Classification of the reprogrammed portfolio is a part of the document Procedure for internal classification and provisioning.
- Credit cards and fees for transaction accounts and private individual accounts will not exert impact on reclassification of other clients' parties from the viewpoint of the rule for related parties if the card/overdraft/fee claim is less than or equal to EUR 1,000 (31 December 2010: 1 EUR = 105.4982 RSD), because of their material insignificance as regards the total portfolio. These parties will have their class established according to the number of days in arrears on the classification date. Therefore, if there is a legal entity borrower in the Bank, and the owner as related party is using a credit card in the amount of up to EUR 1,000, credit card default will not have impact on reclassification of credit parties disbursed to the legal entity.

Provisioning weights:

General/group classification	Party class	Provisioning weight 2010	Provisioning weight 2009
No repayment arrears or arrears up to 30 days	I	1.00%	1.00%
Reprogrammed loan – Standard, arrears up to 30 days	Standard	3.50%	
Reprogrammed loan – Watch, arrears up to 30 days	Watch	12.00%	7.00%
Reprogrammed impaired – arrears up to 30 days	Impaired	25%	25%
Arrears between 31 and 90 days	II	55%	45%
Arrears between 91 and 180 days	III	70%	60%
Arrears between 181 and 360 days and terminated agreements	IV	100%	100%
Individual provisioning	Impairment	Individually determined	Individually determined

Individual provisioning assessment (impairment)

Individual provisioning is calculated for clients whose total debt amount to the Bank exceeds EUR 30,000 (31 December 2010: 1 EUR = 105.4982 RSD) at the moment of classification (incl. client and all parties of related persons), and whose arrears exceed 30 days at the end of the quarter (refers to both standard and reprogrammed loan). Condition satisfaction is evaluated one month prior to the end of the quarter, so that the Bank's employees could be able to prepare the analysis by the deadlines envisaged for booking.
In case of a client who has already had individual impairment calculated, fulfilment of the conditions and a new calculation are prepared on a yearly basis.
Likewise, individual impairment can be calculated even in case when the client is in arrears less than 30 days (over EUR 30,000 of total outstanding debt per group of related parties) if there are indicators of changes in the client's business, i.e. if the client is facing certain problems in business and if the indicators show that the loan will exceed 30-day arrears. When monitoring the borrower's financial position, whereby the frequency of monitoring is determined by the credit committee in accordance with the Bank's policies, the credit committee assesses the credit risk pursuant to the criteria defined by the Bank's different rules and regulations.
The frequency of monitoring is determined by the credit committee pursuant to credit rules, and it is no less than once per year for credit clients of the Bank.

When monitoring any one borrower, all factors which may have impact on aggravation of a client's eligibility, or exacerbation of the pledge quality are taken into account, which may lead to some problems in claim collection, those factors being:

- Information about the borrower's financial problems or potential aggravation of the financial situation, from borrowers' financial reports monitoring
- Possibility of business cessation on account of financial problems, owner's death or illness, changes in management structure, changes in buyer or supplier structure, changes in competition that may have a considerable adverse effect on the client's business
- Decrease in pledge value or liquidity
- Historical trend of loan instalment payments, implying it is not likely that the total loan amount will be returned by the borrower
- Other factors, such as general economic conditions, region risk, industry risk, regulatory risk, dependence on buyers and suppliers, and the like.

The Credit Analysis Department, in cooperation with the responsible Loan Officer, is in charge of preparation of the Impairment analysis for such a loan, on the basis of which the weight for individual provisioning is determined, taking also into consideration collection through pledge, and it gives proposals to appropriate credit committee level defined by credit rules, which makes the decision on individual provisioning for the respective client.

Basis

In case of individual impairments, the basis represents total amount of balance sheet receivables (due and undue principal, due interests), without deduction for deposit amount.

Analysis of discounted cash flows (impairment analysis) – defining individual impairment weights

Individual impairment of the book value of claim is determined on the basis of net present value of future inflows.
Impairment analysis is performed at the level of the group of related parties for all balance sheet receivables of the bank from that borrower. Impairment analysis should be performed once per year for each client for whom the decision to have provisions with individual weight has been reached. If material changes occur during the quarter with the respect to the moment when individual weight has previously been determined, it is necessary to do a new analysis and determine a new weight. Risk weight used in this case in the event of calculation of provisioning presents potential loss for the bank in percentages.

Impairment analysis is prepared taking into account both qualitative and quantitative criteria:

- Client's (group of related parties) total debt with respect to all credit (balance sheet) products in the bank, including bill of exchange protests, but excluding potential liabilities (documentary products) or ProCredit Leasing's placements.
- Claimed amount monitored in the course of the analysis are total due liabilities of the group of related parties (principal, due interest and due booked penalty interest).
- Expected problems with loan collection, and problems client is facing.
- Data on the pledge type and value, as well as pledge activation possibility.
- Expected loan amount collection through borrower's payments or through enforced collection from loan collateral activation in the next 3 years, and costs of activation.

It is executed at the annual level by monitoring cash flows (operating cash flows that can be the source of loan repayment, sale of property and sale of collateral items). By discounting the said cash flows we obtain present value of future cash flows, and further potential loss in percentages (compared to present value of receivables), which is used as the provisioning weight.

For the purpose of determining weight for individual claim provisioning from a particular borrower, it is necessary to:

- Prepare cash flow projection that will include data on loan instalment maturity, as well as data about the expected loan collection through borrower's payments and collection from sale of collateral items
- Future cash flows of the expected collection are discounted by the weighted effective interest rate of the borrower's total loans
- The projected loss is calculated, on the date of impairment analysis, as a difference between receivables from borrower and present value of the projected collection arising from those receivables

The weight for individual provisioning of the borrower's total claims is calculated as a percentage of the projected Special rules for loan classification during loan repayment period

The following cases require reclassification:

1. Irrespective of the number of days in arrears, an individual loan will promptly be reclassified in class V pursuant to the credit committee decision if the loan agreement has been terminated ("Terminated" status).
2. Portfolio management committee (a body founded in accordance with ProCredit Bank's procedures) has the right to pass on a decision on change of loan risk class in its regular monthly meetings, and on the basis of the proposal from the credit committee, for an individual case with increase in credit risk exposure, request impairment analysis on the basis of which the client will be individually reserved.

Write-off policy

As a rule of thumb, ProCredit Bank writes off all loans in loan repayment arrears for more than 360 days with the outstanding debt of

over EUR 10,000, and loans in arrears in excess of 180 days with the outstanding debt less than EUR 10,000. An exception would be loans with the outstanding debt in excess of EUR 30,000, with acceptable collateral, over 360 days in arrears, and with expected collection, as the claim is not written off in this situation.
As a general rule, claim write-off is possible only if the claim already has 100% provisioning.

Necessary documentation

All branches / regional centres are under obligation, according to credit procedures of the Bank, to create a credit file for each client they have established credit relations with, be it a loan, credit card, overdraft or documentary business. The necessary credit file documentation is defined by the document CFO (credit file order).

Calculation of allowances for impairment – provisions against potential losses for ProCredit Leasing

Loan loss classification and creation of the allowance for credit risk for financial leases is conducted depending on the number of days in arrears, amount of the receivable from the client and depending on the status of the leasing contract. Loan loss classification is conducted on the level of the client and not the level of individual financial leasing contracts.
"Leased" status means that the financial leasing contract with the client is active. Within this status allowances are created in line with number of days in arrears, estimated losses on the portfolio level and probability of these losses for group (portfolio) level allowances, while on the level on individual clients this is done for significant receivables on the individual basis by using the analysis of discounted cash flow.
"Terminated" status means that the financial lease contract with the client was terminated. It has two more sub statuses – "In Possession" when the leased asset is in the possession of ProCredit Leasing and "Out of Possession" when the leased asset is not in the possession of ProCredit Leasing.
Calculation of the risk classes and allowances is conducted on quarterly level except for the sub status "In Possession" for which it is calculated at the moment of acquiring this status.
Basis for calculating allowances is outstanding debt of the client in the moment of determining loan loss classification which includes outstanding principle, principle in due, interest and penalties.

Loan loss classification as well as impairment provisions as of end of December 2010, are shown in the table below.

Status	Number of Days in Arrears / Substatus	Up to EUR 50,000	Over EUR 50,000
Leased	0	–	–
Leased	1 to 30 Days	–	–
Leased	31 to 60 Days	–	–
Leased	61 to 90 Days	Portfolio level 20%	Client level
Leased	91 to 180 Days	Portfolio level 30%	Client level
Leased	Over 180 Days	Client level	Client level
Terminated	In Possession	Client level	Client level
Terminated	Out of possession	Portfolio level, 42% till 6 months after contract termination, after this 100%	Client level

Leasing internal loan loss classification rating for 2009 is shown below.

Status	Number of Days in Arrears / Substatus	Up to 50,000 eur	Over 50,000 eur
Leased	0	–	–
Leased	1 to 30 Days	–	–
Leased	31 to 60 Days	–	–
Leased	61 to 90 Days	Portfolio level 20%	Client level
Leased	91 to 180 Days	Portfolio level 30%	Client level
Leased	Over 180 Days	Client level	Client level
Terminated	In Possession	Client level	Client level
Terminated	Out of possession	Portfolio level, 42% till 6 months after contract termination, after this 100%	Client level

The impairment provision shown in the balance sheet at year-end is derived from each of the five internal rating classes. However, the majority of the impairment provision comes from the bottom two classes. The table below shows the percentage of the Group's balance sheet items relating to loans and advances and the associated impairment provision according to the rules of Group's internal methodology.

