ProCredit Bank

Serbia


# Annual Report 2009

# Key Figures

| | EUR '000 | | RSD '000 | | Change |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | RSD |
| **Balance Sheet Data** | | | | | |
| Total Assets | 692,319 | 742,953 | 66,385,674 | 65,826,358 | 0.8% |
| Gross Loan Portfolio* | 440,663 | 450,132 | 42,254,688 | 39,882,154 | 5.9% |
| Business Loan Portfolio | 245,025 | 263,041 | 23,495,126 | 23,305,719 | 0.8% |
| EUR ‹ 10,000 | 86,378 | 97,883 | 8,282,715 | 8,672,503 | -4.5% |
| EUR › 10,000 ‹ 50,000 | 76,633 | 89,610 | 7,348,199 | 7,939,577 | -7.4% |
| EUR › 50,000 ‹ 150,000 | 41,136 | 39,480 | 3,944,442 | 3,497,938 | 12.8% |
| EUR › 150,000 | 40,878 | 36,068 | 3,919,770 | 3,195,701 | 22.7% |
| Agricultural Loan Portfolio | 110,671 | 103,150 | 10,612,079 | 9,139,152 | 16.1% |
| Housing Improvement Loan Portfolio | 41,600 | 38,693 | 3,989,006 | 3,428,253 | 16.4% |
| Other | 43,368 | 45,248 | 4,158,476 | 4,009,030 | 3.7% |
| Allowance for Impairment on Loans | 16,508 | 11,070 | 1,582,920 | 980,799 | 61.4% |
| Net Loan Portfolio | 424,156 | 439,062 | 40,671,768 | 38,901,355 | 4.6% |
| Liabilities to Customers | 392,592 | 343,368 | 37,645,140 | 30,422,765 | 23.7% |
| Liabilities to Banks and Financial Institutions (excluding PCH) | 203,517 | 302,498 | 19,515,039 | 26,801,656 | -27.2% |
| Shareholders' Equity | 89,313 | 90,995 | 8,564,069 | 8,062,269 | 6.2% |
| **Income Statement** | | | | | |
| Operating Income | 54,163 | 49,914 | 5,193,670 | 4,422,408 | 17.4% |
| Operating Expenses | 45,091 | 43,942 | 4,323,695 | 3,893,332 | 11.1% |
| Operating Profit Before Tax | 9,073 | 5,971 | 869,974 | 529,076 | 64.4% |
| Net Profit | 8,421 | 6,953 | 807,518 | 616,031 | 31.1% |
| **Key Ratios** | | | | | |
| Cost/Income Ratio | 71.3% | 78.0% | | | |
| ROE | 9.7% | 9.6% | | | |
| Capital Ratio | 19.4% | 18.4% | | | |
| **Operational Statistics** | | | | | |
| Number of Loans Outstanding | 103,363 | 113,854 | | | -9.2% |
| Number of Loans Disbursed within the Year | 60,825 | 83,145 | | | -26.8% |
| Number of Business and Agricultural Loans Outstanding | 66,525 | 77,059 | | | -13.7% |
| Number of Deposit Accounts | 450,656 | 478,745 | | | -5.9% |
| Number of Staff | 1,864 | 1,860 | | | 0.2% |
| Number of Branches and Outlets | 79 | 86 | | | -8.1% |

Exchange rate as of December 31:
2009: EUR 1 = RSD 95.8888
2008: EUR 1 = RSD 88.601

* Total gross loan portfolio under management by ProCredit Bank Serbia including the securitised portfolio and cross-border loans as of 31 December 2009: EUR 473 million.

## 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 continued to achieve solid performance in 2009 despite the turbulence in global markets and the myriad of challenges facing the banking industry. The aftermath of the crisis had a direct impact on the local financial system, ending a decade of stability, and the bank was not left unaffected. However, the effects were mitigated by our prudent policy of not engaging in high-risk activities such as consumer lending and speculative transactions.*

*The cost of external financing was driven higher by the deterioration of Serbia's credit rating in 2008 and the tight monetary policy pursued by the central bank at the start of the year. A drop in foreign direct investment combined with reduced production and exports prompted most institutions to restrict their lending activities. The subsequent slowdown in credit growth led to a liquidity shortage in the real economy that triggered an increase in the rate of arrears. For the banking sector as a whole, the Credit Bureau reported a portfolio at risk over 90 days of 4.38% for loans to legal entities.*[1]

*In line with its mission to foster long-term development, ProCredit Bank responded to these challenges by continuing to provide loans in a responsible manner to small and medium-sized enterprises, private entrepreneurs and agricultural producers. This sent a clear signal to our more than 293,000 clients that they have a solid partner whom they can rely on to meet their financial needs – not only in a buoyant economy, but also during more difficult times.*

*Demonstrating our commitment to building deep and durable customer relationships, we increased both the loan portfolio and the deposit base in 2009. The loan portfolio expanded by 5.9% to RSD 42.3 billion (EUR 440.7 million), while total deposits rose by 23.7% to RSD 37.6 billion (EUR 392.6 million), spread across 450,656 accounts. As a true "neighbourhood bank", we continued to organise branch events to promote transparency in the financial sector as well as a range of activities for the benefit of the broader community.*

*Maintaining high portfolio quality has always been a primary goal at ProCredit Bank. Our proven credit technology is based on a thorough financial analysis of each applicant, and our staff receive regular training so that they are able to offer up-to-date professional advice and the highest standard of customer care. At the close of 2009, the bank had a portfolio at risk over 90 days of 2.48%, which was significantly lower than the sector average.*

*The bank's financial results for the year demonstrated its ability to overcome the problems of a challenging business environment. Net profit amounted to RSD 807 million (EUR 8.4 million), translating into a return on equity of 9.71%. At the end of December, the capital adequacy ratio stood at 19.42%.*

*These encouraging results would not have been possible without a motivated team of employees who are guided by the principles of responsible banking. In this sense, staff training will remain a central priority in 2010, both locally and at the ProCredit Academies in Germany and Macedonia. We will also focus on expanding our services for the SME and agricultural sectors, positioning ourselves as the "house bank" for all their day-to-day financial needs.*

*On behalf of the Board of Directors, I would like to express my gratitude to our shareholders for their continued support of our vision. Our appreciation also goes to the employees and management of ProCredit Bank for their commitment and hard work. It is thanks to them that we are able to present this positive report, and we truly value their contribution to the bank and the development of its business.*

*Dörte Weidig*
*Chairperson of the Board of Directors*

***Members of the Board of Directors as of December 31, 2009:***
*Dörte Weidig (Chairperson)*
*Claus-Peter Zeitinger*
*Gabriele Heber*
*Goran Zivkov*
*Helen Alexander*
*Dr. Klaus Glaubitt*
*Rainer Ottenstein*

***Members of the Executive Board as of December 31, 2009:***
*Svetlana Tolmacheva*
*Mirjana Garapic-Zakanyi*
*Dejan Janjatovic*

[1] Unpublished data provided directly to ProCredit Bank Serbia.

# 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 now 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. 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.

The founding shareholders of ProCredit Bank Serbia were KfW, the European Bank for Reconstruction and Development (EBRD), Commerzbank, the Netherlands Development Finance Company (FMO), and ProCredit Holding. 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 72.6 million.

| Shareholder (as of Dec. 31, 2009) | Sector | Headquarters | Share | Paid-in Capital (in EUR million) |
|---|---|---|---|---|
| ProCredit Holding | Investment | Germany | 83.33% | 60.5 |
| Commerzbank AG | Banking | Germany | 16.67% | 12.1 |
| **Total Capital** | | | **100%** | **72.6** |

**ProCredit Holding** is the parent company of a global group of 22 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 group-wide 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 2009, the equity base of the ProCredit group is EUR 388 million. The total assets of the ProCredit group are EUR 4.9 billion.

**COMMERZBANK** **Commerzbank** is one of Germany's leading banks 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. The new Commerzbank has approximately 15 million private and corporate customers worldwide, who can now enjoy an even broader and more attractive range of Commerzbank products and advisory services.

The new Commerzbank promises to be an even stronger and more 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, the new Commerzbank is also strengthening its position as 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 46 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 3.7 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

## Responsibility Goes Beyond Banking

ProCredit Bank Serbia has always strived to give its clients all the information they need to make sound choices when selecting products and services. In line with our core values, we take a responsible approach to all aspects of our operations. Thus, from the very beginning we have sought to enable both our clients and the general public to properly assess the increasingly complex products offered by financial institutions.

In 2009, the bank placed particular emphasis on financial education. At the beginning of the year, we organised regional presentations of our free educational brochure "How to Talk to a Bank". It briefly explains basic banking terms and services and was originally issued as part of a national initiative in 2007 and 2008. In 2009 we distributed it through local media and our branches in a campaign supported by regional media presentations around the country.

In parallel, the bank implemented its programme "Financial Education for Children", which was supported by the National Bank of Serbia. Nearly 70 specially-trained employees gave presentations in schools, explaining basic banking products and services to more than 1,500 children. They also conducted interactive workshops in kindergartens and gave presentations at high schools on the economic crisis and on personal financial management.

Our fifth annual "Children's Savings Day" helped promote both good savings habits and environmental awareness. In a special competition, nearly 3,500 children vied with each other to make the most creative toys out of recyclable materials, with 228 receiving prizes for their ideas.

The focus on financial education in 2009 was also reflected in activities for adults, including quizzes and seminars on two key topics: "Planning Your Household Budget" and "Where Does Your Money Go?". For farmers, we held a series of lectures covering the same topics but also dealing with investment and financing strategies for agricultural producers. These lectures were also given at a five-day workshop held at the Agricultural Fair in Novi Sad, the largest event of its kind in Serbia.


In 2009 the global economic crisis began to impact the real economy in Serbia. Thus, toward the end of the year we decided it was time to offer our core client group additional support, over and above the provision of tailored banking services. Accordingly, one-day seminars for SMEs entitled "Time to Move On" were held in all four of our regional centres, and our branches distributed an accompanying brochure. Developed and led by external consultants, the seminars covered basic elements of business management in times of crisis, and interest was so great that a fifth seminar had to be held. A total of 1,500 people attended these events.

Our clients' high level of interest in all of these activities and their positive feedback underscored just how much they appreciated our financial education efforts. *"I am very pleased by ProCredit Bank's willingness to support its clients in this way. For me, this type of co-operation further enhances our business relationship,"* explained a seminar participant. Thus, we will continue to undertake initiatives of this type, demonstrating that there is more to responsible banking than just providing high-quality products and service.

# Management Business Review


***Executive Board*** *from left to right:*

***Mirjana Garapic Zakanyi***
*Member of the Executive Board*

***Dejan Janjatovic***
*Member of the Executive Board*

***Svetlana Tolmacheva***
*Chairperson of the Executive Board*

## Political and Economic Environment

Politically, 2009 was an eventful year for Serbia. The US Vice President visited Belgrade in May to support the country's bid to join the EU. The Russian President also travelled to the capital when the world's largest gas company, Gazprom, signed an agreement with NIS (Petroleum Industry of Serbia) to collaborate on the development of the Serbian section of the South Stream pipeline. The aim of this project is to supply Europe with Russian gas from the Black Sea by 2015.

Russia also approved a loan of EUR 1 billion, which is intended to support the Serbian government's efforts to eliminate the budget deficit and finance the construction of new roads and railways.

Although Serbia signed the Stabilisation and Association Agreement in April 2008, the EU immediately froze negotiations when the Netherlands called on Belgrade to deliver two former military leaders to The Hague. Improved cooperation in 2009 opened the door to an interim trade agreement in December, and the EU Commission decided to abolish visa requirements for Serbian citizens.

GDP reached USD 50 billion in 2008, having grown by 5.6% over the previous year despite the effects of the financial sector crisis in the final quarter.[1] The subsequent global recession had a direct impact on economic activity in 2009, however. Domestic businesses faced reduced demand and a drop in foreign investment. As a result, real GDP declined by an estimated 2.8%, although early signs of stabilisation were already apparent in the second half of the year.[2]

International financial institutions provided substantial support for the struggling Serbian economy. The IMF increased the funding available under its stand-by agreement to EUR 2.6 billion with a maturity date of April 2011. Additionally, the EBRD approved a loan of EUR 150 million to finance construction of part of the Pan-European Corridor between Salzburg and Thessalonica, which passes through Belgrade. The World Bank forwarded debt of USD 550 million to Kosovo because it had been generated by the territory prior to its independence.

Standard & Poor's affirmed its "BB-" long-term sovereign credit rating and revised the country's outlook from negative to stable. The government's commitment to complying with the IMF programme and the narrowing current account deficit were key factors in this development.

In order to stimulate the economy, the government set aside RSD 40 billion (EUR 417 million) to provide subsidised loans to businesses and private individuals. By making credit more available and with lower interest rates, the goal of this lending programme was to boost GDP by around RSD 180 billion (EUR 1.88 billion). Government initiatives of this kind are expected to continue into 2010.

The beginning of 2009 was marked by high growth in consumer prices. However, the rate of price increase declined in the second quarter of the year, when it was not only lower than in the previous two quarters, but also lower than projected and moved within the target range. By the end of 2009, core inflation reached 4.1%. According to information published by the Statistical Office of the Republic of Serbia, the trade deficit stood at EUR 5.2 billion, 39.2% less than in the previous year.

During 2009, the dinar was strongest on January 5, when the exchange rate stood at RSD 89.54 per EUR, and the weakest on December 7, when the middle exchange rate was RSD 96.57 per EUR. The greatest weakening of the RSD was recorded in January, when the decline amounted to 5.8%. Although it remained practically stable throughout the second and third quarters, the dinar lost an average of 1.3% per month in the fourth quarter. The depreciation was most pronounced in December, when it rose to nearly 3% by the end of the month.[3]

1 World Bank, Serbia: Country Brief 2009, www.worldbank.rs.
2 National Bank of Serbia, "Current Macroeconomic Challenges", 24 Jan 2010, www.nbs.rs.
3 National Bank of Serbia, Inflation Report, www.nbs.rs/export/internet/latinica/90/90_5/inflation_feb_2010.pdf

## Financial Sector Developments

The composition of the Serbian banking sector did not change in 2009. At the end of the year, there were 34 banks and 6 representative offices of foreign banks operating in the country.[4] The sector's total assets amounted to RSD 2,293.7 billion (EUR 24.4 billion), representing an increase of 12.9% in real terms compared to 2008.