	2010		2009	
	Impairment provision (%)	Loans and Advances (%)	Impairment provision (%)	Loans and Advances (%)
I	1.1	95.9	1.0	96.4
II	50.2	0.5	44.5	0.7
III	65.3	0.5	61.5	0.4
IV	98.3	0.9	116.7	1.6
Impairment	23.5	2.2	36.5	0.8
	3.0	**100.0**	**3.4**	**100.0**

Associated impairment provision percentages in this case represent the relation between the extracted impairment provision and gross amount of loans and advances to customers without taking into consideration the deductive items which can lower the basis for calculating impairment provision. Financial lease receivables are for the purpose of this analysis shown in risk class I in case that their status is “Leased” and arrears up to 30 days. Financial lease receivables are shown in risk class II in case that their status is “Leased” and arrears between 31 and 90 days. Financial lease receivables are shown in risk class III in case that their status is “Leased” and arrears between 91 and 180 days. Financial lease receivables are shown in risk class IV in case that their status is “Leased” and arrears between over 180 days or in case that their status is “Terminated”.

B.3. Quality of the Loan Portfolio and the Maximum Exposure to Risk before Collateral Held

Quality of the loan portfolio is high which is reflected through the low level of portfolio at risk (defined as unpaid part of loan portfolio with at least one instalment due over 30 days). General rule of the bank is that the write off takes place after 360 days in arrears. However, in special cases the write off is possible even before this period.

The following table shows exposure to credit risk on 31 December 2010 and 2009 indicating total exposure to credit risk without taking into consideration means of collateral. The table also includes off balance items which might lead to credit risk.

Maximum Exposure Before Collateral		
	2010	2009
Balance Sheet Exposure		
Balances with Central Bank other than mandatory reserve deposits	10,788	509,558
Loans and advances to banks		
Loans to banks within a group	16,443	2,647
Loans to OECD banks	271,562	162,978
Loans to domestic and non-OECD banks	425,641	613,947
Total loans and advances to banks	**724,433**	**779,572**
Loans and advances to customers (net):		
Business	25,562,625	21,235,424
Agricultural	11,264,906	9,586,248
Housing	4,002,508	3,834,506
Finance leases	2,233,984	2,571,657
Consumer	2,262,784	1,349,394
Other	1,649,549	2,094,539
Total loans and advances to customers	**46,976,356**	**40,671,768**
Other financial assets (Note 22)	37,951	50,748
Off balance Credit Risk Exposure (Note 34)	8,099,743	7,534,014
On 31 December	**55,838,482**	**49,545,660**

The table above represents the scenario of the maximum credit risk exposure of the Group at 31 December 2010 and 2009, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet.

- 84.1% from total exposure is related to loans to customers and financial leases thus reflecting the major business activity of the Group (2009: 82.1%);
- 95.9% from total loans and advances is classified in most favourable impairment class according to the Group’s internal methodology (2009: 96.4%);
- 29.1% loans and advances to customers are covered with mortgages or deposits of the customers (2009:30.3%);

The table bellow shows structure of the quality of the loan portfolio (gross amounts):

		2010		2009
	Loans to Clients	Loans to Banks	Loans to Clients	Loans to Banks
Neither past due nor impaired	44,893,077	724,432	40,333,077	779,572
Past due but not impaired	1,885,468		986,647	–
Impaired	1,834,344		934,964	–
Total	**48,612,889**	**724,432**	**42,254,688**	**779,572**

The total allowances for impairment is RSD 1,636,533 thousand (31 December 2009: RSD 1,582,920 thousand). Out of this amount, individually impaired loans are RSD 399,373 RSD thousand (31 December 2009: RSD 165,975 thousand) and the remaining amount of RSD 1,237,160 thousand (31 December 2009: RSD 1,416,945 thousand) represents the group allowance.

(a) Loans and advances neither past due or impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the Group. All loans and advances to customers that are neither past due nor impaired are mostly classified in risk class I according to Group's internal methodology.

		2010		2009
Business Loans	24,445,522	54.45%	21,271,300	52.74%
Agriculture Loans	10,930,451	24.35%	9,769,850	24.22%
Consumer Loans	2,041,545	4.55%	1,341,771	3.33%
Housing improvement loans and housing loans	3,833,864	8.54%	3,921,478	9.72%
Other	1,640,270	3.65%	2,239,053	5.55%
Finance leases	2,001,425	4.46%	1,789,624	4.44%
Total loans to customers	**44,893,077**	**100.00%**	**40,333,076**	**100.00%**

The loans and advances to banks are with banks which have the following credit rating by the rating agency Standard and Poor's used:

		2010		2009
AAA rated	–	0.0%	–	0.0%
AA- to AA+ rated	13,671	1.92%	35,648	4.6%
A- to A+ rated	364,207	51.03%	95,299	12.2%
BB-	319,451	44.76%	643,690	82.6%
Not rated	16,316	2.29%	4,935	0.6%
Total loans and advances to banks	**713,645**	**100.0%**	**779,572**	**100.0%**

The following table indicates quality of the loans and advances to customers and banks which are neither past due nor impaired for 2009 and 2010:

		2010		2009
	Loans to Clients	Loans to Banks	Loans to Clients	Loans to Banks
I	44,802,428	724,432	40,317,244	779,572
II	38,634	–	8,123	–
II	23,201	–	3,684	–
IV	28,814	–	4,026	–
Total	**44,893,077**	**724,432**	**40,333,077**	**779,572**

(b) Loans and advances past due but not impaired

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Gross amount of loans and advances by class to customers that were past due but not impaired were as follows:

31 December 2010	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Other	Finance leases	Total
Past due up to 30 days	747,581	313,063	213,835	151,482	1,220	152,005	1,579,186
Past due 31 to 90 days	149,552	42,853	22,446	47,380	1,306	42,745	306,282
Total	**897,133**	**355,916**	**236,281**	**198,862**	**2,526**	**194,750**	**1,885,468**
Fair value of collateral	140,225	66,154	25,276	51,171	633	290,899	574,358

31 December 2009	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Other	Finance leases	Total
Past due up to 30 days	303,909	120,941	6,241	32,292	148,209	133,603	745,196
Past due 31 to 90 days	106,854	37,600	5,086	15,212	15,825	60,873	241,451
Total	**410,763**	**158,541**	**11,328**	**47,504**	**164,035**	**194,477**	**986,647**
Fair value of collateral	246,339	124,457	2,329	23,316	7,523	303,191	707,155

For certain types of loans and advances to customers the Group is well collateralized, with fair value of collateral exceeding amounts of claims that are past due. This is particularly the case with financial lease since it bears down-payment which protects the Group against the depreciation of the leasing subject. In such a manner the bank is protected against the potential default of the client.
The disclosed fair value of collateral is determined by local certified evaluator and represents value realizable by the legal owners of the assets. The impairment provisions reflect the probability that management will not be able to enforce its rights and repossess collateral on defaulted loans. Despite of the length in the process of enforcing repossession of collateral, the Bank's management will vigorously pursue the outstanding debts with all possible means at their disposal.

This applies to long-term loans to business or agriculture clients exceeding EUR 50,000 and loans for housing purposes.

c) Loans and advances to customers individually impaired

Loans that are overdue by 91 or more days are considered to be impaired. This includes in addition individually impaired loans. Those are loans disbursed in the original amount of over EUR 50,000 that are overdue by less than 90 days, but related to clients with identified significant financial problems.
For year 2010 individually impaired loans amounted to RSD 1,053,380 thousand, with fair value of the collateral amounting to RSD 899,557 thousand. For year 2009 individually impaired loans amounted to RSD 412,565 thousand, with fair value of the collateral amounting to RSD 381,652 thousand.
The following table shows composition of individually impaired loans, allowances and fair value of collateral.

	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Finance leases	Total
31 December 2010						
Individually Impaired loans	699,077	153,881	793	83,710	115,919	1,053,380
Allowance	273,403	69,681	231	15,200	40,858	399,373
Fair value of collateral	570,737	135,004	295	77,602	115,919	899,557
31 December 2009						
Individually Impaired Loans	226,800	46,748	45	21,260	117,712	412,565
Allowance	87,365	18,485	–	1,788	58,337	165,975
Fair value of collateral	**216,192**	**28,263**	**76**	**19,409**	**117,712**	**381,652**

(d) Loans and advances renegotiated

Renegotiation of loans and advances includes all activities undertaken by the Group which alter any of the important conditions under which the loans and advances were originally approved to a customer. This includes change of the loan maturity, interest rate, change of the due date of instalment, change of the instalment amount etc. Renegotiation of the loans and advances to customers is not only done in case that the customer is facing financial difficulties.

In case that the customer is facing financial difficulties that might seriously jeopardise his/her loan repayment capacity, renegotiation can be done only under the circumstances described in the Credit Standards of the Group. Renegotiation is possible only if the client is still able to generate sufficient cash flow to repay new – restructured loan. Regardless of the loan amount disbursed and regardless of the type of customer all loan renegotiation requests include on-site visit to client and execution of monitoring on his/her financial position. All renegotiation requests for loans originally

disbursed in amounts exceeding EUR 25,000 have to be approved by Risk Sector of Management of the Group.
The following table indicates volume of renegotiated loans and advances to customers as of 31 December 2010 and 2009.

	2010	2009
I	2,390,602	2,747,395
II	93,068	82,668
III	115,872	36,316
IV	313,861	71,510
Total	**2,913,403**	**2,397,889**

Amount of the renegotiated loans and advances that would otherwise be impaired, due to deterioration of the client's financial position, during 2010 was RSD 1,973,582 thousand (2009: RSD 2,508,678 thousand). During year 2010 renegotiation of the originally approved loan features came as a consequence of more active role of the bank in solving arrears problems which resulted in quite similar arrears rates compared to the situation in previous year.

(e) Repossessed collateral

During 2010, the Group collected its overdue loans and advances by taking possession of collateral in court proceedings and out of court settlements in amount of RSD 124,632 thousand (2009: RSD 112,546 thousand). The figure relates to all types of assets gained, both movable and immovable.
The following table below indicates volume and types of repossessed collateral held by the group on 31 December 2010 and 2009.

	2010	2009
Movable Collateral Bank	8,213	391
Movable Collateral from Financial Lease	65,499	28,022

B.4. Collateral Policy

In the light of the impact of the global financial crisis on the liquidity and financial position of the Group's borrowers, the Group has tightened the collateral conditions. As a general rule, collateral or external guarantor (or combination of those two types of security) is required for all disbursed loans. For loans with housing purpose, real-estate as collateral is demanded. The same rule applies for housing improvement loans disbursed in the amounts exceeding EUR 10,000.
For all loans to be approved in amounts over EUR 50,000 or loans in smaller loan amounts that demand collateral with registration legal opinion of the bank's lawyer is necessary screening legal risks related to client's business and collateral itself.
For all loans with mortgage as collateral, to be disbursed in amounts over EUR 50,000 or with maturities over 59 months it is necessary to have official mortgage estimation done by external court-certified expert and approved by bank's Investment Group.
When financing purchase of new cars or taxi vehicles Casco insurance assigned to the bank is necessary mean of collateral. In addition when using mortgages as collateral the bank reserves the right to demand real-estate insurance against common risks. Also the bank can ask for credit life insurance of the client (only in case of a private person) if deemed necessary.

B.5. Structure and Diversification of the Loan Portfolio

Concentration of exposure risk to various industries and sectors is under constant observation. Achieved sector diversification is on a high level thus diminishing the exposure risk arising from the exposure to credit risk.
For analysis of the portfolio diversification/concentration the HHI index was used (Hirschman Hiefendahl Index), representing sum of squares of relative participation of every sector/industry in the bank's portfolio. If the result is closer to 1, the portfolio is more concentrated. If the result is closer to ideal proportion this indicates low level of portfolio concentration. In case of Group ideal proportion would be 1/40, or HHI ratio of 0.025 having in mind that the loan portfolio is separated in 40 different sectors/industries. The following table shows the values of HHI ratio for years 2010 and 2009:

2010		2009	
HHI ratio by number of loans	HHI ratio by volume of loans	HHI ratio by number of loans	HHI ratio by volume of loans
0.2176	0.1329	0.2409	0.1487

The following table sets basis for interpretation of the degree of concentration of the loan portfolio of the Group according to the Hirschman Hiefendahl Index:

Concentration level	HHI
Low	0.025 – 0.26875
Medium	0.26876 – 0.5125
High	0.5126 – 0.75625
Critical	0.75626 – 1

The table below indicates breakdown of the Group's loan portfolio by industries including loans to financial institutions, loans to business clients and agricultural loans on 31 December 2010 and 31 December 2009.

	2010		2009	
	Placements to clients	%	Placements to clients	%
Financial Institutions	724,432	1.83%	779,572	2.36%
Trade	10,891,059	27.45%	7,746,659	23.46%
Industry and other production	6,951,638	17.52%	6,739,394	20.41%
Construction	921,274	2.32%	1,073,458	3.25%
Transport	2,754,183	6.94%	2,708,263	8.20%
Tourism	1,140,574	2.87%	1,038,699	3.15%
Other Services	3,601,872	9.08%	2,296,927	6.96%
Mixed	902,375	2.27%	628,455	1.90%
Agricultural Loans	11,787,339	29.71%	10,011,840	30.32%
Total	**39,674,746**	**100.00%**	**33,023,267**	**100.00%**

B.6. Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Guarantees or letters of credit are subjected to the same approval mechanism as regular loans. This also implies that the same collateral requirements apply for off balance commitments as for loans. Moreover, the bank measures total client exposure and creditworthiness by adding also off-balance commitments to him/her and by taking into consideration the connected parties and their exposure and creditworthiness.

C) Market risk

Policy of the Group is not to take any speculations and to keep all kind of risk on acceptable level. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices. The Group complies with the limits on value of risk that may be accepted that are prescribed by the Central Bank as well as with limits set by Risk Committees.

Foreign currency risk exposure is monitored regularly through compliance with the regulatory limits prescribed by the Central Bank. The Group maintains the foreign currency position by granting loans with foreign currency clauses. On the other hand, the Group has active approach to currency risk management, and it is prudently assessing and managing open foreign currency position through making foreign currency swaps and keeping open currency risk exposure in limits set by Central Bank, as well as with internal rules and limits prescribed by Management and Risk Committees.

The table below summarizes the Group exposure to foreign currency exchange risk at 31 December. In the table are included Group's assets and liabilities at carrying amounts, categorized by currency.

31 December 2010	EUR	USD	Other currencies	Total foreign currencies	Local Currency	Total
Assets						
Cash and balances with the Central Bank	17,812,781	532,032	92,464	18,437,277	2,588,068	21,025,345
Loans and advances to banks	576,567	100,595	32,836	709,998	3,647	713,645
Loans and advances to customers	34,292,740	–	–	34,292,740	12,683,616	46,976,356
Derivative Financial Assets	–	–	–	–	105	105
Available-for-sale financial assets	1,979	11,639	–	13,618	–	13,618
Other financial assets	–	–	–	–	7,924	7,924
Intangible assets	–	–	–	–	220,676	220,676
Property, plant and equipment	–	–	–	–	1,316,447	1,316,447
Deferred income tax assets and Current Tax assets	–	–	–	–	253,344	253,344
Other assets	15,272	8	–	15,280	360,514	375,794
Total assets	**52,699,339**	**644,274**	**125,300**	**53,468,913**	**17,434,341**	**70,903,254**
Liabilities						
Deposits from banks	947,968	–	2,215	950,183	1,244,997	2,195,180
Derivative financial liabilities	4,460	–	–	4,460	1,189	5,649
Due to customers	27,851,654	1,121,077	138,872	29,111,603	8,021,123	37,132,726
Other borrowed funds	19,350,784	–	–	19,350,784	–	19,350,784
Subordinated debt	2,886,643	–	–	2,886,643	–	2,866,643
Tax liabilities	–	–	–	–	–	–
Provisions	–	–	–	–	92,232	92,232
Other liabilities	22,611	182	–	22,793	546,159	568,952
Equity	–	–	–	–	8,671,088	8,671,088
Total liabilities and equity	**51,064,120**	**1,121,259**	**141,087**	**52,326,466**	**18,576,788**	**70,903,254**
Net on-balance sheet position	**1,635,219**	**(476,985)**	**(15,787)**	**1,142,447**	**(1,142,447)**	**–**
Credit commitments (Note 34)	–	–	–	–	1,961,441	1,961,441

continued	EUR	USD	Other currencies	Total foreign currencies	Local Currency	Total
31 December 2009						
Total assets	49,991,260	556,127	135,165	50,682,552	15,703,122	66,385,674
Total liabilities and equity	49,799,817	659,930	69,840	50,529,587	15,856,087	66,385,674
Net on-balance sheet position	**191,443**	**(103,803)**	**65,325**	**152,965**	**(152,965)**	**–**
Credit commitments (Note 34)	**–**	**–**	**–**	**–**	**1,884,115**	**1,884,115**

Following table provides overview of sensitivity analysis of the exposure to currency risk under the assumption of the change in local currency exchange rate by 15%:

	Open currency position based on balance sheet data on 31 December		Effect of 15 % depreciation of RSD to Open Currency Position		Effect of 15% appreciation of RSD to Open Currency Position	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
USD	(476,985)	(103,308)	(71,548)	(15,570)	71,548	15,570
EUR	1,635,219	191,443	245,283	28,716	(245,283)	(28,716)
Other Currencies	(15,787)	65,325	(2,368)	9,799	2,368	(9,799)

Having in mind the currency structure of the balance sheet the appreciation of the local currency by 15% would result in negative effect profit of RSD 171,367 thousand (2009: negative effect of 22,954 thousand). In case of depreciation of the local currency by 15% positive effect on profit would be RSD 171,367 thousand (2009: positive effect of 22,954 thousand).

C.2. Interest rate risk

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rates may increase or decrease as a result of such changes and may create negative effects to the Groups capital and/or income. Interest rates are based on market rates which the Group reprises and reassesses regularly.

Risk management activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Group's business strategies. In managing maturity structure, senior management considers among others:

- Macro- and microeconomic forecasts,
- Forecasts in liquidity conditions and
- The anticipated trends in interest rates.

Interest rate risk presented in gaps between remaining maturities of assets and liabilities with fixed interest rate is managed by balancing the structure of loans and advances to customers with due to customers and other types of short- and long-term borrowings. Interest rate risk presented in gaps between maturities of reprising of taken long term loans linked to floating rates, and reprising of loans disbursed at floating interest rates, is prudently hedged with Fixed-for-Floating Interest Rate Swap. As of 31 December 2010 the Group had Interest Rate Swap in the outstanding notional amount of EUR 1.938 million (31 December 2009: EUR 2.625 million).

The table below summarizes the Group's exposure to interest rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorized by the earlier of contractual reprising or maturity dates.