In a diagnostic study of the 16 institutions with the largest share in total assets, the National Bank of Serbia (NBS) determined that the banking sector is adequately capitalised and liquid. The majority of banks use local deposits as the main source of financing and place most of their excess liquidity within the country. Given the limited volume of investments abroad, banks suffered no major losses as a direct result of the international financial crisis.

Nevertheless, media coverage of the crisis eroded the public's trust in banks and prompted a high level of deposit withdrawals in the final quarter of 2008. The majority of these funds were returned, however, and total deposits grew to EUR 6.43 billion in 2009. Compared to the end of the previous year, this represented overall growth of 24.8%.

In February the Ministry of Economy and Regional Development launched a lending programme, subsidising bank loans in order to increase liquidity in the economy. The combined volume of such loans totalled RSD 93.3 billion (EUR 973 million), or around 20% of the total volume of disbursements in 2009.[5]

Total loans amounted to RSD 1,400 billion (EUR 14.6 billion), representing growth of 5%. This expansion was much more moderate than in 2008, when the consolidated loan portfolio grew by 14.1%. Business loans increased 8.8% to RSD 973.3 billion (EUR 10.2 billion). Loans to legal entities rose by 9.96% to RSD 930.7 billion (EUR 9.7 billion), while loans to private entrepreneurs decreased by 11.9% to RSD 42.8 billion (EUR 446 million), reflecting the reduced demand in this segment as well as the higher lending criteria imposed by many banks.

The top three banks (Intesa Bank, Komercijalna Bank and Raiffeisen Bank) accounted for more than 34% of total assets – a similar market share compared to 2008.

The European Bank Co-ordination Initiative has helped to stabilise the Serbian financial system by maintaining the liquidity of the local banking sector and preventing the subsidiaries of foreign banks from pulling out of Serbia and other countries that have been impacted by the crisis.

Regulatory reforms by the NBS were designed to increase customer protection and ensure the integrity of banks' operations. These included more stringent risk management and reporting requirements, specifically with regard to liquidity, foreign exchange and market risk. In line with its forecasts of lower inflation, and in order to promote increased lending in the local currency, the NBS had lowered the its "repo" rate from 17.75% in January to 9.5% by year-end.

Due to the economic downturn, a total of 13 banks recorded a loss in 2009, and the number of employees in the sector fell by 627, or around 2%. For business loans, the portfolio at risk (PAR – arrears over 90 days) increased from 6.69% to 12.46%, while PAR in the agricultural sector rose from 5.83% to 16.91%.

ProCredit Bank maintained a consistent market position in terms of total assets (12th), loans (11th) and deposits (11th).

## ProCredit Performance

In response to the challenges of the year under review, ProCredit Bank continued to demonstrate a strong commitment to responsible banking, the fundamental principle of the ProCredit group. The problems that have characterised the global banking sector since the final quarter of 2008 have reaffirmed that our approach – adherence to a simple business model and a focus on clients' needs – is the most prudent way to conduct the banking business.

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[4] Financial sector data based on National bank of Serbia: www.nbs.rs.

[5] Fond za razvoj, www.fondzarazvoj.gov.rs.

In line with our mission to provide a professional and personalised service, we were proactive in finding appropriate solutions in cases where businesses were facing financial difficulties. Our credit team maintained open communication with clients and monitored the portfolio very closely to detect payment problems at an early stage. Loans were restructured when necessary to reflect reduced revenues, helping to ensure that our clients were able to meet their obligations.

Our branches also organised informative events for the benefit of small business owners to discuss the challenges presented by the changing economic climate.

It was clear that some enterprises were able to take advantage of the new business environment in 2009, and they required a partner that would offer the necessary financial support for expansion. In this respect, ProCredit Bank made credit widely available to small-scale businesses while many banks focused on serving only larger SME clients. Furthermore, we promoted our broad range of deposit and other banking services, confirming our position as a reliable, full-service "house bank" for SMEs.

By striving to meet the particular needs of our diverse customer base, we were able to offer tailored products and services that remained in high demand. Teams were reorganised at head office to improve co-ordination of the activities of departments and branches following the bank's shift from a product-oriented approach to a customer-oriented model, with a specific focus on enterprise clients and private individuals. These strategic and organisational changes implied intensive training for the employees whose roles were most directly affected.

Unlike many financial institutions in Serbia, we achieved a high level of stability in the year under review. The loan portfolio showed moderate growth and good quality. On the deposit side, we continued to invest in financial education initiatives with the aim of fostering a savings culture among people of all ages. Our staff also provided sound advice regarding the sometimes confusing deposit market, helping customers to achieve their financial goals in more uncertain times. This approach enabled the bank to recover the substantial withdrawals made when the financial crisis started in Southeast Europe.

Despite growing public concern about the risks of borrowing and doubts about the safety of bank deposits, ProCredit Bank achieved good financial results for the year. More important, we demonstrated that people look for more than an attractive interest rate when choosing a long-term financial partner or a reliable institution for their savings.

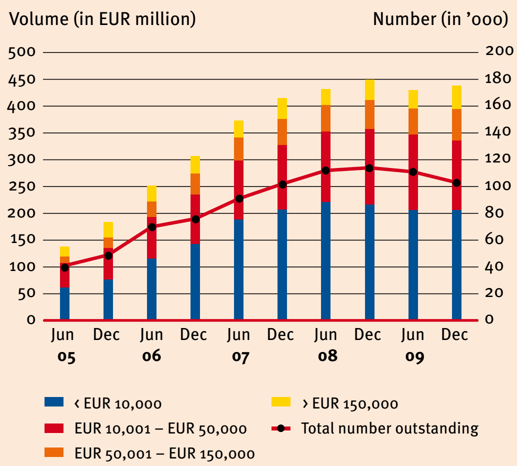
## Lending

ProCredit Bank achieved a moderate increase in the loan portfolio in 2009, thus fulfilling one of its key business objectives for the year. By continuing to make financing available to its core target groups, the bank increased the gross loan portfolio by 5.9% to RSD 42.3 billion (EUR 440.7 million) spread across 103,363 loans.

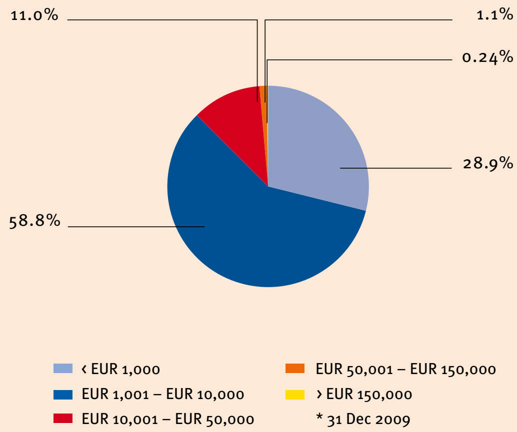
We disbursed over 60,800 loans with a combined volume of of RSD 34.6 billion (EUR 360.7 million). Reflecting our focus on serving small-scale businesses and agricultural households, the average loan disbursement was RSD 511,550 (EUR 5,335).

In line with its commitment to supporting local businesses, the bank joined a lending programme organised by the Ministry of Economy and Regional Development in February. We made it a priority to provide government subsidised loans to local enterprises, enabling them to make investments in a difficult business environment.

**Loan Portfolio Development**




**Number of Loans Outstanding – Breakdown by Loan Size***




* 31 Dec 2009

Of the 27 banks involved, ProCredit Bank took fifth place in terms of the volume of financing disbursed – a total of RSD 8.5 billion (EUR 87.99 million).[6]

Extending financing to SMEs remains at the core of the bank's lending activities. Of all the loans disbursed in 2009, 72.0% were business loans (this does not include agricultural loans), and loans to business clients constituted 62% of the year-end portfolio.

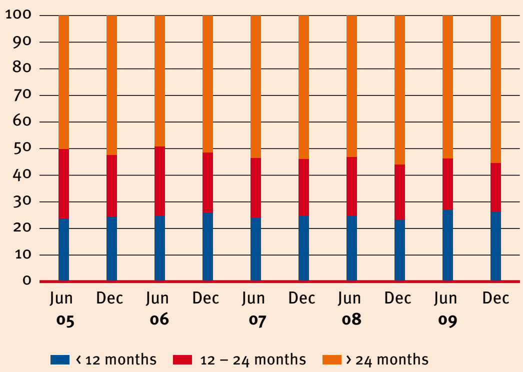
Small loans (EUR 10,000 to EUR 100,000 represented 41% of the business portfolio (2008: 43%), while very small loans (below EUR 10,000) accounted for 23%. The portfolio of loans above EUR 100,000 grew by 30% to RSD 10.3 billion (EUR 107.7 million). These developments reflect our efforts to build long-term relationships with businesses that have the potential to grow and create employment, thus making an important contribution to economic development.

Agriculture is a vital sector of the Serbian economy, and one that continued to expand despite the recession. To support the operations of rural producers, the bank offers tailored loans for purposes such as the purchase of farming inputs and modern machinery. In 2009 we disbursed close to 16,000 loans in this category with a combined volume of RSD 5.5 billion (EUR 57 million). Much

[6] Figures provided to ProCredit Bank by the Ministry of Economy and Development.

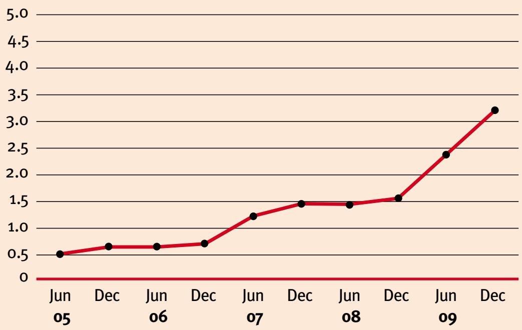
**Business Loan Portfolio – Breakdown by Maturity**

in %




**Loan Portfolio Quality (arrears ›30 days)**

in % of loan portfolio




**Net write-offs:** in 2005: EUR 612,741; in 2006: EUR 929,437; in 2007: EUR 2,169,502; in 2008: EUR 4,812,045; in 2009: EUR 2,674,104 of this was made possible by another government lending programme: according to the Ministry of Agriculture, ProCredit Bank accounted for almost 60% of the total volume of subsidised loans disbursed to the agricultural sector.[7] This segment of the bank's portfolio grew by 6.1% to RSD 10.4 billion (EUR 108.7 million).

As a socially responsible institution, the bank provides financing to enable customers to make home improvements that would enhance their quality of life, including energy efficiency loans to help people overcome the rising cost of utilities. In total, we disbursed 4,330 housing improvement loans, and this segment of the portfolio increased by 11% to RSD 5.3 billion (EUR 55.4 million), representing 8.6% of the year-end portfolio.

Loan portfolio quality remained at an acceptable level in 2009 given the challenging macroeconomic climate. The PAR was equivalent to 3.2% of the year-end portfolio (2008: 1.53%). Loan loss provisions were increased to RSD 1.4 billion (EUR 15.3 million) and were more than sufficient to cover the PAR at all times during the year. Net write-offs totalled RSD 256 million (EUR 2.7 million).

We attribute our success in limiting arrears primarily to the effectiveness of our lending methodology and the hard work of our staff. By closely monitoring the portfolio and maintaining frequent communication with their clients, our credit team responded quickly to payment problems and found mutually beneficial solutions. 5.4% of the portfolio was restructured in 2009, enabling customers to regain control over their outgoing cash flow.

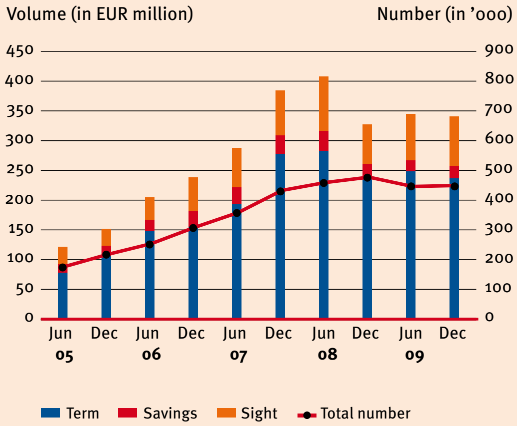
[7] Ministry of Agriculture, www.minpolj.sr.gov.yu.

## Deposits and Other Banking Services

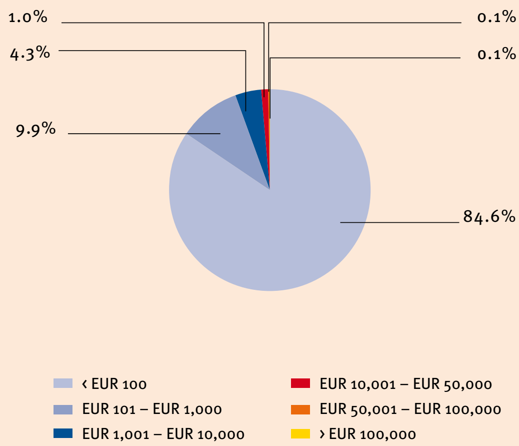
The uncertainty caused by the outbreak of the financial sector crisis led to a high level of withdrawals in Serbia during the final quarter of 2008. At ProCredit Bank, we therefore made it a priority in 2009 to communicate the stability of the institution to our customers and the broader public. Branches organised frequent informative events and direct promotions to encourage people to place their money at the bank, explaining that their funds would not be at risk. By involving our customers in open dialogue and continuing to offer a range of attractive savings options, we succeeded in stabilising and increasing the deposit base.

Total deposits grew over the year by 23.7% to RSD 37.6 billion (EUR 392.6 million). Although many accounts were opened, the bank also closed a larger number of inactive accounts, reducing the total number by 16.2% to 536,000. At the same time, the deposit-to-loan ratio increased from 68.3% to 89.1%.