31 December 2010	Up to 1 month	1 – 3 months	3 – 12 months	1 – 2 years	2 – 5 years	over 5 years	Non-Interest Bearing	Total
Assets								
Cash and balances with the Central Bank	–	–	–	–	–	–	21,025,345	21,025,345
Loans and advances to banks	–	–	–	–	–	–	713,645	713,645
Loans and advances to customers	20,195,363	2,615,628	10,136,201	6,573,369	6,597,423	367,418	490,955	46,976,357
Derivative Financial Assets	–	–	–	–	–	–	105	105
Available-for-sale financial assets	–	–	–	–	–	–	13,618	13,618
Other financial investments	–	–	–	–	–	–	7,924	7,924
Other assets	–	–	–	–	–	–	375,794	375,794
Total assets	**20,195,363**	**2,615,628**	**10,136,201**	**6,573,369**	**6,597,423**	**367,418**	**22,627,386**	**69,112,788**
Liabilities								
Liabilities to banks	2,195,180	–	–	–	–	–	–	2,195,180
Derivative financial liabilities	–	–	5,649	–	–	–	–	5,649
Due to customers	11,536,786	6,227,789	9,825,335	191,503	315,460	76,256	8,959,597	37,132,726
Other borrowed funds	4,096,457	3,562,136	5,892,627	624,490	4,930,705	–	244,369	19,350,784
Subordinated debt	–	–	–	–	2,886,643	–	–	2,886,643
Other liabilities	–	–	–	–	–	–	568,952	568,952
Total liabilities	**17,828,423**	**9,789,925**	**15,723,611**	**815,993**	**8,132,808**	**76,256**	**9,772,918**	**62,139,934**
Interest sensitivity gap	**2,366,940**	**(7,174,297)**	**(5,587,410)**	**5,757,376**	**(1,535,385)**	**291,162**	**12,854,468**	**6,972,854**
31 December 2009								
Total Assets	**18,098,739**	**2,995,595**	**9,285,638**	**7,129,894**	**8,401,263**	**629,121**	**17,839,945**	**64,380,195**
Total Liabilities	**18,475,793**	**8,038,183**	**12,052,248**	**1,452,038**	**9,201,665**	**454,517**	**7,079,199**	**57,726,643**
Interest sensitivity gap	**(377,054)**	**(5,042,588)**	**(2,766,610)**	**5,677,856**	**(800,402)**	**174,604**	**10,760,746**	**6,653,552**

Negative gap in time brackets in the table shown above is the consequence of significant volume of assets being immobilized in minimum reserves. Part of the minimum reserves kept in foreign currency is not interest rate sensitive.

At 31 December 2009, if interest rates had been 200 basis points lower with all other variables were held constant, the Group's profit for the year would respectively increase by approximately RSD 112,861 thousand (2008: increase by RSD 8,803 thousand). The following table indicates influence in the movements of interest rates to profit/loss for 2009 and 2008 respectively.

Income statement sensitivity to change in interest rates						
	2% increase of interest rates			2% decrease of interest rates		
	Total	EUR	RSD	Total	EUR	RSD
31 December 2010	(58,640)	(71,852)	17,342	58,640	71,852	(17,342)

Income statement sensitivity to change in interest rates						
	2% increase of interest rates			2% decrease of interest rates		
	Total	EUR	RSD	Total	EUR	RSD
31 December 2009	(112,861)	(112,957)	2,685	112,861	112,957	(2,685)

At 31 December 2009, if interest rates had been 200 basis points lower with all other variables were held constant, the Group's economic value of the capital would respectively increase by approximately RSD 259,901 thousand (2008: decrease by RSD 256,780 thousand). The following table indicates influence in the movements of interest rates to economic value of the Group's capital for 31 December 2009 and 2008 respectively.

Influence to Economic Value of the Capital						
		2% increase of interest rates			2% decrease of interest rates	
	Total	EUR	RSD	Total	EUR	RSD
31 December 2010	(270,825)	(186,510)	(90,109)	270,825	186,510	90,109

Influence to Economic Value of the Capital						
		2% increase of interest rates			2% decrease of interest rates	
	Total	EUR	RSD	Total	EUR	RSD
31 December 2009	(259,901)	(174,130)	(88,352)	259,901	174,130	88,352

Having in mind presented volume of potential impact of the changes in interest rates to the economic capital value and profit/loss, the Group considers its interest rate risk profile to be adequate.

D) Liquidity risk

Liquidity risk arises in the general funding of the Group's activities and in the management of its liquidity position. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Group has diversified funding base. Funding base includes:

- customer deposits with wide ranges of maturity
- money market deposits
- loans from foreign banks and financial institutions
- subordinated debt
- share capital

The Group continually assesses liquidity risk by identifying and monitoring changes in funding required meeting business goals and targets set in terms of the overall Group's strategy.
The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.
Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month respectively, as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets.
Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represents future cash requirements, since many of these commitments will expire or terminate without being funded.

D.1 Non derivatives cash flow

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

As at 31 December 2010	Up to 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 4 years	Over 4 years	Total
Financial Liabilities							
Liabilities to banks	2,215,022	–	–	–	–	–	2,215,022
Due to customers	8,423,786	11,384,001	8,249,774	7,516,066	1,421,301	251,890	37,246,818
Other borrowed funds	1,279,205	587,495	574,464	2,366,592	15,001,577	1,820,481	21,629,813
Provisions	4,964	9,927	14,891	29,781	–	32,670	92,233
Subordinated debt	6,578	134,246	13,131	129,557	1,420,736	1,815,600	3,519,848
Other liabilities	77,425	–	1,916	–	–	–	79,341
Total Financial Liabilities (by contractual due dates)	**12,006,980**	**12,115,669**	**8,854,176**	**9,104,222**	**18,546,865**	**4,155,163**	**64,783,075**
Total Financial Assets (by expected due dates)	**23,540,235**	**4,549,756**	**6,266,205**	**10,400,006**	**26,383,870**	**6,513,465**	**77,653,537**

As at 31 December 2009	Up to 1 month	1 – 3 months	3 – 12 months	1 – 2 years	2 – 5 years	Over 5 years	Total
Financial Liabilities							
Liabilities to banks	354,261	–	–	–	–	–	354,261
Due to customers	19,960,440	6,297,730	10,734,569	905,071	583,167	138,068	38,619,045
Other borrowed funds	1,486,875	554,265	2,770,244	4,244,732	9,322,058	565,331	18,943,505
Provisions	2,078	23,052	11,989	–	–	37,581	74,700
Subordinated debt	2,743	77,959	136,571	221,946	2,942,580	–	3,381,799
Other liabilities	110,908	100,651	–	–	–	–	211,559
Total Financial Liabilities (by contractual due dates)	**21,917,305**	**7,053,657**	**13,653,373**	**5,371,749**	**12,847,805**	**740,980**	**61,584,869**
Total Financial Assets (by expected due dates)	**20,452,629**	**3,564,894**	**13,811,677**	**9,776,202**	**15,347,164**	**4,065,472**	**67,018,038**

Assessment of the expected inflows of the financial assets were done on the basis of contractual cash flows diminished on the basis of the historical data on write offs and premature repayments of loans by clients.

D.2 Derivatives settled on a gross basis

The Group's derivatives that will be settled on a gross basis include Foreign currency swaps.

The table below analyses the Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

At 31 December 2010	Less than one month	From 1 – 3 months	From 3 – 12 months	Over 1 Year	Total
Foreign currency swaps:					
Outflow	–	–	490,567	–	490,567
Inflow	–	–	495,706	–	495,706
At 31 December 2009					
Foreign currency swaps:					
Outflow	–	–	64,154	–	64,154
Inflow	–	–	61,202	–	61,202

D.3 Derivatives settled on a net basis

The Group's derivatives that will be settled on a net basis include interest rate swaps.

The table below analyses the Group's derivative financial instruments that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet to the contractual or settlement maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

At 31 December 2010	Less than one month	From 1 – 3 months	From 3 – 12 months	Over 1 Year	Total
Interest rate swaps:					
Outflow	–	–	4,460	–	4,460
Inflow	–	–	–	–	–
At 31 December 2009					
Interest rate swaps:					
Outflow	–	–	4,416	–	4,416
Inflow	–	–	–	–	–

D.4 Contingent Liabilities and Credit Commitments

The table below provides analysis of the maturity structure of contingent liabilities and credit commitments on the basis of remaining maturity. Entire stock of credit commitments is related to local currency potential loan placements to clients, maturing mostly up to 24 months.

At 31 December 2010	No later than 1 year	1 – 4 years	Over 4 years	Total
Approved but unused overdraft limits for consumer clients	140,284	–	–	140,284
Approved but unused overdraft l imits for business clients	1,264,716	–	–	1,264,716
Approved but unused credit card limits	207,430	349,011	–	556,441
Payments and guarantees	2,039,677	850,465	2,377,222	5,267,364
Letters of credit	97,538	–	–	97,538
Performance guarantees	374,526	323,197	122,678	820,401
Total	**4,124,171**	**1,522,673**	**2,499,900**	**8,146,744**

At 31 December 2009	No later than 1 year	From 1 – 2 years	From 2 – 5 years	Over 5 years	Total
Approved but unused overdraft limits for consumer clients	141,080	15	12	–	141,107
Approved but unused overdraft limits for business clients	1,166,839	10	–	–	1,166,849
Approved but unused credit card limits	419,152	152,769	4,238	–	576,159
Payments and guarantees	2,101,309	562,609	1,373,372	958,888	4,996,178
Letters of credit	43,036	–	–	–	43,036
Performance guarantees	599,052	896	5,875	–	605,823
Total	**4,470,468**	**716,299**	**1,383,497**	**958,888**	**7,529,152**

E) Fair values of financial assets and liabilities

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

		Carrying value		Fair value
	2010	**2009**	**2010**	**2009**
Financial assets				
Loans and advances to customers	47,033,829	40,671,768	47,718,580	41,515,967
Business	25,617,817	21,235,424	26,252,557	21,903,945
Agro	11,264,906	9,586,248	12,223,785	10,476,780
Housing Loans	4,002,508	3,834,506	4,190,888	4,027,293
Consumer	2,265,065	2,571,657	821,988	1,340,844
Leasing	2,233,984	1,349,394	3,475,172	2,428,961
Other	1,649,549	2,094,539	754,190	1,338,143
Loans and advances to banks	697,202	779,572	673,625	753,299
Total Financial Assets	**47,731,031**	**41,451,340**	**48,392,205**	**42,269,266**
Financial liabilities				
Deposits from banks	2,195,180	349,697	2,120,947	341,252
Due to customers	33,542,406	37,645,140	33,675,520	37,791,032
Corporate	4,620,996	7,062,409	4,601,991	7,047,872
SME	10,768,884	10,533,415	10,793,956	10,554,413
Private individuals	18,152,526	20,049,316	18,279,573	20,188,747
Due to IFI's and other borrowings	15,799,082	16,543,430	15,100,878	16,585,310
Subordinated debt	2,886,643	2,621,912	2,971,608	2,162,599
Total Financial Liabilities	**54,423,311**	**57,160,179**	**53,868,953**	**56,880,192**

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist to measure the financial instrument.
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 carrying amounts of other financial assets and other financial liabilities represent reasonable approximation of fair value due to their short term maturity.

Loans and advances to banks
The fair value of placements with and loans to other banks approximately equals the carrying amount since they all have less than a six-month maturity.
The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers
The fair value of loans and advances to customers is their expected cash flow discounted at current market rates. Current market rates are interest rates we would charge at the moment (year end). Loans and advances to customers are stated net of provisions for impairment.

Deposits from banks
The fair value of liabilities to banks approximately equals the carrying amount since they all have less than a six-month maturity.

Due to customers
The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.
The estimated fair value of term deposits is calculated by discounting the cash flows at agreed dates with current market rates on deposit that have more than a six-month maturity and where actual interest rate is not the same as the agreed for these deposits.

Other borrowed funds
Fair value of Liabilities to International Financial Institutions shows that the Group, based on its current position in the market, strong shareholders and achieved results was able to contract very good conditions for long term loans. Fair value is smaller than carrying amount, discounted by interest rate that ProCredit Holding would ask for.

Subordinated debts
Subordinated debts carry predominantly floating rates and due to the interest rate reprising carrying value is not materially different from their fair value.

Fair value hierarchy
IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

- *Level 1* – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities (from New York Stock Exchange).
- *Level 2* – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes the majority of the OTC derivative contracts. The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.
- *Level 3* – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

Assets and liabilities measured at fair value as at 31 December 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets				
Derivative financial assets	–	105	–	105
Available for sale financial assets	13,618	–	–	13,618
Total Financial Assets	**13,618**	**105**	**–**	**13,723**
Financial liabilities				
Derivative financial liabilities	–	5,649	–	5,649
Total Financial Liabilities	**–**	**5,649**	**–**	**5,649**

In 2010 there was no transfer between level 1 and level 2 of the fair value hierarchy. There were no Level 3 items as of 31 December 2010 and 2009.

F) Operational Risk

In line with Basel II Accord, we define operational risks as the risk of loss resulting from inadequate or failed internal processes, people and systems and/or external events. This category includes all "risk events" in the areas of personnel, processes, and information technology.
To further expand the processes for managing operational risks, a new Operational Risk Policy was implemented in the bank in 2009. The principles outlined in this document have been designed to effectively manage the operational risk exposure, and they are in compliance with the Basle II requirements for the "standard approach".
The overall framework to manage operational risks is as a complementary and balanced system with its key components Corporate Culture, Governance Framework, Policies and Procedures, Risk Assessments, New Risk Approvals (NRAs) and the Risk Event Database. While of the Corporate Culture, the Governance Framework, and Policies and Procedures are installed to set the basic organisational requirements, Risk Assessments, New Risk Approvals (NRAs) and the Risk Event Database are the key instruments to execute the risk management process.

The overall objectives of the Group's approach to the management of operational risks are:
- to understand the drivers of the bank's operational risks;
- to be able to identify critical issues as early as possible;
- to avoid losses caused by operational risks; and
- to ensure efficient use of the bank's capital.

To deliver on these goals the following tools and processes have been implemented in detail, being part of the framework components as depicted above. They are presented as they are used within the process to manage operational risks. This process is subdivided into the phases of identification, evaluation, treatment, monitoring, documentation & communication, and follow up. All corresponding details have been implemented in the bank by approving the Group Operational Risk Policy.

Identification
- Annual Operational Risk Assessments
- Detailed Process Reviews as appropriate
- New Risk Approval (NRA) process
- Risk identification and documentation in Risk Event Database (RED)
- Ad hoc identification of potential risks

Evaluation / Quantification
- Agreed standards to quantify risks (impact likelihood, Scenario Analysis, Stress testing, Risk Bearing Capacity, ...)

Mitigation and Treatment
- Implementation of measures to avoid, reduce or mitigate the risks depending on priorities, efficiency considerations and regulations
- Transfer of risk to an insurance or other party

Monitoring & Control
- Process owners responsibility to monitor risks
- Operational Risk Reports as form of MIS, Risk Bearing Capacity calculation and monitoring

Communication, Escalation, Documentation
- Escalation levels to management bodies, regular reporting, risk committees
- RED, Management summary documents for risk events

Issue Tracking / Follow up tables for material action plans
- Follow up tools used in banks

The following categories of operational risk are looked at specifically:

People Risks
- The bank seeks to avoid key person dependencies and enforces a two-weeks consecutive leave policy
- Staff training has a very high priority in the bank and ensures continuous development of staff members' personal attitude and commitment and their professional skills

IT Risks:
- Business continuity plans are in place
- Information Security standards are in place

Legal Risks:
- Suitable legal resources are employed to deal with legal matters (internal legal staff and / or external legal counsel)
- The legal function is involved whenever required and appropriate (e. g. NRA process, all legal issues)

Compliance and Regulatory Risk
- The bank ensures the identification of new regulations or updates on the interpretation of regulations and covenants agreed with financing institutions in a timely manner. This function is hosted in legal/compliance department.

Fraud Risk and AML Risk
- A new Group AML Policy and a Group Fraud Prevention Policy have been implemented in the bank and corresponding risk assessments have been executed for these areas, based on the German standards.
- A new group wide IT solution to manage unusual transactions has been acquired and is being rolled out to the bank of the group.

Reputational Risk
- Any extraordinary mentions (whether positive or negative) are reported to the management board and to the risk management department to decide on possible responses.

External Risk Factors
- External risk events such as a natural disaster that damages a firm's physical assets as well as electrical or telecommunications failures that disrupt business are analysed by risk managers.

As of December 2010, there were 56 cases in which the Group was prosecuted (2009: 23). Consequentially, based on its procedure the Group set aside reserves for estimated potential losses originating from the court cases in the amount of RSD 25,691 thousands (2009: RSD 9,447 thousands).

4. Net interest income

	Year ended 31 December	
	2010	**2009**
Interest income		
Interest income from loans and advances to banks	109,292	239,243
Interest income from financial institutions	59,627	1,016,315
Interest income from loans and advances to customers	7,139,758	6,817,942
	7,308,677	**8,073,500**
Interest expenses		
Interest expenses on liabilities to banks	118,892	331,059
Interest expenses on liabilities to customers	1,541,041	1,939,214
Interest expenses on liabilities to international financial institutions	942,122	1,049,192
Interest expenses on subordinated debt	138,438	158,799
	2,740,493	**3,478,264**
Net interest income	**4,568,184**	**4,595,236**

5. Allowance for impairment losses on loans and advances

	Year ended 31 December	
	2010	**2009**
Charge for the year on loans to customers (Note 14)	2,701,679	2,204,661
Expenses derived from write-offs	6,628	11,749
Release of provision on loans to customers (Note 14)	(1,593,180)	(1,281,319)
Recovery of written- off loans	(120,771)	(61,024)
Total impairment provision	**994,356**	**874,067**

6. Net fee and commission income

	Year ended 31 December	
	2010	2009
Fee and commission income		
Payment transfer and transactions	666,302	598,176
Account maintenance fee	263,625	336,719
Letters of credit and guarantees	117,688	109,026
Debit/credit cards	126,876	143,146
Other fees and commission income	22,287	26,611
	1,196,778	**1,213,677**
Fee and commission expense		
Payment transfers and transactions	144,197	141,602
Other fees and commission expenses	16,142	16,675
	160,339	**158,277**
Net fee and commission income	**1,036,439**	**1,055,400**

Other fee income include fees and commissions from banks in the amount of RSD 4,772 thousand (2009:5,288 thousand), fees on travelers' cheques in the amount of RSD 859 thousand (2009: RSD 1,503 thousand) and other fees from customers in the amount of RSD 16,656 thousand (2009: RSD 19,820 thousand).