**Customer Deposits**



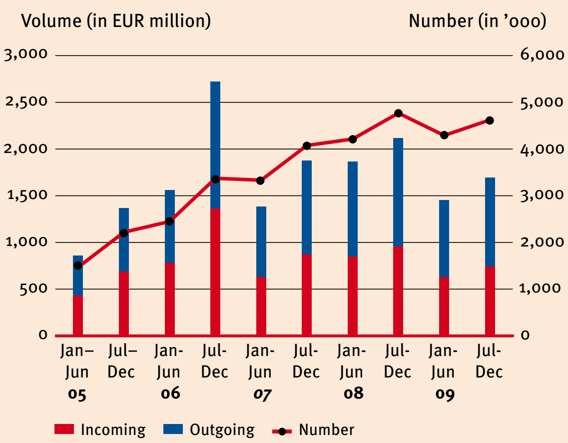

**Number of Customer Deposits – Breakdown by Size***



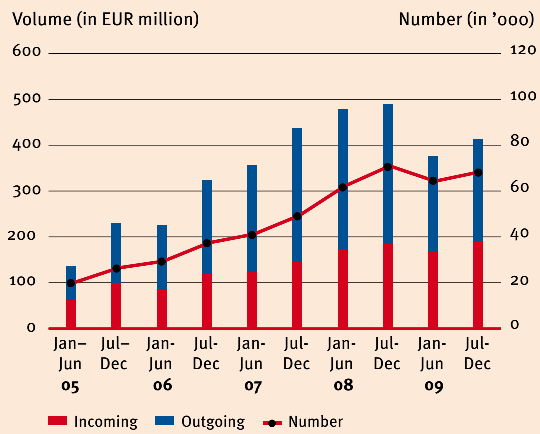

* 31 Dec 2009

A particularly challenging period was the month of November, following World Savings Day, when competitor banks pursued aggressive marketing campaigns, offering high short-term interest rates in an attempt to increase customer funds. In order to raise public awareness of these misleading practices and to foster an understanding of the importance of saving, our staff took great pains to explain that interest rates alone should not dictate people's choice of bank. Instead, we emphasised the advantages of straightforward products and a bank that is reliable and transparent. In this way, we succeeded in maintaining a stable deposit base without taking part in the price war.

**Domestic Money Transfers**




**International Money Transfers**




Deposits from business customers grew by 32.5%, outpacing private individual deposits, which rose by only 12.2%. Nevertheless, the latter continued to represent the majority of customer deposits with a share of 56.0%. Reflecting our efforts to maintain long-term customer relationships, term deposits accounted for 63.6% of the total base, followed by current accounts (30.0%) and regular savings accounts (6.4%).

In addition to deposit accounts, ProCredit Bank has always aimed to provide a full range of retail banking services to meet the needs its broad customer base. In 2009 we installed 18 additional ATMs, bringing the total number to 154. The bank also expanded its network of POS terminals to more than 470 units.

We encourage our customers to use payment cards as a secure and convenient alternative to cash, and credit cards are offered to eligible customers who require a higher degree of flexibility. At the end of the year, we had over 84,000 cards in circulation, more than 40% of which were being used at least once a month. In order to improve efficiency, the bank cancelled cards that had been inactive for an extended period, increasing the activity rate by 9.7%.

The bank operates a call centre to field public enquiries and to enable customers to access services from the convenience of their offices or homes. The number of calls received rose by 34.4% in 2009, reaching 247,000. We also offer an Internet banking facility that is used by an increasing number of customers each month.

In its payment transfer business, the bank carried out domestic transactions with a total volume of RSD 431 billion (EUR 4.5 billion) in 2009, representing an increase of 18.2%. Due to the depressed economy, the volume of international transfers decreased by 32.1% to RSD 39.6 billion (EUR 413 million).

## Financial Results

In response to the challenges that faced the financial sector in the year under review, ProCredit Bank developed a strategy to limit the rate of arrears while maintaining ample liquidity and improving operational and administrative efficiency. A particular priority in the first quarter, however, was to stabilise the loan portfolio by extending loans to SME and agricultural clients.

Despite the effects of the global economic crisis, total assets increased by 0.95% to RSD 66.5 billion (EUR 693.3 million) in 2009. Although this growth was modest, we consider it appropriate under the circumstances. The gross loan portfolio expanded by 12% to RSD 45 billion (EUR 473 million), including cross-border loans with a combined volume of RSD 3.1 billion (EUR 32.7 million). At the close of the year, liquid assets represented 33.2% of total assets.

Reflecting continued public confidence in the bank, total deposits rose by 23.7% to RSD 37.6 billion (EUR 392.6 million), mainly driven by a 7.61% increase in deposits from legal entities. The deposit base constituted 65% of total liabilities and was equivalent to 89.1% of the gross loan portfolio at year-end.

The bank’s external funding amounted to RSD 14.5 billion (EUR 150.8 million). This was provided by Dexia Micro-Credit Fund (4.64%), EFSE (23.7%) and KfW (19.4%, a portion of which also financed the operations of ProCredit Leasing).

Total operating income for the year was RSD 5 billion (EUR 52.4 million). Of this amount, 91.5% was generated by net interest income. Net interest income was mainly driven by the bank’s lending activities and rose by 17.4% to RSD 8.1 billion (EUR 84.2 million).

Net fee and commission income showed significant growth, increasing by 24.7% to RSD 1.2 billion (EUR 12.7 million). This development reflected the bank's one-time decision to revise its account maintenance fees in line with the market trends.

The bank revised the calculations used when setting provisions in line with the level of risk associated with each exposure. Prudent allowances for impairment were made for restructured loans, and these were increased if clients continued to miss payments. Compared to the previous year, loan loss provisions increased by 35.6% to RSD 1.5 billion (EUR 15.6 million).

As a result of depreciation of the local currency, higher amortisation costs and increased tax liabilities, operating expenses rose by 9.06% to RSD 4.2 billion (EUR 43 million). The bank continued to invest in extensive staff training, spending more than RSD 21.3 million (EUR 0.2 million) in this area. The cost-to-income ratio rose from 78.0% in 2008 to 71.3%.

ProCredit Bank posted a net profit for 2009 of RSD 807.5 million (EUR 8.4 million). This result represented an increase of 23.7% over the previous year and translated into a return on equity of 9.71% (2008: 9.16%). Thanks to the continued support of the shareholders, the capital adequacy ratio at year-end was 19.4%, substantially above the local requirement of 12%.

## Outlook

The main challenges that Serbia will face in 2010 continue to be unemployment, which is increasing due to the global economic downturn, and the size of the current account deficit, which is forecast to rise again after declining in 2009. However, GDP growth of 1.5% has been forecast for 2010, driven mainly by higher levels of investment, consumption and export demand.[8]

[8] National Bank of Serbia, "Inflation Report February 2010", www.nbs.rs; and "IMF Country Info Serbia", www.imf.org

Institutional reforms and political stability remain two key targets in the political realm, on the road to EU accession projected for 2014 – the country submitted its membership application on 22 December 2009. This development is likely to lead to an increase in the volume of pre-accession funds flowing into the country, giving the economy a timely boost.

In the financial sector, many banks are expected to continue closing branches and reducing staff numbers. This is not only because business has been impacted by the macroeconomic climate; significant losses are also anticipated in some cases due to the volume of restructured loans that are still not performing.

Thanks to its responsible approach, ProCredit Bank maintained high asset quality and is in a good position to focus on other strategic goals in 2010. One of our major priorities will be to increase efficiency, further improving the level of service offered in our branches. We aim to introduce a convenient "one stop" banking model that will allow all of our customers to perform day-to-day transactions in a secure and efficient way. At the same time, we will continue investing in modern technology to provide alternative channels of communication.

In our lending activities, we will focus on the small business segment. Although many of the enterprises in this category have strong growth potential, they are underserved by traditional banks, most of which seek instead to increase their outreach to consumer and corporate clients. ProCredit Bank has a proven history of serving the SME sector, and our experienced staff have developed a deep understanding of how to build and maintain mutually beneficial relationships with small business owners.

Energy efficiency projects, as a part of strategic partnerships with IFIs, will not only be a new area of activity in 2010. Such projects will become the core business focus of ProCredit Leasing Serbia, with the goal of significantly improving both living and working conditions in the country and creating a broader awareness of energy efficiency issues.

# Risk Management

After years of steady growth, the economic downturn which Serbia experienced in 2009 had a significant impact on the country's banking sector. However, thanks to its responsible approach to all aspects of its operations, ProCredit Bank was able to successfully manage its risk exposures even in such a challenging environment. A high degree of internal and external transparency, as well as the simplicity of both its business model and its products, helped to ensure the continued trust of both clients and investors.

The bank's senior management is responsible for ensuring that an effective risk management system is in place. However, responsibility for the identification, measurement, assessment, control and mitigation of risk exposures lies with the Risk Department, which carries out its tasks within a framework of policies and procedures established by the executive management. By working in close co-operation with both senior management and all process owners, the Risk Department facilitates the timely analysis and mitigation of risks, ensuring that the bank operates within the limits of its risk-bearing capacity. The comprehensive risk management system is supported by well-documented procedures governing all important processes.

Risk-related decision-making and internal communication is organised within a structure consisting of specialised bodies, each of which addresses an individual area of risk. These include the Credit Risk Committee, the Assets and Liabilities Committee (ALCO), the Operational Risk Committee and the Information Security Committee.

The bank reports regularly on its risk exposure to the Group Risk Management Department of ProCredit Holding, which oversees risk management activities throughout the group and provides valuable guidance to the individual banks in this area. The group's minimum standards and rules regarding risk management have been set in line with the requirements of the German Federal Financial Supervisory Authority (BaFin).

## Credit Risk

The bank's highly developed credit technology ensures that credit risk management is an integral part of all stages of the lending process. The initial analysis of a prospective borrower's creditworthiness is conducted by the responsible loan officer, who carries out a detailed analysis of the applicant's business operations, including rigorous cross-checks to verify all data. As a matter of principle, the bank does not use credit scor-

ing systems, but rather takes an individualised approach, carefully assessing every applicant's business and financial situation. All lending decisions are made by an independent credit committee whose composition varies depending on the type and size of the loan being considered. Outstanding loans are closely monitored by the responsible loan officer throughout the maturity period.

The broad sectoral diversification of the loan portfolio has helped us to maintain a rather high level of asset quality. Moreover, the fact that our borrowers are not integrated into global markets to any significant extent has reduced the impact of the worldwide economic downturn on their ability to meet their obligations. At year-end, 89.2% of the total number of loans outstanding involved disbursed volumes of less than EUR 10,000 and the average amount outstanding was EUR 3,707, reflecting our focus on small business lending.

The ten largest exposures accounted for only 4.7% of the gross portfolio.

At the portfolio level, credit risk is addressed by the Credit Risk Committee, ensuring regular and frequent monitoring of portfolio diversification, provisioning levels and collateral coverage. Nonetheless, the portfolio at risk (PAR – loans in arrears by more than 30 days) increased during the first half of 2009, due primarily to the economic downturn. Consequently, at the end of the year, the PAR was equivalent to 3.2% of the loan portfolio, or EUR 14.0 million. However, this was still significantly lower than the consolidated PAR of the banking sector in Serbia, which stood at 12.1% at the end of 2009.[1]

The overall effectiveness of the bank's credit risk management system is indicated by the low level of loan write-offs, which were equivalent to 0.8% of the year-end loan portfolio, or EUR 3.3 million. Its conservative approach to lending is also demonstrated by the ratio of the loan impairment allowance to the PAR, which stood at 134% at year-end.

In response to the economic downturn, the bank introduced a number of changes to enable it to better address the increased level of credit risk. These included changes in the work-out process for overdue loans and in collateral requirements, as well as improvements to the approval process. The bank's emphasis on building long-term relationships with its borrowers continues to play a key role in its overall approach to assessing and managing credit risk.

## Market Risk

As the bank remains strongly focused on its core business activities and strictly avoids any forms of speculative or proprietary trading, its level of exposure to market risk is low. In addition, it does not engage in derivative transactions except for hedging purposes. Hence, the management of market risk can be limited to monitoring and reducing the potential negative effects of exchange rate and interest rate movements. Open currency positions, interest rate gaps and modified duration are monitored and assessed by the ALCO.

The bank makes use of open currency positions exclusively to protect against the potential negative impacts of exchange rate movements. Consequently, such positions are maintained at low levels: the average total open currency position for 2009 amounted to 1.0% of the bank's regulatory capital.

In order to limit exposure to interest rate risk, the bank minimises the maturity gaps in its balance sheet across all maturity ranges. This is facilitated by the high proportion of short-term loans in the portfolio, which enables it to re-price its portfolio on a regular basis. At year-end, 60.4% of the outstanding lending volume had a remaining maturity of less than one year.

## Liquidity Risk

The key task for the bank in addressing liquidity risk is to make sure that the structure of its assets and liabilities remains sound and to avoid maturity mismatches under both normal and stress-test scenarios. Stress tests are performed regularly to ensure that the bank is able to withstand the levels of liquidity pressure that would be created under varying assumptions. The exposure to liquidity risk is monitored and assessed by the ALCO.

Given the maturity structure and quality of the loan portfolio, it provides a regular inflow of liquidity that is sufficient to service the liabilities that fall due. From a funding perspective, the bank's liabilities represent an appropriate mix of customer deposits and both short- and long-term loans from IFIs. Moreover, its deposit portfolio is well diversified and includes a large number of small deposits (average deposit balance at year-end: EUR 918).

ProCredit Bank's favourable liquidity position was underscored by the value it reported for the "Sufficient Liquidity" ratio, a measure defined by ProCredit Holding as the proportion of assets with a maturity below 30 days to liabilities in the same maturity bracket: the bank's average

[1] Credit Bureau of the Serbian Banking Association, figures on arrears as of December 2009.

value for 2009 for this indicator was 2.56. In addition, at year-end the ratio of loans to deposits was 128.9% (2008: 137.5%). However, if the bank should face liquidity constraints in the future, it can obtain additional funding from the ProCredit group – an option which facilitates the maintenance of a sound liquidity position.

## Operational Risk

Operational risk includes the risk of losses due to inadequate or failed systems, processes, external events and human error or fraud. The bank has a robust system of operational risk management based on international best practices. Staff duties and responsibilities are properly segregated and the "four eyes" principle is rigorously adhered to for approval of all sensitive transactions. In addition, targeted training measures are regularly conducted to promote operational risk awareness among staff at all levels.

The exposure to operational risk is regularly assessed by the Operational Risk Committee. It compiles and analyses data on relevant risk events and monitors the key indicators of operational risk. These measures are complemented by the regular controls and analyses carried out by the Internal Audit, Compliance and Credit Control departments.

## Capital Adequacy

Throughout the year, the bank had sufficient capital (Tiers I and II) in relation to its risk-weighted assets. Reflecting the Basel II standard, all ProCredit institutions must maintain a capital adequacy ratio (CAR) in excess of 12%, which is also in line with the local regulatory requirements in Serbia. However, at year-end the bank's CAR was significantly higher, namely 17.3% (2008: 16.9%). This reflects the strong support provided by its shareholders over the years, and also the prudent capital management policy instituted by the National Bank of Serbia.

In October 2009, Fitch Ratings confirmed the risk rating of "BB-" which it had given ProCredit Bank in 2008. The bank's high capital adequacy ratio, together with its stable rating, underscores that it has sufficient risk-bearing capacity.

## Branch Network

At year-end, ProCredit Bank's branch network consisted of 79 branches in 51 cities and towns throughout Serbia. During 2009 we did not expand our outreach by opening new branches. Rather, we sought to enhance our ability to serve our customers by restructuring, consolidating and strengthening the existing branch network. This approach was in line with the bank's overall response to the changes in the operating environment in Serbia, which clearly began to feel the effects of the global economic crisis in the year just ended.

Reflecting our emphasis on consolidation, we merged several smaller branches with a larger one in the same town (this was done in Novi Sad, Nis, Vrsac and Subotica) or closed outlets and transferred their functions to the branches to which they had been attached (customers of the outlet in Apatin are now served by the branch in Sombor, and the office in Ub was merged with the Valjevo branch). These moves have allowed us to allocate staff more efficiently, thus enhancing our capacity to provide high-quality services to




our existing clients. They have also enabled us to make an even greater effort to attract new clients and broaden our coverage of our target groups.

During 2009, we moved two of our existing branches to larger and more suitable premises: the offices in Krusevac and Zrenjanin were relocated to make them more attractive and accessible for our clients. The layout and overall appearance of the bank's offices in these two towns is now fully in line with the ProCredit group's current corporate design standards.

The number of teller cash recyclers and statement printers in our branches did not increase in 2009, but we installed 18 additional ATMs. At year-end, we had a network of over 150 ATMs in 69 towns and cities, providing our customers with safe, convenient access to their funds around the clock.

Thanks to a co-operation agreement with other local banks, most notably Bank Intesa Belgrade, we were able to add over 190 units to our network of POS terminals. This increased our total number of POS terminals to over 470 country-wide.

In 2010 we plan to further strengthen our ability to serve our target groups in all parts of Serbia. In support of that goal, we will focus even more on increasing the quality of service provided through our existing branch network.

# Organisation, Staff and Staff Development

ProCredit Bank can only continue to provide excellent customer service if it has highly dedicated, motivated staff who are eager to learn. We foster transparency in all areas including the bank's salary structure, as well as open communication and mutual respect among our staff, and our efforts have borne fruit: in a survey conducted by the most important domestic web portal for employment-related issues[1], ProCredit Bank was voted the Employer of the Year for 2009, and it also ranked first in the categories "Best Development Opportunities" and "Best Interpersonal Relationships".

The year just ended was characterised by significant changes. We introduced a new head office organisational structure, reflecting a shift from a product to a client orientation. This resulted in the consolidation of various departments to form three new high-level units at senior management level: Private Individuals, Legal Entities and Operations. New positions were also introduced at branch level, with more than 50 highly qualified staff being appointed to serve as Co-operation Officers, with responsibility for client acquisition.

Both these changes within the bank and those which took place in our operating environment underscored the need for high-quality, intensive training programmes. Our already strong learning culture was reinforced by more than 450 training events comprising almost 2,000 training days. In addition, mathematics courses are being introduced to further improve our staff's skills in this fundamental area. The bank's total investment of over RSD 45 million (EUR 0.5 million) in training in 2009 reflects our commitment to promoting our employees' professional development. By relying almost exclusively on internal training resources, we were able to provide more customised and more frequent training. In order to broaden employees' understanding of our mission and core values and promote a culture of discussion within the bank, we introduced the concept of a "training week" consisting of seminars held over a period of 3-5 days. At evening sessions, senior head

[1] the Infostud website: www.infostud.com

office personnel led discussions on topics such as responsible banking, transparency and effective communication.

The development of management potential continued to be a top priority, and in 2009 management staff attended in-house seminars as well as the middle-management courses at the ProCredit Regional Academy for Eastern Europe in Macedonia. In addition, 12 managers attended the ProCredit Academy in Germany, with five completing its programme and earning the “ProCredit Banker” diploma.

English is the official working language of the ProCredit group, and higher-level staff in particular need to have a good command of both spoken and written English in order to communicate with colleagues from other countries and to benefit fully from group-level training measures. The bank continues to offer English courses locally, while ProCredit Holding’s language school provides eight-week intensive courses both in Germany and at the Regional Academy in Macedonia. In 2009, nine employees attended these intensive courses.

Specialists from the various ProCredit banks worldwide regularly take part in international seminars and workshops organised by ProCredit Holding. In 2009, more than 50 of our employees participated in such training measures, which enabled them to share knowledge, insights, and experiences with colleagues from 21 other countries.

We recognise the importance of our staff’s commitment and professionalism and also offer them a range of benefits to improve the quality of their lives at a personal level. These benefits include private health insurance, gifts for their children and all newborn babies, and free recreational activities. All staff members also have access to specially designed credit and non-credit services.

We firmly believe that the nurturing, yet demanding environment which we have created for our employees provides a sound foundation for both professional and personal growth. And that in turn helps to ensure the continued sound growth of ProCredit Bank.


KREDITI ZA LEGALIZACIJU
PREMNI ZA VAŠE
www.procreditbank.rs

# 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.

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

The ProCredit group comprises 22 financial institutions whose business focus is on providing responsible banking services in transition economies and developing countries. We aim to provide accessible, reliable services to small businesses and the ordinary people who live and work in the neighbourhoods in which we operate. At the end of 2009 our 19,600 employees, working in more than 830 branches, were serving 3.1 million customers in Eastern Europe, Latin America and Africa.

The first ProCredit banks were founded more than a decade ago with the aim of making a significant development impact by promoting the growth of small businesses. We sought to achieve this by providing loans tailored to their requirements and offering attractive deposit facilities that would enable and 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 development mission and socially responsible approach remain as relevant today as they have always been. Indeed, their importance has been underscored by the widespread macroeconomic decline which most of our countries of operation experienced in 2009. The challenges this has created for individual clients as well as for national economies are significant. While the impact has differed from country to country and from region to region, it is clear that our customers need a reliable banking partner now more than ever. Many small businesses have adjusted to the new environment and are beginning to invest again, and ordinary people are regaining their trust in banks. That is why we will continue to apply the principles that have defined the ProCredit group since its foundation.

Our mission is to provide credit in a responsible manner 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 local economy. Unlike most other banks operating in our markets, we avoid aggressive consumer lending and all 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 all credit risks. By making the effort to know our clients well and maintain long-term working 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. In 2009, 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.

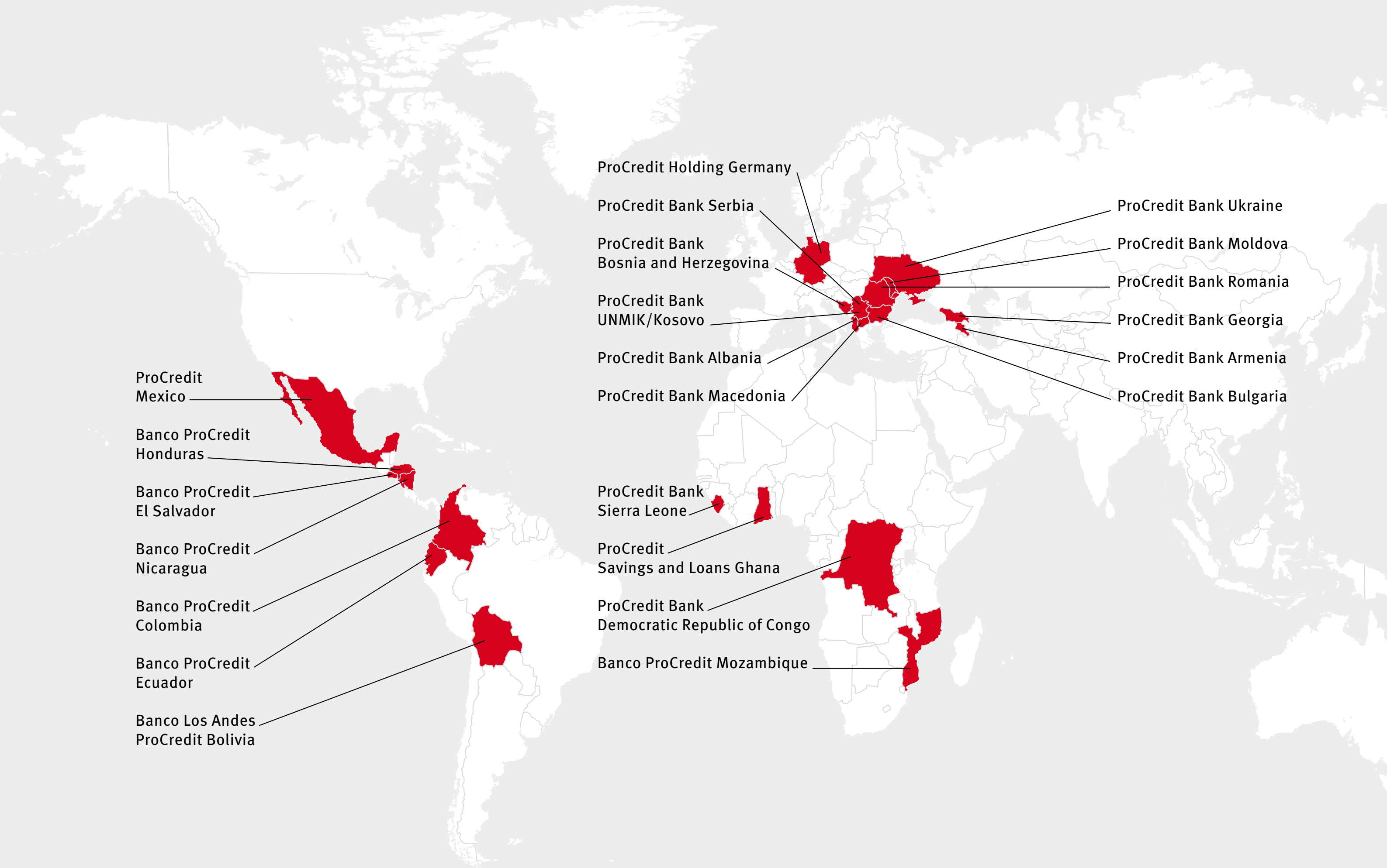
Furthermore, our targeted efforts to foster a savings culture in our countries of operation have enabled us to build a stable deposit base. ProCredit deposit facilities are appropriate for a broad range of lower- and middle-income customers. We place particular emphasis on working with the owners, employees 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. Despite considerable public nervousness about the safety of banks and intense competition in the deposit market, the ProCredit institutions managed to steadily increase their overall retail deposit base in 2009, increasing the number of deposit accounts by some 300,000 and securing a very comfortable liquidity position for the group.

The ProCredit group has a simple business model: providing banking services to a diverse range of enterprises and mobilising deposits from 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 2009 with a good liquidity position, comfortable capital adequacy, PAR over 30 days of 2.68%, 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, 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

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



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% – 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.

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 first ProCredit Academy participants graduated in September 2008. 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 2010 will reflect the prevailing conditions of the countries in which we work. 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. In our lending activities, we will increase the minimum loan size for enterprise clients to EUR/USD 1,000-2,000 in most countries since we have found that below this limit there is broad access to loans from consumer finance providers, a situation which prevents us from maintaining loyal client relationships and keeping arrears levels at a sustainable level in that particular segment. It follows that for these client groups we would rather offer deposit accounts and other banking services. Furthermore, we believe that our development impact can be more significant if we focus on issuing slightly larger loans to businesses with the greatest capacity for job creation. Our other priorities in the coming year will be to focus on loan portfolio quality and on further improving the efficiency of our banking services.

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. It prides itself on the high standard of transparent, professional services it provides to all its clients – the ordinary people who live and work in the vicinity of the 539 ProCredit branches across the region.

2009 proved to be a very challenging year for Eastern Europe. The region had enjoyed several years of sustained economic growth, in part fuelled by the rapid expansion of banking sectors dominated by Western European banks. The effects of the global financial crisis and the ensuing global recession were bound to be felt across the region. In nearly all the countries in which we operate, banking sector growth stalled and there was a strong GDP decline in 2009. The nature and severity of the impact differed from country to country. At one extreme was Ukraine, in which GDP is estimated to have declined by more than 15%, whilst other countries such as Kosovo and Albania experienced a less severe recession.

As a rule for banking sectors across Eastern Europe, though, 2009 was a year dominated by concerns first about liquidity and then about non-performing loans. The performance of the ProCredit group in Eastern Europe this year as regards liquidity and loan portfolio quality highlights both the important development role that the ProCredit banks play in the region and their relatively low risk profile.