Other fees and commission expenses include fee expenses to banks in the amount of RSD 15,964 thousand (2009: RSD 15,760 thousand) and other fees to others in the amount of RSD 178 thousand (2009: RSD 915 thousand).

7. Net trading income

	Year ended 31 December	
	2010	2009
Translation losses/ (gains)	(9,495)	42,939
Transaction losses from foreign exchange trading operations with banks	(5,520)	(36,320)
Transaction gains from foreign exchange trading operations with customers	187,421	277,282
Total net trading income	**172,406**	**283,901**

8. Net result from financial assets at fair value through profit or loss

	Year ended 31 December	
	2010	2009
Losses from fair value changes for financial assets at fair value through profit and loss	(164,435)	(20,643)
Gains from fair value changes for financial assets at fair value through profit and loss	176,344	1,206
Net result from financial assets at fair value through profit or loss	**(11,909)**	**(19,437)**

9. Operating income

	Year ended 31 December	
	2010	2009
Insurance indemnity	3,979	22,565
Reimbursement of expenses for bills of exchange and safe bags for money	11,689	14,093
Net gains from disposal of property and equipment	3,394	17
Income from litigation settlements	6,674	833
Release of provision on guarantees	–	86,145
Release of provision on retirement benefit obligations (Note 28)	4,912	1,807
Other	45,919	27,177
Total operating income	**76,567**	**152,637**

10. Operating expenses

	Year ended 31 December	
	2010	2009
Staff costs		
Wages and salaries	1,468,980	1,399,412
State pension contributions	646,379	408,497
Taxes and contributions on salaries	266,312	499,210
Fringe benefits	111,827	102,944
Other staff costs		474
Total staff costs	**2,493,498**	**2,410,537**
Office rent	403,262	450,176
Depreciation and amortization	304,629	370,787
Marketing and representation	163,862	149,397
Office supplies and other office utilities	129,086	148,713
Other service expenses	128,875	144,246
Communication expenses	74,068	91,304
Expenses for consulting services	128,965	77,143
Transport expenses	61,624	51,343
Legal and advisory expenses	57,577	37,849
Security	45,337	54,403
Other taxes	78,051	92,739
Training expenses	10,217	21,299
Expenses for royalties on software	3,341	3,603
Expenses for repairs and maintenance	42,097	31,837
Insurance expenses	19,049	13,664
One-time working contracts	3,756	3,800
Other administrative expenses	732	791
Expenses for deposit insurance fund	144,306	128,276
Expenses for provisions on guarantees	–	4,194
Expenses for litigation settlements	23,125	1,190
Expenses for disposal of property and equipment	44,478	13,419
Others	4,952	22,985
Total other operating expenses	**1,871,389**	**1,913,158**
	4,364,887	**4,323,695**

11. Income taxes

	Year ended 31 December	
	2010	2009
Current income tax expenses	(82,806)	(90,361)
Deferred income tax credit	21,717	27,905
Total income tax expenses	**(61,089)**	**(62,456)**

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the official rate as follows:

	Year ended 31 December	
	2010	**2009**
Profit before tax	506,261	869,974
Tax calculated at a tax rate of 10% (2009: 10%)	(50,626)	(86,997)
Fines and penalties	(695)	(5)
Accounting depreciation above tax depreciation	(8,350)	(10,960)
Other non-deductible expenses	(41,487)	(5,895)
Utilized tax credits	18,352	13,496
Unutilized tax credits brought forward	21,717	27,905
Current tax expenses	**(61,089)**	**(62,456)**

According to Serbian tax law, the Group is entitled to use tax credits based on the amounts invested in property and equipment and number of new employees hired and to reduce the current income tax liability. Tax credits on new employees hired can be used by the Group only in the year when declared. Tax credit on new investments in property and equipment can be carried forward for a period on 10 years. In order to be eligible to use these investment tax credits, the Group should not dispose related property and equipment items during a period of three years from the year when tax credit was declared. Tax credit calculation is open to tax audit by Tax Administration in a period of 5 years from the year when the tax become due for payment.

12. Cash and balances with the Central Bank

	At 31 December	
	2010	**2009**
Cash on hand	1,221,927	1,120,969
Mandatory reserve	19,792,630	20,735,686
Other Balances with the Central Bank	10,788	9,294
Treasury bills	–	500,264
Total included in Cash and cash equivalents (Note 33)	**21,025,345**	**22,366,213**

The National Bank of Serbia (NBS) regulations related to mandatory reserve has been changed during 2010. At the end of December mandatory reserve in local currency was calculated by applying the rate of 5% on the average daily amount of Group's deposit base in local currency in the preceding month. At the end of December mandatory reserve in foreign currency for borrowings from abroad and for deposits in foreign currency were calculated by applying the rate of 25% on the average daily amount of Bank's deposit base in foreign currency in the preceding month.

Mandatory reserves on subordinated debt are calculated applying the rate of 0% on the average daily liabilities for subordinated debt in preceding month, and for leasing agreements applying the rate of 20% on average daily Leasing borrowings from abroad in preceding month.

In March 2010 the National Bank of Serbia put into force decision that stipulates that banks shall keep the average daily balance of allocated foreign currency required reserves at least at the level of the reference foreign currency required reserves, in any maintenance period in which the calculated foreign currency required reserves are lower than the reference foreign currency required reserves.

The foreign currency required reserves are equal to the required reserves calculated in Euros on March 17th 2010 in line with the National Bank's previous decision, reduced by the amount of required reserves as calculated on that day in respect of foreign currency balances held by leasing companies and increased by the amount of dinar required reserves calculated on the same day in respect of foreign currency clause indexed dinar liabilities. Banks could also reduce the reference foreign currency required reserves by 25% of the increase in special purpose loans relative to their balance on February 28th 2010 on condition that this obligation after reduction is not lower that the amount of calculated foreign currency required reserves.

Mandatory reserves can be used by the Group in its day-to-day operations. The NBS pays interest of 2.5% on mandatory reserve in RSD and does not pay any interest on mandatory reserve in foreign currency.

13. Loans and advances to banks

	At 31 December	
	2010	**2009**
Nostro accounts (Note 33)	234,593	118,635
Money market placements (Note 33)	479,052	662,263
Total loans and advances to banks	**713,645**	**780,898**

Nostro accounts represent the account balances with Commerzbank, Dresdner bank, ProCredit Bulgaria and Standard Chartered bank GMBH, Standard Chartered bank New York and Deutsche Bank AG.

All loans and advances to banks are current assets.

14. Loans and advances to customers

	2010	**2009**
Legal entities	19,090,498	14,051,592
Small and medium enterprises	9,744,979	10,119,363
Agricultural	9,404,800	10,256,561
Private individuals	11,091,168	8,620,706
Total loans and advances to customers	**49,331,445**	**43,048,222**
Unearned future finance income on finance leases	(307,407)	(422,854)
Deferred fee income	(411,149)	(370,680)
Allowance for impairment	(1,636,533)	(1,582,920)
Net loans to customers	**46,976,356**	**40,671,768**

Accrued interest amounts RSD 450,834 thousand (2009: RSD 474,036 thousand).

Movement in allowance for losses on loans and advances are as follows:

	2010	**2009**
Balance at 1 January	1,582,920	980,799
Provision charge for loans and advances impairment (Note 5)	1,022,379	923,342
Loans written off	(1,031,702)	(395,106)
Exchange rate differences	62,936	73,885
Balance 31 December	**1,636,533**	**1,582,920**

Loans and advances to customers include finance lease receivables:

	2010	2009
Gross investment in finance leases:		
No later than 1 year	1,234,602	1,273,715
Later than 1 year and no later than 5 years	1,394,359	1,779,714
Later than 5 years	2,169	2,613
	2,631,130	**3,056,042**
Unearned future finance income on finance leases	(307,406)	(406,720)
Net investment in finance leases	**2,323,724**	**2,649,322**

Net investment in finance lease is analyzed as follows:

	2010	2009
No later than 1 year	1,063,833	1,066,285
Later than 1 year and no later than 5 years	1,257,870	1,580,493
Later than 5 years	2,021	2,544
	2,323,724	**2,649,322**

15. Derivative financial assets

Derivative financial assets in the amount of RSD 105 thousand (2009: RSD 4 thousand) include currency swaps with clients bank. Currency swaps are commitments to exchange one set of cash flows for another. The risk is monitored on an ongoing base with reference to the current fair value, and the liquidity of the market.
During 2010 the Group entered into foreign currency swap agreements in order to hedge its open currency position. The foreign currency swaps are economic hedges only and the hedge accounting is not being applied.

16. Financial assets available for sale

Financial assets available for sale include Visa International shares in amount RSD 11,639 thousand and SWIFT shares in amount RSD 1,979 thousand.

	At 31 December	
	2010	2009
Shares in companies situated in OECD countries	13,618	13,973
Total available-for-sale financial assets	**13,618**	**13,973**

The revaluation for available for sale financial assets in other comprehensive income show the following changes in:

Movements in revaluation reserve (AFS)

	2010	2009
As at January 1	5,384	998
Fair value remeasurement	(2,825)	4,873
Deferred taxes	282	(487)
As of December 31	**2,841**	**5,384**

17. Other financial investments

	At 31 December	
	2010	2009
Shares in equity – PC Academy Eastern Europe	7,924	7,924
Total financial investments	**7,924**	**7,924**

Other financial investments are classified as financial assets available for sale. The Banks has investment in the capital of PC Academy Eastern Europe. The amount of capital paid in 2007 is EUR 100 thousand which corresponds with 9.09% of the total capital of this entity. The investment is carried at cost. There is no active market for this investment and there are no recent transactions which would provide evidence for their current market value.