The ProCredit banks in Eastern Europe quickly built a comfortable liquidity buffer in 2009, despite the strong withdrawals of customer funds that most of our markets experienced in the last quarter of 2008. This reflected the trust and confidence of our retail deposit clients.

ProCredit has focused for many years on promoting a savings culture amongst its clients. Setting money aside can help protect savers against the uncertainties of life, and since the ratio of deposits to GDP in Eastern European countries is well below Western European levels, we believe that mobilising savings is an important development priority. Accordingly, 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%. Thus, in 2009 we did not have to rely on unpredictable capital markets for funds.

And our experience in 2009 confirmed that our clients appreciate the transparent, responsible approach we take. We offer simple and reliable retail banking services, including flexible savings and deposit accounts to accommodate depositors' long- and short-term needs. 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. Thanks to the trust that the public has placed in ProCredit, the group reported solid growth in customer deposits in 2009, although we did not participate in the very aggressive pricing campaigns that many other banks undertook to shore up their liquidity positions. All the ProCredit institutions in Eastern Europe ended the year with a comfortable liquidity position, most without a significant increase in the average cost of funds.

ProCredit banks were also in a strong position to manage loan portfolio growth and quality. They had never participated in the aggressive consumer and corporate lending in which other banks had engaged, and which is now creating significant loan portfolio problems in the region. We had always maintained that consumer loans have only limited development impact and risk creating overindebtedness if aggressively advertised and disbursed without adequate analysis of clients' ability to repay a loan – and this is precisely the approach that financial institutions usually took to consumer lending in much of Eastern Europe in recent years.

Instead, at ProCredit we focus on providing responsible banking services to small entrepreneurs and family businesses. We aim to be their banking partner of choice, able to understand their needs and offer sound, professional advice. We believe that these businesses are still an important driving force behind economic growth and job creation across Eastern Europe. We continued lending strongly to small businesses throughout 2009, although other banks significantly scaled back their lending activities. The only segment in which we slowed lending was that of very small


"microenterprise loans" with volumes of less than EUR 2,000. In this segment, we found many families to indeed be overindebted due to excessive use of consumer loans, and businesses to be less viable than in the past. Looking ahead, we plan to stop serving this segment of the market and focus above all on small and medium-sized clients taking loans in the size range from EUR 2,000 – EUR 150,000.

Our approach is to provide business loans based on a careful, individual analysis of each client's ability to meet his or her obligations. We have decentralised decision-making systems in place and a body of highly qualified staff who are able to conduct an efficient and reliable risk assessment even in more volatile economic conditions. ProCredit is guided by a responsible, long-term attitude towards business development. We aim to build lasting relationships with our clients and do not forget that a loan is also a debt.

These values are particularly pertinent when managing potential arrears in cases where clients have to adapt to lower-than-expected sales. In anticipation of the difficulties we felt would emerge in 2009, we introduced more conservative lending policies and more intensive arrears management procedures in response to greater credit risk. Our staff focused on working closely with our clients to help them understand and respond to changing conditions. This approach meant that our Eastern European banks ended the year with a PAR (>30 days) of 2.81% and a PAR (>90 days) of 1.93%. Only in our two most difficult markets, Ukraine and Bosnia, did the PAR (>30 days) rise above 5% during the year. Relative to the banking sectors as a whole, this was a significant achievement.

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. We also provide housing improvement loans to help families renovate their homes and improve energy efficiency.

Given our focus on quality rather than quantity, the group did not increase the number of branches significantly in 2009, and the number of staff was also reduced. In 2010 we expect the macroeconomic situation in Eastern Europe to continue to be difficult. Our focus will still be on the quality of our staff and on deepening our relationships with our clients. Only our newer banks, in Armenia and Moldova, are likely to add branches. In all countries, we aim to consolidate our position as the most reliable banking partner for small and medium-sized enterprises.

Our staff is the key element in our approach to being a stable, down-to-earth and personal banking partner. The ProCredit group has a strong commitment to staff training, professional development and the cultivation of an open, honest communication culture. Staff exchanges, cross-border training programmes and regional workshops are an important part of our approach. We have an Eastern European Academy, located near Skopje in Macedonia, which is dedicated to the training of ProCredit middle managers. The Academy is an important channel for rapid and consistent communication region-wide and one that helps us adapt quickly to face new challenges: More than 200 managers have already graduated from the six-week intensive course since the facility was founded. A language centre at the Academy also provides residential English courses, maximising the potential for international exchange within the group. Like all prudent banks, we will continue to focus on efficient cost management in 2010 and beyond. Investment in our staff is, however, 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<br>42 branches<br>39,443 loans / EUR 153.6 million in loans<br>192,840 deposit accounts / EUR 246.5 million<br>867 employees | Legal address: Sami Frasheri St., Tirana<br>Mailing address: Dritan Hoxha St., Tirana<br>P.O. Box 2395<br>Tel./Fax: +355 4 2 271 272 / 276<br>info@procreditbank.com.al<br>www.procreditbank.com.al |
| **ProCredit Bank Armenia** | Founded in December 2007<br>9 branches<br>3,847 loans / EUR 23.5 million in loans<br>15,479 deposit accounts / EUR 13.0 million<br>239 employees | 31/99 Moskovyan St.<br>0002 Yerevan<br>Tel./Fax: + 374 10 514 860 / 853<br>info@procreditbank.am<br>www.procreditbank.am |
| **ProCredit Bank Bosnia and Herzegovina** | Founded in October 1997<br>26 branches<br>39,762 loans / EUR 119.7 million in loans<br>105,106 deposit accounts / EUR 124.1 million<br>662 employees | 8 Emerika Bluma<br>71000 Sarajevo<br>Tel./Fax: +387 33 250 950 / 971<br>info@procreditbank.ba<br>www.procreditbank.ba |
| **ProCredit Bank Bulgaria** | Founded in October 2001<br>86 branches<br>55,504 loans / EUR 550.8 million in loans<br>227,104 deposit accounts / EUR 334.7 million<br>1,797 employees | 26 Todor Aleksandrov Blvd.<br>1303 Sofia<br>Tel./Fax: +359 2 813 5100 / 5110<br>contact@procreditbank.bg<br>www.procreditbank.bg |
| **ProCredit Bank Georgia** | Founded in May 1999<br>59 branches<br>63,993 loans / EUR 220.9 million in loans<br>400,215 deposit accounts / EUR 159.0 million<br>1,680 employees | 154 D. Agmashenebeli Ave.<br>0112 Tbilisi<br>Tel./Fax: +995 32 20 2222 / 24 3753<br>info@procreditbank.ge<br>www.procreditbank.ge |
| **ProCredit Bank UNMIK/Kosovo** | Founded in January 2000<br>62 branches<br>99,336 loans / EUR 471.7 million in loans<br>399,539 deposit accounts / EUR 638.3 million<br>1,177 employees | 16 “Mother Tereze” Boulevard<br>10000 Prishtina<br>Tel./Fax: +381 38 555 777 / 248 777<br>info@procreditbank-kos.com<br>www.procreditbank-kos.com |
| **ProCredit Bank Macedonia** | Founded in July 2003<br>41 branches<br>31,999 loans / EUR 135.8 million in loans<br>134,603 deposit accounts / EUR 142.3 million<br>689 employees | 109a Jane Sandanski Blvd.<br>1000 Skopje<br>Tel./Fax: +389 2 321 99 00 / 01<br>info@procreditbank.com.mk<br>www.procreditbank.com.mk |
| **ProCredit Moldova** | Founded in December 1999<br>1 branch<br>7,108 loans / EUR 13.0 million in loans<br>85 employees | 65 Stefan cel Mare Ave.<br>office 900, Chisinau<br>Tel./Fax: +373 22 836555 / 273488<br>office@procredit.md<br>www.procredit.md |
| **ProCredit Bank Moldova** | Founded in December 2007<br>27 branches<br>6,715 loans / EUR 22.4 million in loans<br>22,646 deposit accounts / EUR 12.7 million<br>533 employees | 65 Stefan cel Mare Ave.<br>office 901, Chisinau<br>Tel./Fax: +373 22 836555 / 273488<br>office@procreditbank.md<br>www.procreditbank.md |
| **ProCredit Bank Romania** | Founded in May 2002<br>43 branches<br>35,533 loans / EUR 180.5 million in loans<br>136,576 deposit accounts / EUR 133.3 million<br>1,006 employees | 62-64 Buzesti St., Sector 1<br>011017 Bucharest<br>Tel./Fax: +40 21 201 6000 / 305 5663<br>headoffice@procreditbank.ro<br>www.procreditbank.ro |
| **ProCredit Bank Serbia** | Founded in April 2001<br>79 branches<br>118,249 loans / EUR 472.9 million in loans<br>450,656 deposit accounts / EUR 345.7 million<br>1,864 employees | 17 Milutina Milankovica<br>11070 Belgrade<br>Tel./Fax: +381 11 20 77 906 / 905<br>info@procreditbank.rs<br>www.procreditbank.rs |
| **ProCredit Bank Ukraine** | Founded in January 2001<br>64 branches<br>25,510 loans / EUR 188.3 million in loans<br>121,435 deposit accounts / EUR 104.7 million<br>1,417 employees | 107a Peremohy Ave.<br>03115 Kyiv<br>Tel./Fax: +380 44 590 10 17 / 01<br>info@procreditbank.com.ua<br>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.

## Our Clients


# Rajko Ratkovic, Restaurant Owner and Retail Banking Client

Rajko Ratkovic, 23, inherited a passion for the restaurant business from his father Branislav, an experienced restaurant manager. In 2007, after finishing his studies in restaurant management, Rajko used his savings and funds provided by his father to purchase a restaurant on the outskirts of Belgrade – the very one his father had managed for years. By putting their collective skills, training and experience to work, Rajko and Branislav have been able to significantly increase its business volume. The “Natalija” restaurant now has a total of six employees – Branislav and Rajko’s brother as well as four other staff – and is well-known for its tasty local dishes and excellent service. Rajko has also expanded the business by introducing a food delivery service and making the restaurant available as a venue for parties and other social functions.

Soon after buying the restaurant in 2007, Rajko was looking for a banking partner for the business, and a friend who was already a ProCredit customer recommended the bank to him. He inquired about account services at the Zemun branch and decided to open a current account for the restaurant. Soon thereafter he also opened a term deposit account to help him save for future investments. Rajko was impressed by the bank’s high-quality customer service and the staff’s efficiency and friendly attitude, and thus he decided to use ProCredit for all the restaurant’s banking needs.

*“I was looking for a bank that would provide the same high level of service that we strive to achieve in our own business. And ProCredit Bank meets that standard: it’s not just a safe place for my savings and a reliable business partner; its staff is also friendly, attentive and highly professional,”*
he says.

In addition to savings and current accounts, the business now makes use of other retail services offered by the bank, including debit cards. And ProCredit also covers Rajko’s personal retail banking needs, including deposit, current account and card services.

Encouraged by his success thus far, Rajko is planning to open a second restaurant. And although he has substantial savings, he knows he will need a loan in order to undertake this major investment. He also knows that he can rely on the staff of ProCredit Bank to advise him on the best financing option to supplement his own funds.

*“Dedication and enthusiasm, dependable employees and maybe a bit of luck – that’s what it takes to run a restaurant that people like to dine at. But if you want the business to be a success and grow, you also need a reliable bank that is interested in building close, long-term client relationships. And that’s why ProCredit is my bank,”*
says Rajko.

# Slobodan Neskovic, Producer of Protective Apparel and SME Client

In 1992, after completing his studies in business administration, Slobodan Neskovic founded a company in Belgrade with the goal of producing protective clothing for the workplace. His father had spent his entire working life in the same field, and the establishment of Albo, as the new firm was called, represented the realisation of a family dream. Both Slobodan's father and his brother, a trained engineer, enthusiastically supported him in this ambitious undertaking. The production of protective working clothes is still Albo's principal area of activity, but it has since expanded its product range and now serves a broader market.

Albo began its successful relationship with ProCredit in November 2007. Slobodan knew that it had a good reputation as a specialist bank for small businesses, so he decided to inquire about its services. After talking to the staff at his local branch in Belgrade, he started using ProCredit's payment services. Soon the company began making use of the bank's credit facilities as well, and to date it has taken out a total of three loans, both to meet working capital needs and to finance investments in fixed assets. Albo also takes advantage of other services offered by ProCredit, including electronic banking.

Albo currently boasts a product range of 2,000 items, consisting primarily of protective clothing and other related products either produced or imported by the company. Over the past 17 years, Albo has grown to become the main local distributor for many of the world's leading manufacturers of protective equipment for the workplace, and it currently has 32 employees. In 2007, the company established a subsidiary in Bosnia and Herzegovina and it also began serving markets in Croatia, Montenegro and Macedonia. At the end of 2009, it was finalising plans to move from rented premises to a building it recently purchased with financing support from ProCredit. With around 3,000 square metres of floor space, the new facility will include both a warehouse and offices.

*"A real understanding of our needs and a commitment to serving those needs: put very simply, that is what ProCredit Bank offers us, and that is what makes it the ideal bank for us. Our company is growing rapidly, and we're also moving into new markets. So we need a bank that understands our changing requirements and can support us with both tailored services and sound advice. Albo has found such a partner in ProCredit Bank,"*

says Slobodan.

Looking ahead, Albo seeks to further expand in both domestic and foreign markets and maintain its current annual growth rate of around 100 percent. The company knows that it can count on ProCredit Bank's continuing support as it pursues its ambitious goals for the future.

# Milorad Minic, Wine Producer and Agricultural Loan Client

Milorad Minic, 60, is the founder and owner of the Minic winery, a family business in Trzac, a village near the town of Aleksandrovac in southern Serbia. Milorad has been a wine and brandy producer all his life, having followed in his father's and grandfather's footsteps. He and the other members of the family regard their work as a labour of love, and their labours have been well rewarded: today the Minic winery, which has been operating since 1936, is one of the best-known wine producers in the region and employs five people in addition to family members.

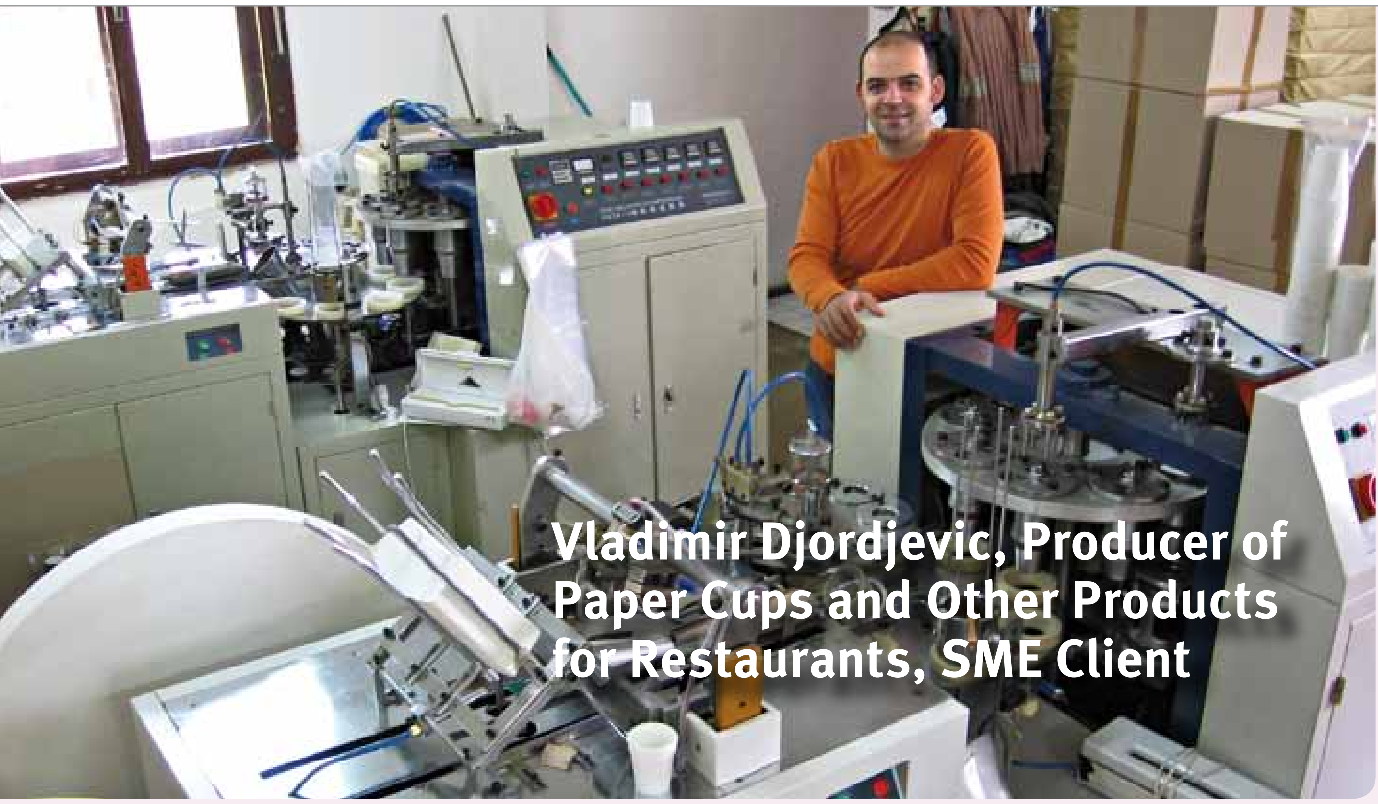
Milorad first learned about ProCredit in May 2009 at Serbia's largest agricultural fair, in Novi Sad, where he attended a presentation given by the bank on its agricultural loans. This prompted him to inquire about financing at the Krusevac branch, and soon thereafter he obtained a loan from the bank for EUR 12,000 to purchase a new tractor, which helped the winery to significantly increase its productivity. Milorad was very satisfied with the bank's service and recommended ProCredit to his neighbours, several of whom have now also become clients of the bank.

Although the winery sells primarily to wholesalers, its products can also be purchased in hotels and restaurants, and directly through its own outlets. In addition to operating their own wine cellar, the Minic family recently turned the courtyard of their home into a picturesque rural inn dedicated exclusively to wine tasting.

*"We are proud to be continuing the Minic family tradition. We want more and more people to enjoy our fine wines. This means we will have to further increase our output and also promote our products on a larger scale. And for that, we will need external financing. That's why it's good to know that we have a strong, reliable banking partner that understands our business: ProCredit Bank,"*

says Milorad.

In recent years, the Minic family has purchased new barrels and wine cooling equipment, as well as making investments in their wine cellar, building and furnishing a wine tasting room and establishing a new vineyard. Their future plans include adding a high-quality brandy to their product range and expanding into foreign markets. They look forward to continuing their successful relationship with ProCredit Bank and know they can count on its support to help them realise their plans.



# Vladimir Djordjevic, Producer of Paper Cups and Other Products for Restaurants, SME Client

Ten years ago, at the age of 28, Vladimir Djordjevic, a trained electronics specialist, started a small business in Belgrade producing paper cups. Since then, his company, VDJ Trade, has grown significantly, and today, with a total of 15 employees, it produces a wide range of products for restaurants and bars, supplying well-known local and international companies, such as Costa Café, McDonald's, Coca-Cola, Pepsi and Lavazza. Paper cups are still the company's main product, and while their basic design does not vary much, the lettering, logo and colour scheme differ greatly depending on what the customer's order specifies. And many of the orders Vladimir fills are quite large: His machines produce between 15,000 and 20,000 paper cups per day, and a sizeable number are exported to neighbouring Bosnia and Herzegovina and Montenegro.

Vladimir has been a ProCredit customer since 2005, and his relationship with the bank began when he took out a working capital loan at its name branch. As he explains:

*"I was looking for a banking partner for my business and had carefully researched all the banks in Serbia that seemed potentially suitable. I chose ProCredit because of its focus on SME clients and its expertise in catering for their needs."*

Since then, Vladimir has taken out five more loans from ProCredit Bank. He has used the funds to purchase equipment and make other investments in fixed assets, including a fully equipped new building for his company. The new premises will house VDJ Trade's offices and production facilities as well as display rooms to showcase its various products.

*"It takes a good idea and strong, reliable partners to succeed. Select the right range of products to sell on the market, and find the right partners – above all, a sound bank that understands your company and what you do. Those are the two essential ingredients to make a business grow. There is no doubt in my mind that I chose the right bank for my company. Our small family operation would never have grown as it has without the support of ProCredit Bank,"*
he says.

Vladimir intends to remain a loyal customer of the bank and knows he can rely on its continued support in the years to come. In addition to loans, the company also makes use of other services ProCredit offers, including current accounts and payment cards.

# Financial Statements

For the year ended 31 December 2009.
Prepared in accordance with International Financial Reporting Standards.

PRICEWATERHOUSECOOPERS

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**INDEPENDENT AUDITORS REPORT**

**To the Shareholders of ProCredit Bank a.d. Belgrade**

We have audited the accompanying consolidated financial statements of ProCredit Bank a.d. Belgrade and its subsidiary (together the "Group"), which comprise the consolidated balance sheet as of 31 December 2009 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

***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. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

***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 whether the 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 financial statements.

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

PRICEWATERHOUSECOOPERS

*Opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2009 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers doo

PricewaterhouseCoopers d.o.o. Belgrade

Belgrade, 23 April 2010

## Consolidated Income Statement

For the year ended 31 December 2009

| *in thousand of Dinars* | Notes | Year ended 31 Dec 2009 | Year ended 31 Dec 2008 |
|---|---|---|---|
| Interest and similar income | | 8,073,500 | 7,379,093 |
| Interest expense and similar charges | | (3,478,264) | (3,583,004) |
| **Net interest income** | 4 | **4,595,236** | **3,796,089** |
| | | | |
| Allowance for impairment losses on loans and advances | | (874,067) | (566,534) |
| **Net interest income after allowances** | 5 | **3,721,169** | **3,229,555** |
| | | | |
| Fee and commission income | | 1,213,677 | 926,270 |
| Fee and commission expense | | (158,277) | (131,447) |
| **Net fee and commission income** | 6 | **1,055,400** | **794,823** |
| | | | |
| Net trading income | 7 | 283,901 | 320,312 |
| Net result from financial assets at fair value through profit or loss | 8 | (19,437) | (2,670) |
| Operating income | 9 | 152,637 | 80,388 |
| **Operating income** | | **417,101** | **398,030** |
| Personnel expenses | | (2,410,537) | (2,032,005) |
| Other administrative expenses | | (1,913,158) | (1,861,327) |
| **Operating expenses** | 10 | **(4,323,695)** | **(3,893,332)** |
| | | | |
| **Operating result** | | **869,974** | **529,076** |
| Income taxes | 11 | (62,456) | 86,955 |
| | | | |
| **Profit for the year** | | **807,518** | **616,031** |

## Consolidated statement of comprehensive income

| | 2009 | 2008 |
|---|---|---|
| Profit for the year | 807,518 | 616,031 |
| Change in revaluation reserve from available-for-sale financial assets | 4,873 | 1,109 |
| Change in deferred tax on revaluation reserve from available for sale assets | (487) | (111) |
| | | |
| Other comprehensive income | 4,386 | 998 |
| **Total comprehensive income** | **811,904** | **617,029** |

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 2009**
*(All amounts expressed in thousand of Dinars unless otherwise stated)*

**Consolidated balance sheet**

| | Note | As of 31 December 2009 | As of 31 December 2008 restated |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with the Central Bank | 12 | 22,366,213 | 18,000,999 |
| Loans and advances to banks | 13 | 779,572 | 6,559,920 |
| Loans and advances to customers | 14 | 40,671,768 | 38,901,355 |
| Derivative financial assets | 15 | 4 | - |
| Available-for-sale financial assets | 16 | 13,973 | 6,882 |
| Other financial investments | 17 | 7,924 | 7,924 |
| Intangible assets | 18 | 251,010 | 33,346 |
| Property and equipment | 19 | 1,483,578 | 1,703,089 |
| Deferred income tax assets | 20 | 270,891 | 288,655 |
| Other assets | 21 | 540,741 | 324,188 |
| **Total assets** | | **66,385,674** | **65,826,358** |
| **LIABILITIES** | | | |
| Deposits from banks | 22 | 349,697 | 3,204,000 |
| Derivative financial liabilities | 23 | 4,832 | 1,830 |
| Due to customers | 24 | 37,645,140 | 30,422,765 |
| Other borrowed funds | 25 | 16,543,430 | 21,159,635 |
| Subordinated debt | 26 | 2,621,912 | 2,438,021 |
| Tax liabilities | 27 | 10,814 | - |
| Provisions | 28 | 84,148 | 176,006 |
| Other liabilities | 29 | 561,632 | 361,833 |
| **Total liabilities** | | **57,821,605** | **57,764,090** |
| **EQUITY** | | | |
| Share capital | 30 | 3,663,012 | 3,663,012 |
| Share premium | 30 | 2,776,745 | 2,776,745 |
| Retained earnings | | 773,336 | 545,328 |
| Revaluation reserve on available for sale financial assets | | 5,384 | 998 |
| Special banking risk reserves | 31 | 1,345,592 | 1,076,186 |
| **Total equity** | | **8,564,069** | **8,062,269** |
| **Total equity and liabilities** | | **66,385,674** | **65,826,358** |

The accompanying notes on pages 6 to 77 form an integral part of these consolidated financial statements.

These consolidated financial statements have been approved by Executive Board on March, 15 2010 and signed on their behalf by:

Svetlana Tolmacheva
Chairperson of the Executive Board

ProCredit Bank a.d. Beograd
4

Mirjana Garapić- Zakanyi
Member of the Executive Board

2

## Consolidated Statement of Changes in Equity

For the year ended 31 December 2009

| *in thousand of Dinars* | Notes | Share Capital | Share Premium | Retained earnings | Revaluation reserve on available for sale (Restated) | Special banking risk reserves | Total |
|---|---|---|---|---|---|---|---|
| **At 1 January 2008** | | **2,363,274** | **1,325,813** | **461,133** | **–** | **663,204** | **4,813,424** |
| Total comprehensive income | | – | – | 616,031 | 998 | – | 617,029 |
| Transfer to special banking risk reserves | 32 | – | – | (412,982) | – | 412,982 | – |
| Distributed dividends | | – | – | (118,854) | – | – | (118,854) |
| New shares issued | | 1,299,738 | 1,450,932 | – | – | – | 2,750,670 |
| **At 31 December 2008** | | **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** |

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 2009

| *in thousand of Dinars* | Notes | Year ended 31 Dec 2009 | Year ended 31 Dec 2008 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Profit before tax | | 869,974 | 529,076 |
| | | | |
| **Adjustments for non cash items:** | | | |
| Impairment loss | | 803,140 | 566,534 |
| Depreciation and amortization | | 370,787 | 302,394 |
| Unrealized gains on foreign currency revaluation | | (42,939) | (9,250) |
| Provisions | | (90,534) | 43,511 |
| **Net cash flow from operating activities before changes in operating assets and liabilities** | | **1,910,428** | **1,432,265** |
| | | | |
| **Changes in operating assets:** | | | |
| Decrease/ (increase) in loans and advances to banks | | 0 | (3,359,507) |
| (Increase)/decrease in derivative financial assets | | (4) | 7,221 |
| (Increase) in loans and advances to customers | | (2,238,539) | (5,865,425) |
| (Increase) in other assets | | (216,814) | (136,983) |
| | | **(2,455,357)** | **(9,354,694)** |
| | | | |
| **Changes in operating liabilities:** | | | |
| (Decrease)/ increase in deposits from banks | | (2,854,303) | 4,325,310 |
| Increase/(Decrease) in due to customers | | 7,222,375 | (1,192,726) |
| Increase in other liabilities | | 199,799 | 204,560 |
| | | **4,567,871** | **3,337,144** |
| | | | |
| **Net cash from/ (used in) operating activities** | | **4,022,942** | **(4,585,285)** |
| | | | |
| **Cash flow from investing activities:** | | | |
| Proceeds from disposal of property and equipment | | 125 | 3,793 |
| Purchase of property and equipment and intangible assets | | (480,969) | (688,984) |
| **Net cash (used in) investment activity** | | **(480,844)** | **(685,191)** |
| | | | |
| **Cash flow from financing activities:** | | | |
| Increase in other borrowed funds | | 4,966,498 | 900,972 |
| Repayments of other borrowed funds | | (9,525,054) | (1,995,866) |
| Paid dividends | | (398,940) | (226,975) |
| Issued share capital | | 0 | 3,362,921 |
| **Net cash (used in)/from financing activities** | | **(4,957,496)** | **2,041,052** |
| | | | |
| **Net (decrease) in cash and cash equivalent** | | **(1,415,134)** | **(3,229,424)** |
| **Cash and cash equivalents as at 1 January** | | **24,560,919** | **27,790,343** |
| **Cash and cash equivalents as at 31 December** | 32 | **23,145,785** | **24,560,919** |

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 2009

*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 2009 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. Commerzbank AG owns the remaining 16.67%. The ultimate parent of the group is ProCredit Holding AG.
On 31 December 2009, the Group has head office located in Belgrade, Milutina Milankovica 17 and 79 branches throughout Serbia.
These consolidated financial statements have been approved for issue by the Executive Board on April, 15 2010.