18. Intangible assets

The movement in intangible assets for the years 2010 and 2009 is presented in table below:

Software	
Cost	
Balance, 1 January 2009	61,183
Disposals	239,640
Additions	(22)
Balance, 31 December 2009	300,801
Accumulated amortization	
Balance, 1 January 2009	27,837
Charge for the year	21,976
Disposals	(22)
Balance, 31 December 2009	49,791
Net Book Value 31 December 2009	**251,010**
Cost	
Balance, 1 January 2010	300,801
Additions	23,618
Disposals	(87)
Balance, 31 December 2010	**324,332**
Accumulated amortization	
Balance, 1 January 2010	49,791
Charge for the year	53,943
Disposals	(78)
Balance, 31 December 2010	103,656
Net Book Value 31 December 2010	**220,676**

19. Property and equipment

The movement in intangible assets for the years 2009 and 2008 is presented in table below:

	Building	Leasehold improvements	IT and other equipment	Furniture and fixtures	Total
Cost					
Balance, 1 January 2009	688,685	341,944	1,254,514	206,013	2,491,156
Additions	15,561	16,724	104,714	5,622	142,621
Disposals	–	(13,727)	(49,749)	(4,154)	(67,630)
Balance, 31 December 2009	**704,246**	**344,941**	**1,309,479**	**207,481**	**2,566,147**
Accumulated Depreciation					
Balance, 1 January 2009	–	122,313	588,422	77,332	788,067
Disposals	–	(7,956)	(43,808)	(2,544)	(54,309)
Charge for the year	17,427	54,785	245,701	30,898	348,811
Balance, 31 December 2009	**17,427**	**169,141**	**790,315**	**105,686**	**1,082,569**
Net Book Value 31 December 2009	**686,819**	**175,800**	**519,164**	**101,795**	**1,483,578**
Cost					
Balance, 1 January 2010	704,246	344,941	1,309,479	207,481	2,566,147
Additions	23,761	3,534	99,306	1,389	127,990
Disposals	–	(52,110)	(61,488)	(12,231)	(125,829)
Balance, 31 December 2010	**728,007**	**296,365**	**1,347,297**	**196,639**	**2,568,308**
Accumulated Depreciation					
Balance, 1 January 2010	17,427	169,141	790,315	105,686	1,082,569
Disposals	–	(15,718)	(57,292)	(8,385)	(81,395)
Charge for the year	17,626	46,617	167,519	18,925	250,687
Balance, 31 December 2010	**35,053**	**200,040**	**900,542**	**116,226**	**1,251,861**
Net Book Value 31 December 2010	**692,954**	**96,325**	**446,755**	**80,413**	**1,316,447**

20. Deferred income tax assets

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 10% (2009: 10%).

Deferred tax assets are attributable to the following items:

	At 31 December	
	2010	**2009**
Tax credit carried forward (expiring in the period over 5 years)	223,210	246,449
Accelerated tax depreciation	28,279	24,442
As of 31 December	**251,489**	**270,891**

The movement in deferred income tax account is as follows:

	At 31 December	
	2010	**2009**
As of 1 January	270,891	288,655
Income statement charge	22,283	27,905
Fair value measurement of available for sale securities	(282)	(488)
Deferred tax on tax credit	(41,403)	(45,180)
As of 31 December	**251,489**	**270,891**

The deferred tax charge in the consolidated income statement comprises the following temporary differences:

	At 31 December	
	2010	**2009 restated**
Tax credit on investment in property and equipment	17,880	20,562
Accelerated tax depreciation	3,837	7,343
As of 31 December	**21,717**	**27,905**

All deferred tax assets are to be recovered after more than 12 months.

21. Current Tax asset

Current Tax Assets in amount of RSD 1,855 (2009: RSD 0) is current prepaid of income tax, which can be used in 2011 in payment of monthly advance for income tax.

22. Other assets

	At 31 December	
	2010	**2009**
Accounts receivables	37,951	50,694
Pre-payments	194,115	359,707
Repossessed properties	54,745	28,413
Deferred items	76,353	85,412
Claims on insurances	100	48
Claims from customs and taxes	1.554	6
Inventory items	10,103	14,632
Others	873	503
	375,794	**539,415**

Prepayments mostly relate to Interest expenses paid in advance to the clients using Pro Advance deposit in the amount of 64,407 RSD thousand (2009: RSD 284,983 thousand).

Deferred items consist of following:

- Deferred expenses that are related to marketing and rent in the amount of RSD 48,562 thousand (2009: RSD 65,944 thousand);
- Deferred invoice from ProCredit group in the amount of RSD 5,007 thousand (2009: RSD 3,431 thousand);
- Other deferred expenses in the amount of RSD 22.783 thousand (2009:RSD 25,037 thousand);

Others represent losses in cash box and litigated receivables in the amount of RSD 873 thousand (2009: RSD 503 thousand).

a) Financial and non-financial assets

	2010	**2009**
Financial	124,111	112,080
Non-financial	251,683	428,661
	375,794	**540,741**

b) All other assets are current assets

23. Deposits from banks

	At 31 December	
	2010	**2009**
Liabilities for term transactions	2,194,577	349,683
Other banks deposits	9	14
Accrued interest on deposits	594	–
	2,195,180	**349,697**

Liabilities for term transactions as of 31 December 2010 consist of spot transactions in the amount of RSD 424,570 thousand (2009: RSD 307,424 thousand), fx deals in the amount of RSD 53,272 thousand (2009: RSD 42,259 thousand) and other short term deposits in the amount of RSD 1,716,735 thousand.
Other bank deposits as of 31 December 2010 consist of deposits from banks in process of bankruptcy in the amount of RSD 5 thousand (2009: RSD 14 thousand) and loro accounts with OECD banks in the amount of RSD 4 thousand.
All deposits from banks are current liabilities.

24. Derivative financial liabilities

Derivative financial liabilities in the amount of RSD 5,649 thousand (2009: RSD 4,832 thousand) consist of interest rate swaps in the amount of RSD 4,460 thousand and interest rate currency swap in the amount of RSD 1,189 thousand. Interest rate swap is used to change commitments with floating interest rates for commitments with fixed interest rates.
As of 31 December 2010 the Group had Fixed-for-Floating Interest Rate Swap with Commerzbank AG of EUR 10,625 thousand. The Group entered into swap agreements in order to hedge its open gap between maturities of reprising of taken long term loans linked to floating rates, and reprising of loans disbursed at floating interest rates (Note 3.C.2 Interest rate risk).
Fair Value of interest rate swaps are presented in Income statement in position Net result from financial assets at fair value through profit or loss (Note 8).

25. Due to customers

	At 31 December	
	2010	**2009**
Current accounts		
private individuals	1,988,940	1,858,013
corporates	7,831,902	7,840,979
other customers	357,761	274,362
Savings accounts		
private individuals	2,464,072	2,061,617
Term deposit accounts		
private individuals	12,279,001	14,190,691
corporates	7,107,727	6,373,552
ProCredit Holding	2,637,455	2,397,220
other customers	128,308	154,262
Deposit as collateral for credit commitment	23,863	4,722
Deposit as collateral on balance exposure	1,667,496	1,915,184
Other liabilities	300,392	335,554
	36,786,917	**37,406,156**
Accrued interest on deposits	345,809	238,984
Total deposits	**37,132,726**	**37,645,140**
Current	35,058,950	36,164,697
Non-current	2,073,776	1,480,443
	37,132,726	**37,645,140**

Other liabilities as of 31st December consist of pending client transfers the amount of RSD 300,120 thousand (2009: RSD 334,789) and other liabilities in the amount of RSD 272 thousand (2009: RSD 765 thousand).

26. Other borrowed funds

Other borrowed funds include long term borrowed funds from International Financial Institutions and foreign banks. The table below summarizes other borrowed funds as of 31 December 2010:

	Initial loan in EUR	Carrying value in EUR 2010	Maturity	Interest rate	RSD thousand 2010	RSD thousand 2009
European Bank for Reconstruction and Development (EBRD)	10,000,000	10,000,000	2010-2015	ERBR + 4.00%	1,054,982	–
Kreditanstalt für Wiederaufbau (KfW)	55,000,000	43,571,428	2007-2017	1,75% - ERBR + 4,90%	4,596,707	2,894,472
International Finance Corporation	45,000,000	33,750,000	2007-2014	ERBR + 2,65% - 3%	3,560,564	1,917,776
Instituto de Credito Oficial	15,000,000	14,000,000	2004-2015	ERBR + 2.34% - 2.50%	1,476,975	1,438,332
Financierings - Maatschappij voor Ontwikkelingslanden (FMO)	63,000,000	21,350,000	2005-2013	ERBR + 2.65% - 6,68%	2,252,387	4,104,041
EFSE	34,183,333	19,642,857	2006-2016	ERBR + 2.3% - 3.10%	2,072,285	843,821
Dexia Micro credit fund	7,000,000	7,000,000	2009-2012	6mERBR + 3.50%	738,487	671,222
PC Finance B.V.	125,000,000	32,850,000	2007-2012	6%	3,465,615	4,506,773
	354,183,333	**182,164,285**			**19,218,002**	**16,376,437**
Accrued interest					276,175	330,701
Deferred fees					(143,393)	(163,708)
Total					**19,350,784**	**16,543,430**

The Group is obliged to comply with a number of debt covenants set in the borrowing contracts, such as risk weighted capital adequacy, single client exposure ratio, aggregate large exposure ratio, group exposure ratio, related party exposure ratio, maturity gap to available capital ratio, open credit exposure ratio, unhedged open foreign currency position in any currency and in aggregate. One of the most significant debt covenants is risk weighted capital adequacy ratio, which as at 31 December 2010 was as follows:

	Required (higher than)	Actual
International Finance Corporation	12%	17,86%
FMO (loan to ProCredit Bank)	12%	17,31%
FMO (loan to ProCredit Leasing)	10%	17,31%
European Bank for Reconstruction and Development	13%	17,86%

The methodology of calculation of the risk weighted capital adequacy ratio is different, based on specific requirements of the loan agreements.