## 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, amendments and interpretations effective on or after January 1, 2009*

The following standards, or amendments to standards, were already issued in 2008 or before and become effective for annual periods beginning on or after January 1, 2009: Amendment to IFRS 2 "Share-based payment – Vesting Conditions and Cancellations", IFRS 8 "Operating Segments", Revised IAS 1 "Presentation of Financial Statements", Revised IAS 23 "Borrowing Costs", IFRIC 13 "Customer Loyalty Programmes". The amendments to IFRS 2, IFRS 8 and IFRIC 13 do not have any effect on the bank´s financial statements. The revised IAS 1 has an impact on the presentation of the financial statements; and revised IAS 23 has a minor impact on the bank´s financial statements.
In June 2006 the IASB issued amendments to IAS 32 and IAS 1 "Puttable Financial Instruments and Obligations Arising on Liquidation". The amendments are applicable for annual periods beginning on or after January 1, 2009. These amendments do not have any impact on the bank's financial statements.
On May 22, 2008, the IASB published amendments to IFRS 1 and IAS 27 "Cost of an Investment in a Subsidiary, Jointly-Controlled Entity or Associate", which are applicable for annual periods beginning on or after January 1, 2009. The amendments have no impact on the bank´s financial statements.
In May 2008, the IASB published "Improvements to International Financial Reporting Standards" which are partly applicable starting from January 2009 and partly starting from January 2010. None of them have an impact on the financial statements.
On March 5, 2009, the IASB issued amendments to IFRS 4 "Insurance Contracts" and IFRS 7 "Financial Instruments: Disclosures". These amendments are applicable for annual periods beginning on or after January 1, 2009 .
On March 12, 2009, the amendments to IFRIC 9 and IAS 39 "Embedded Derivatives" were issued by the IASB in November 2009. These are applicable for annual periods beginning on or after January 1, 2009. The amendments will have no impact on the financial statements of the bank.

*(b) Standards and interpretations issued but not yet effective*

In January 2008, the IASB issued amendments to IAS 27 "Consolidated and separate financial statements", and a revised IFRS 3 "Business Combinations". The amendments are applicable for annual periods starting on or after July 1, 2009. The application of the amended IAS 27 or revised IFRS 3 will have no impact on the financial statements of the bank.
In July 2008, the IASB issued amendments to IAS 39 "Recognition and Measurement: Eligible Hedged Items", which are applicable from July 1, 2009 on. In October 2008, the IASB issued further amendments to IAS 39 and IFRS 7 "Reclassification of Financial Assets – Effective Date and Transition", which have been endorsed in September 2009 by the EU. The amendments have no impact on the bank. The bank does not hold financial instruments for which the amendments would have been relevant.
The revised version of IFRS 1 "First Time Adoption of IFRS" replaces the existing IFRS 1 in order to make IFRS 1 easier to use and amend in the future. It was issued by the IASB on July 23, 2009. The revised standard will not have any impact on the bank´s financial statements.
IFRIC 17 "Distributions of Non-Cash Assets to Owners" provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to owners either as a distribution of reserves or as dividends. The IFRIC issued IFRIC 17 in November 2008, effective starting from November 1, 2009. As the bank does not distribute non-cash assets to owners, this IFRIC does not have any impact on the bank.

On January 29, 2009, the IFRIC 18 "Transfers of Assets from Customers", which is applicable for annual periods beginning on or after November 1, 2009, was issued by the IFRIC. The bank does not transfer assets from customers; therefore the interpretation has no impact on the financial statements of the bank.
In August 2009 the IASB published amendment to IAS 32 "Financial Instruments: Presentation: Classification of Rights Issues". It is applicable for periods beginning on or after February 1, 2010. This amendment does not have any impact on the bank´s financial statements.
Further standards, or amendments to standards, are approved by the IASB/IFRIC (in order of their issuance): Revised IAS 24 "Related Party Disclosures", Amendments to IFRS 1 "Additional Exemptions for First-time Adopters", Amendments to IFRS 2 "Group Cash-settled Share-based Payment Transactions", Improvements to IFRSs, IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments", Amendment to IFRIC 14 "Prepayments of a Minimum Funding Requirement" and IFRS°9 "Financial Instruments". The application of IFRS 9 "Financial Instruments" will have an impact on the financial statements on the bank, but it is mandatory as of January 1, 2013. The other amendments, revision and interpretation are unlikely to have any impact on the 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 trough 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 financialasset 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, pastdue 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 licenses 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 licenses 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 and 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.
IIn 2009 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 – 4 years,
- Furniture – 6–8 years,
- Computers – 3 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 Labor 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 2009 per economy;
- Estimated annual increase in salaries of 3%; and
- Discounting rate of 10%.

**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*

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.

| 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** | – |

### 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. 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**

At the end of 2007 the sub-prime mortgage crisis in the United States of America 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 the extent of sub-prime crisis caused recession in the majority of developed countries. Consequently, the crisis spread from the financial sector to the real economy.

In the last quarter of 2008, 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 2009 the Government of the Republic of Serbia resumed its stimulating measures through various programs and mechanisms.

Despite the IMF's projection that the world economy will most likely realize the global economic growth accounting for 3.9% in 2010, the large growth percentage is the result of the envisaged growth in China accounting for up to 10%, whereas the forecasts for the eurozone predict the growth of just 1%. In view of this estimate, further growth can be expected in 2011 as well, namely 4.3% at the world level and 1.6% at the eurozone level. Central and Eastern Europe can expect the growth of 2% during 2010, and 3.7% during 2011.

At the same time, Serbia recorded a real drop in gross domestic product of 3.5% in 2009, following the growth of 5.5% in 2008. The forecasts for 2010 vary in assessment of growth which is targeted in range between increase in gross domestic product of 1.5% (NBS) and 2% (IMF).

The Bank's clients – borrowers were faced in 2009 with decrease in liquidity, which can also be expected in 2010, 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. 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 moment. 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. 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 the Risk Management Committee.

**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 and it is monitored monthly by the Group's management and Performance Committee. 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*, that consists of share capital, share premium, reserves, retained earnings, profit/loss from buying own shares, deducted by non-material investments;
- *Tier 2 capital*, that 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*, that 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.

Risk weights in calculating risk weighted on-balance sheet and off-balance sheet assets are prescribed by regulatory rules of the National Bank of Serbia. Table below shows capital elements and calculation of capital adequacy for the years ended on 31 December.

| | 2009 | 2008 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 3,663,012 | 3,663,012 |
| Share premium | 2,776,745 | 2,776,745 |
| All types of reserves | 1,345,592 | 663,204 |
| Retained earnings | 773,336 | 543,134 |
| Intangible assets | (251,010) | (33,219) |
| **Total qualifying Tier 1 capital** | **8,307,675** | **7,612,876** |
| | | |
| **Tier 2 capital** | **1,649,627** | **2,493,777** |
| | | |
| **Deductions from equity** | **(335,611)** | **(395,958)** |
| | | |
| **Total regulatory capital** | **9,621,691** | **9,710,694** |
| | | |
| **Risk weighted assets** | | |
| Assets weighted by credit risk | 55,213,836 | 57,019,193 |
| Open currency position | 506,163 | 323,363 |
| **Total risk weighted assets** | **55,719,999** | **57,342,556** |
| **Capital adequacy ratio** | **17.27%** | **16.93%** |

During the year 2009 there were no additional increases of capital compared to end of 2008.

**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 10,902,057 thousands as of the end of December 2009. The Resources Available to Cover Risk (hereinafter: RAtCR) were set at 60% of the risk-taking potential, i.e RSD 6,541,234 thousands. The table below shows the distribution of the RAtCR among the different risk categories as determined by the Risk Committee of the ProCredit Group and the level of utilisation as of the end of December 2009.

| | Limit *in %* | Actual *in %* | Limit | Actual |
|---|---|---|---|---|
| **Total** | **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 2009. 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 corporate 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 to 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 in less than EUR 2,00 (31 December 2009: 1 EUR = 95.8888 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 onto the determined basis, 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 the migration analysis which is an integral part of this document, and it 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.
- The principle of related parties, 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).
- 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 Credit risk management portfolio.

- 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 2009: 1 EUR = 95.8888 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/ weight group classification | Party class | Provisioning |
|---|---|---|
| No repayment arrears or arrears up to 30 days | I | 1.00% |
| Reprogrammed loan – Watch, arrears up to 30 days | Watch | 7.00% |
| Reprogrammed impaired – arrears up to 30 days | Impaired | 25% |
| Arrears between 31 and 90 days | II | 45% |
| Arrears between 91 and 180 days | III | 60% |
| Arrears between 181 and 360 days and terminated agreements | IV | 100% |
| Arrears over 360 days | V | Write-off |

**Individual provisioning assessment (impairment)**

Individual provisioning is calculated for clients whose total debt amount to the Bank exceeds eur 30,000 (31 December 2009: 1 EUR = 95.8888 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.

Credit Analysis Department, in cooperation with the responsible Agro 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 all 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 all 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.
Status „Leased" 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.
Status „Terminated" 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 2009, are shown in the table below:

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

The Group's internal loan loss classification rating for 2008 is shown below. As of 31 December 2008 all financial leasing placements were subject of an impairment provision of 1%, regardless of number of days in arrears.

| Group's internal methodology 2008 | |
|---|---|
| **Rating** | **Impairment Provision** |
| I A | 1.0% |
| I B | 1.3% |
| I C | 1.5% |
| II | 25% |
| III | 50% |
| IV | 100% |
| V | 100% (write off) |

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.

Receivables originating from financial leasing are placed in I risk class:

| | | 2009 | | 2008 |
|---|---|---|---|---|
| | **Impairment provision (%)** | **Loans and Advances (%)** | **Impairment provision (%)** | **Loans and Advances (%)** |
| I | 1.0 | 96.4 | 1.3 | 98.6 |
| II | 44.5 | 0.7 | 24.9 | 0.4 |
| III | 61.5 | 0.4 | 51.1 | 0.2 |
| IV | 116.7 | 1.6 | 97.0 | 0.1 |
| Impairment | 36.5 | 0.8 | 99.5* | 0.7 |
| | **3.4** | **100.0** | **2.4** | **100** |

* Data for 2008 in risk class Impairment actually cover portfolio in arrears over 360 days

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 in 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 2009 and 2008 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 | | |
|---|---|---|
| | **2009** | **2008** |
| **Balance Sheet Exposure** | | |
| Balances with Central bank other than mandatory reserve deposits | 509,558 | 15,039 |
| Loans and advances to banks | | |
| Loans to banks within a group | 2,647 | 78,461 |
| Loans to OECD banks | 162,978 | 3,456,963 |
| Loans to domestic and non-OECD banks | 613,947 | 3,024,496 |
| **Total loans and advances to banks** | **779,572** | **6,559,920** |
| Loans and advances to customers (net): | | |
| Business | 21,235,424 | 20,269,046 |
| Agricultural | 9,586,248 | 8,110,169 |
| Housing | 3,834,506 | 3,300,953 |
| Finance leases | 2,571,657 | 3,357,081 |
| Consumer | 1,349,394 | 973,398 |
| Other | 2,094,539 | 2,890,708 |
| **Total loans and advances to customers** | **40,671,768** | **38,901,355** |
| Other financial assets (Note 22) | 50,748 | 120,183 |
| Off balance Credit Risk Exposure (Note 34) | 7,534,014 | 8,768,785 |
| **On 31 December** | **49,545,660** | **45,476,314** |

The table above represents the scenario of the maximum credit risk exposure of the Group at 31 December 2009 and 2008, 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.

- 82.1% from total exposure is related to loans to customers and financial leases thus reflecting the major business activity of the Group (2008: 71.6%);
- 96.4% from total loans and advances is classified in most favourable impairment class according to the Group's internal methodology (2008: 98.6%);
- 30.3% loans and advances to customers are covered with mortgages or deposits of the customers (2008: 25.3%);
- 39.7% of all loans and advances to customers consist of loans originally disbursed in the amounts below EUR 10,000 significantly improving diversification of the Group's loan portfolio (2008: 45.9%).

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

| | 2009 | | 2008 | |
|---|---|---|---|---|
| | **Loans to Clients** | **Loans to Banks** | **Loans to Clients** | **Loans to Banks** |
| Neither past due nor impaired | 40,333,077 | 779,572 | 39,067,032 | 6,559,920 |
| Past due but not impaired | 986,647 | – | 337,310 | – |
| Impaired | 934,964 | – | 477,812 | – |
| **Total** | **42,254,688** | **779,572** | **39,882,154** | **6,559,920** |

The total allowances for impairment is RSD 1,582,920 thousand (31 December 2008: RSD 980,799 thousand). Out of this amount, individually impaired loans are RSD 165,975 thousand (31 December 2008: RSD 1,222 thousand) and the remaining amount of RSD 1,416,945 thousand (31 December 2008: RSD 979,577 thousand) represents the group allowance. Further information of the impairment allowance is provided in Note 14.