As at 31 December 2010 and 2009 the Group was not in a breach of debt covenants with respect to its borrowed funds, except for the ratios in loan agreement with KfW showing the share of non performing leases in total lease portfolio of ProCredit Leasing and coverage of non performing leases with lease loss provisions. ProCredit Leasing (borrower) has been granted with the waivers from KfW (lender) for year 2010 and year 2011 based on which the lender declares that they do not intend to exercise their rights to require additional securities, or to terminate the loan agreement until 31 December 2010 and 31 December 2011 respectively, provided that the borrower shall not be at any time in breach of any other obligation under the loan agreement.

Loan agreement between PC Finance B.V. and ProCredit Bank is dated on 20 March 2007 with the maturity of five years. Amount of loan is EUR 47 milion; interest rate is 6% per annum and payable annually; interest rate is fixed for the period of five years.

27. Subordinated debt

	Initial loan in EUR	Carrying value in EUR	Maturity	RSD thousand	RSD thousand
		2010		2010	2009
EFSE-subordinated debt	27,000,000	27,000,000	2007-2015	2,848,451	2,588,998
Accrued interest				39,607	35,251
Deferred fees				(1,415)	(2,337)
Total				**2,886,643**	**2,621,912**

	2010	2009
Current	38,192	32,914
Non-current	2,848,451	2,588,998
	2,886,643	**2,621,912**

28. Tax liabilities

Tax liabilities as at 31 December 2010 amounted of RSD 0 (2009: RSD 10,814).

29. Provisions

	At 31 December	
	2010	2009
Company pension provision	32,670	37,581
Provision for losses on pending transactions	25,692	9,448
Provision for untaken vacation	33,870	37,119
Total provisons	**92,232**	**84,148**

Retirement benefit obligations are paid after regular retirement of employee. The right to this benefit is conditioned with keeping employee until the right to retirement is achieved. Expected costs for this allowance are accumulated during the period of employee's working years. Defined retirement obligation is estimated on yearly level by independent, certified actuary applying projected credit sample. Net present value of this liability is determined with discounting future net cash outflows applying interest rate on long term bonds which have same currency and similar maturity as retirement benefit obligations have.
Retirement benefit obligations which mature in more than 12 months after balance sheet date are discounted to net present value.

Movement in provisions is as follows:

	2010	2009
Balance at 1 January	**84,148**	**176,006**
Charge for the year	49,140	37,139
Releases	(42,030)	(129,591)
Other	974	594
Balance 31 December	**92,232**	**84,148**

Movement in provisions for retirement benefit obligations:

	2010	2009
Balance at 1 January	**37,581**	**39,388**
Release	(4,911)	(1,807)
Balance 31 December	**32,670**	**37,581**

30. Other liabilities

	At 31 December	
	2010	2009
Liabilities to employees	71	26
Taxes, contributions and other charges	14,154	6,615
Liabilities to suppliers	75,313	201,302
Received prepayments for credit installments	251,638	189,502
Liabilities to Credit Bureau	11,869	3,616
Deferred income from subvention	194,784	95,221
Received prepayments	15,766	55,575
Other	5,357	9,775
	68,952	**561,632**

	2010	2009
Financial	112,265	219,890
Non-financial	456,687	341,742
	568,952	**561,632**

	2010	2009
Current	374,168	424,934
Non-current	194,784	136,697
	568,952	**561,632**

Position other includes: other due payments RSD 5,296 thousand (2009: RSD 9,754 thousand), liabilities for surplus in cash box RSD 61 thousand (2009: RSD 21 thousand).

31. Share Capital

The ownership structure of the ProCredit Bank a.d. Belgrade as at 31 December 2010 and 2009 is as follows:

	Number of shares		Share in %	
	2010	**2009**	**2010**	**2009**
ProCredit Holding AG	3,052,510	3,052,510	83.33	83.33
Commerzbank AG	610,502	610,502	16.67	16.67
	3,663,012	**3,663,012**	**100.00**	**100.00**

The Group is controlled by ProCredit Holding AG, Germany, which owns 83,33% of shares. The remaining 16.67% is owned by Commerzbank AG. The ultimate parent of the group is ProCredit Holding AG.
The total number of shares at the end of the year was 3,663,012 (2008: 3,663,012) with nominal value of 1,000 RSD per share (2009: 1,000 RSD per share). In 2010. there was no issue of shares (2008: 1.299,738 shares issued affecting increase of Share capital by RSD 1,299,738 thousand and Share premium by RSD 1,450,932 thousand).

32. Special banking risks reserves

According to the Central Bank's decision on classification of banks balance sheet assets and off-balance sheet items, starting with 30 June 2006, the Group is obliged to allocate from retained earnings to a special account reserve in equity the difference between the amounts of allowances for loans and advances to banks and customers calculated based on the Group's internal rules and Central Bank provisioning regulations, respectively. The amounts allocated to special account reserves are not distributable to shareholders.
As at 31 December 2010, the special banking risk reserves under Central Bank's regulations amounted to RSD 1,643,864 thousand (31 December 2009: RSD 1,345,592 thousand).
During 2010 the Bank has allocated to special account reserves the amount of RSD 298,272 thousand (2009: 269,407), after approval of the Bank's shareholders, in order to reach the level prescribed by the Central Bank.

33. Cash and cash equivalents

	At 31 December	
	2010	**2009**
Cash and balances with Central Bank (Note 12)	21,025,345	22,366,213
Nostro accounts with other banks (Note 13)	234,593	118,635
Money market placements (Note 13)	479,052	662,263
	21,738,990	**23,147,111**

34. Contingent liabilities and commitments

The following table indicates the contractual amounts of the Group's off-balance sheet financial instruments that commit it to extend credit to customers:

	At 31 December	
	2010	**2009**
Payments and guarantees	5,266,211	4,996,178
Acceptances and endorsements	4,862	4,862
Loan commitments	1,961,441	1,884,115
Letters of credit	97,538	43,036
Credit related commitments (Note 3.B.3)	7,330,052	6,928,191
Performance guarantees	769,691	605,823
Balance as at 31 December	**8,099,743**	**7,534,014**

The following table shows the Operating lease commitments for rent of business premises:

	At 31 December	
	2010	**2009**
No later than 1 year	8,119	44,499
Later than 1 year and no later than 5 years	91,597	188,588
Later than 5 years	1,202,351	1,453,393
	1,302,067	**1,686,480**

35. Related party transactions

In normal course of business, the Group enters into transactions with its shareholders and other micro finance institutions in Central and Eastern Europe.
A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and foreign currency transactions. There were related-party transactions with the ultimate parent company ProCredit Holding AG, other than the payment of dividends on ordinary shares.

	At 31 December	
	2010	2009
Nostro accounts		
Commerzbank AG	69,356	63,578
ProCredit Bank Bulgaria	16,443	2,647
Loans and advances to banks		
ProCredit Financial	3,465,616	4,506,774
Share in equity		
ProCredit Academy Eastern Europe	7,923	7,923
Other receivables		
ProCredit Holding	340	261
PC Finance II	5,007	3,171
ProCredit Academy Eastern Europe	3,853	–
ProCredit Honduras	2,755	–
ProCredit Bank Kosovo	230	–
Liabilities to group co		
PC Finance II	922,260	2,049,684
ProCredit Holding	2,637,455	2,397,220
Other liabilities to group co		
PC Finance B.V.	3,465,616	4,506,774
ProCredit Holding	29,213	3,113
PC Finance II	1,392	3,372
ProCredit Bank Kosovo	549	–
Germany Academy	75	–
Off balance sheet items		
Guarantees issued to PC Finance II	354,474	244,516

The volumes of related party transactions and related expenses for the year are as follows:

	2010	2009
Deposits from banks		
Outstanding at 1 January	–	–
Deposits collected during year	14,820,162	11,358,304
Deposits returned during the year	(12,182,707)	(8,961,084)
Outstanding at 31 December	**2,637,455**	**2,397,220**
Other borrowed funds		
Loans outstanding at 1 January	4,506,774	8,594,297
Loans repayments during the year	(1,041,158)	(4,087,523)
Loans outstanding at 31 December	**3,465,616**	**4,506,774**

	2010	2009
Interest income from associates	–	1,708
Interest expenses from subsidiaries	62,594	32,573
Interest expenses from associates	60,882	32,502

Paid salaries and other short term employee benefits to the Members of Executive Board as of 31 December 2010 amounted to RSD 17,657 thousand (2009: RSD 15,769 thousand). No other benefits have been paid to the key management.

36. Events after balance sheet date

For the period up to and including 01 March 2011, no post balance sheet events have occurred which have any substantial impact on the consolidated financial statements for the year ending 31 December 2010.

37. Exchange Rates

The official exchange rates as of 31 December 2010 and 2009 are as follows:

	2010	2009
USD	79.2802	66.7285
EUR	105.4982	95.8888
CHF	84.4458	64.4631

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