*(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 classified in risk class I according to Group's internal methodology.

| | | 2009 | | 2008 |
|---|---|---|---|---|
| Business Loans | 21,271,300 | 52.74% | 20,404,711 | 52.23% |
| Agriculture Loans | 9,769,850 | 24.22% | 8,106,409 | 20.75% |
| Consumer Loans | 1,341,771 | 3.33% | 968,862 | 2.48% |
| Housing improvement loans and housing loans | 3,921,478 | 9.72% | 3,328,511 | 8.52% |
| Other | 2,239,053 | 5.55% | 2,965,188 | 7.59% |
| Finance leases | 1,789,624 | 4.44% | 3,293,351 | 8.43% |
| **Total loans to customers** | **40,333,076** | **100.00%** | **39,067,032** | **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:

| | | 2009 | | 2008 |
|---|---|---|---|---|
| AAA rated | – | 0.0% | – | 0.0% |
| AA- to AA+ rated | 35,648 | 4.6% | 19,781 | 0.3% |
| A- to A+ rated | 95,299 | 12.2% | 2,513,320 | 38.3% |
| BB- | 643,690 | 82.6% | 4,021,838 | 61.3% |
| Not rated | 4,935 | 0.6% | 4,981 | 0.1% |
| **Total loans and advances to banks** | **779,572** | **100.0%** | **6,559,920** | **100.0%** |

The following table indicates quality of the loans and advances to customers and banks which are neither past due nor impaired for 2008 and 2009.

| | | 2009 | | 2008 |
|---|---|---|---|---|
| | Loans to Clients | Loans to Banks | Loans to Clients | Loans to Banks |
| I | 40,317,244 | 779,572 | 39,051,601 | 6,559,920 |
| II | 8,123 | – | 7,888 | – |
| III | 3,684 | – | 3,592 | – |
| IV | 4,026 | – | 3,951 | – |
| **Total** | **40,333,077** | **779,572** | **39,067,032** | **6,559,920** |

*(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 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 |

| 31 December 2008 | Business loans | Agriculture loans | Consumer loans | Housing improvement and housing loans | Other | Finance leases | Total |
|---|---|---|---|---|---|---|---|
| Past due up to 30 days | 74,922 | 43,808 | 6,222 | 10,355 | 822 | 56,772 | 192,901 |
| Past due 31 to 90 days | 64,769 | 34,510 | 8,310 | 11,026 | 73 | 25,721 | 144,409 |
| **Total** | **139,691** | **78,318** | **14,532** | **21,381** | **895** | **82,493** | **337,310** |
| Fair value of collateral | 102,562 | 58,941 | 6,565 | 16,544 | 650 | 170,630 | 355,892 |

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 2009 individually impaired loans amounted to RSD 412,566 thousand, with fair value of the collateral amounting to RSD 381,652 thousand. The individually impaired loans for 2009 relate to 181 loans. For year 2008 individually impaired loans amounted to RSD 19,574 thousand, with fair value of the collateral amounting to RSD 18,214 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 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 |
| **31 December 2008** | | | | | | |
| Individually Impaired Loans | 19,574 | – | – | – | – | 19,574 |
| Allowance | 1,222 | – | – | – | – | 1,222 |
| **Fair value of collateral** | **18,214** | **–** | **–** | **–** | **–** | **18,214** |

*(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 jeopardy 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 Credit Risk Department of the Group.

The following table indicates volume of renegotiated loans and advances to customers as of 31 December 2009 and 2008.

| | 2009 | 2008 |
|---|---|---|
| I | 2,747,395 | 435,694 |
| II | 82,668 | 13,159 |
| III | 36,316 | 11,283 |
| IV | 71,510 | 0 |
| **Total** | **2,939,897** | **462,144** |

Amount of the renegotiated loans and advances that would otherwise be impaired, due to deterioration of the client's financial position, during 2009 was RSD 2,508,678 thousand (2008: RSD 197,574 thousand). During year 2009 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 2009, 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 112,546 thousand (2008: RSD 87,156 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 2009 and 2008.

| | 2009 | 2008 |
|---|---|---|
| Movable Collateral Bank | 391 | – |
| Movable Collateral from Financial Lease | 28,022 | 1,553 |

**B.4. Collateral Policy**

In the light of the impact of the global financial crisis to the liquidity and financial position of the Group's borrowers, the Group has tightened the collateral conditions. As a general rule for loans up to EUR 2,000 the collateral is not required, while collateral or external guarantor (or combination of those two types of security) is required for all loans disbursed or exposures in amounts exceeding EUR 2,000. 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.

Having in mind that the participation of the small loans (disbursed in amounts below 10,000 EUR) is 86% (number-wise), we can conclude that the presented collateral is adequate to the bank's operations.

**B.5. Structure and Diversification of the Loan Portfolio**

Concentration of exposure risk to various industries and sectors is under constant observation. Limits with regards to the portfolio diversification exist for the agriculture portfolio. The limit for its growth is 25% from the total loan portfolio of the bank. On 31 December 2009, this indicator was on the level of 23.8% with tendency of increase during 2009 (2008: 21.4%). 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 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 ProCredit Bank 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 2009 and 2008:

| 2009 | | 2008 | |
|---|---|---|---|
| HHI ratio by number of loans | HHI ratio by volume of loans | HHI ratio by number of loans | HHI ratio by volume of loans |
| 0.2409 | 0.1487 | 0.2303 | 0.1123 |

The following table sets basis for interpretation of the degree of concentration of the loan portfolio of the Group according to 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 2009 and 31 December 2008.

| | Placements to clients | 2009 % | Placements to clients | 2008 % |
|---|---|---|---|---|
| Financial Institutions | 779,572 | 2.36% | 6,559,920 | 18.06% |
| Trade | 7,746,659 | 23.46% | 7,872,279 | 21.68% |
| Industry and other production | 6,739,394 | 20.41% | 5,732,929 | 15.79% |
| Construction | 1,073,458 | 3.25% | 893,466 | 2.46% |
| Transport | 2,708,263 | 8.20% | 2,881,435 | 7.93% |
| Tourism | 1,038,699 | 3.15% | 1,064,026 | 2.93% |
| Other Services | 2,296,927 | 6.96% | 2,385,024 | 6.57% |
| Mixed | 628,455 | 1.90% | 705,296 | 1.94% |
| Agricultural Loans | 10,011,840 | 30.32% | 8,218,803 | 22.63% |
| **Total** | **33,023,267** | **100.00%** | **36,313,178** | **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.

**C.1. Foreign currency risk**

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 2009 | EUR | USD | Other currencies | Total foreign currencies | Local Currency | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and balances with the Central Bank | 16,118,804 | 426,379 | 54,135 | 16,599,582 | 5,766,631 | 22,366,213 |
| Loans and advances to banks | 496,438 | 115,784 | 18,172 | 630,394 | 149,178 | 779,572 |
| Loans and advances to customers | 33,334,258 | – | – | 33,334,258 | 7,337,510 | 40,671,768 |
| Derivative Financial Assets | – | – | – | – | 4 | 4 |
| Available-for-sale financial assets | 1,799 | 12,174 | – | 13,973 | – | 13,973 |
| Other financial assets | – | – | – | – | 7,924 | 7,924 |
| Intangible assets | – | – | – | – | 251,010 | 251,010 |
| Property, plant and equipment | – | – | – | – | 1,483,578 | 1,483,578 |
| Deferred income tax assets | – | – | 62,858 | 62,858 | 208,033 | 270,891 |
| Other assets | 39,961 | 1,790 | – | 41,487 | 499,254 | 540,741 |
| **Total assets** | **49,991,260** | **556,127** | **135,165** | **50,682,552** | **15,703,122** | **66,385,674** |
| | | | | | | |
| **Liabilities** | | | | | | |
| Deposits from banks | 181,720 | – | 4,119 | 185,839 | 163,858 | 349,697 |
| Derivative financial liabilities | 4,832 | – | – | 4,832 | – | 4,832 |
| Due to customers | 30,263,053 | 659,930 | 65,383 | 30,988,366 | 6,656,774 | 37,645,140 |
| Other borrowed funds | 16,543,430 | – | – | 16,543,430 | – | 16,543,430 |
| Subordinated debt | 2,621,912 | – | – | 2,621,912 | – | 2,621,912 |
| Tax liabilities | – | – | – | – | 10,814 | 10,814 |
| Provisions | – | – | – | – | 84,148 | 84,148 |
| Other liabilities | 184,870 | – | 338 | 185,208 | 376,424 | 561,632 |
| Equity | – | – | – | – | 8,564,069 | 8,564,069 |
| **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 33) | – | – | – | – | 1,884,115 | 1,884,115 |

| *continued* | EUR | USD | Other currencies | Total foreign currencies | Local Currency | Total |
|---|---|---|---|---|---|---|
| **31 December 2008** | | | | | | |
| Total assets | 48,131,749 | 727,272 | 71,278 | 48,930,299 | 16,896,059 | 65,826,358 |
| Total liabilities and equity | 47,747,097 | 724,208 | 66,092 | 48,537,397 | 17,288,961 | 65,826,358 |
| **Net on-balance sheet position** | **384,652** | **3,064** | **5,186** | **392,902** | **(392,902)** | **–** |
| **Credit commitments** (Note 33) | – | – | – | – | **2,178,592** | **2,178,592** |

As of 31 December 2009 the Group did not have any hedging accounting. The Group had only economic hedging transactions during the reporting period.

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 on 31 December | | Effect of 15 % depreciation of RSD to open currency position | | Effect of 15% appreciation of RSD to open currency position | |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** | **2009** | **2008** |
| USD | (103,803) | 384,652 | (15,570) | 57,698 | 15,570 | (57,698) |
| EUR | 191,443 | 3,064 | 28,716 | 460 | (28,716) | (460) |
| Other Currencies | 65,325 | 5,186 | 9,799 | 778 | (9,799) | (778) |

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 22,954 thousand (2008: negative effect of 58,936 thousand). In case of depreciation of the local currency by 15% positive effect on profit would be RSD 22,954 thousand (2008: positive effect of 58,936 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 2009 the Group had Interest Rate Swap in the outstanding notional amount of EUR 2.625 million (31 December 2008: EUR 3.900 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 2009 | 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 | 5,323,914 | – | – | – | – | – | 17,042,299 | 22,366,213 |
| Loans and advances to banks | 772,232 | – | – | – | – | – | 7,340 | 779,572 |
| Loans and advances to customers | 11,988,620 | 2,995,595 | 9,285,638 | 7,129,894 | 8,401,263 | 621,197 | 249,561 | 40,671,768 |
| Derivative Financial Assets | – | – | – | – | – | – | 4 | 4 |
| Available-for-sale financial assets | 13,973 | – | – | – | – | – | – | 13,973 |
| Other financial investments | – | – | – | – | – | 7,924 | – | 7,924 |
| Other assets | – | – | – | – | – | – | 540,741 | 540,741 |
| **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** |
| | | | | | | | | |
| **Liabilities** | | | | | | | | |
| Liabilities to banks | 349,429 | – | – | – | – | – | 268 | 349,697 |
| Derivative financial liabilities | – | – | 4,832 | – | – | – | – | 4,832 |
| Due to customers | 12,248,592 | 6,408,132 | 10,144,777 | 881,013 | 510,836 | 134,398 | 7,317,392 | 37,645,140 |
| Other borrowed funds | 5,877,772 | 1,630,051 | 1,902,639 | 544,025 | 6,101,831 | 320,119 | 166,993 | 16,543,430 |
| Subordinated debt | – | – | – | – | 2,588,998 | – | 32,914 | 2,621,912 |
| Other liabilities | – | – | – | – | – | – | 561,632 | 561,632 |
| **Total liabilities and equity** | **18,475,793** | **8,038,183** | **12,052,248** | **1,425,038** | **9,201,665** | **454,517** | **8,079,199** | **57,726,643** |
| | | | | | | | | |
| **Interest sensitivity gap** | **(377,054)** | **(5,042,588)** | **(2,766,610)** | **5,704,856** | **(800,402)** | **174,604** | **9,760,746** | **6,653,552** |
| | | | | | | | | |
| **31 December 2008** | | | | | | | | |
| **Total Assets** | **14,021,634** | **3,798,059** | **11,502,696** | **10,845,293** | **7,159,988** | **3,477,694** | **12,995,904** | **63,801,268** |
| **Total Liabilities** | **13,145,873** | **7,656,278** | **13,959,231** | **1,452,864** | **15,064,631** | **1,393,642** | **4,915,565** | **57,588,084** |
| **Interest sensitivity gap** | **875,761** | **(3,858,219)** | **(2,456,535)** | **9,392,429** | **(7,904,643)** | **2,084,052** | **8,080,339** | **6,213,184** |

Negative gap in nearly all 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 2009** | (112,861) | (112,957) | 2,685 | 112,861 | 112,957 | (2,685) |

| 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 2008** | (8,803) | (39,605) | 36,194 | 8,803 | 39,605 | (36,194) |

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 2009** | (259,901) | (174,130) | (88,352) | 259,901 | 174,130 | 88,352 |

| 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 2008** | 256,780 | 320,029 | (73,274) | (256,780) | (320,029) | 73,274 |

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 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** |

| As at 31 December 2008 | 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 | 3,223,316 | – | – | – | – | – | 3,223,316 |
| Due to customers | 8,914,905 | 8,866,941 | 11,499,700 | 912,606 | 1,110,237 | 88,763 | 31,393,152 |
| Other borrowed funds | 2,281,596 | 894,379 | 5,181,882 | 1,789,105 | 17,429,768 | 1,549,380 | 29,126,110 |
| Provisions | 3,054 | 6,107 | 27,483 | – | – | 39,388 | 76,032 |
| Other liabilities | 79,117 | 58,603 | – | – | – | – | 137,720 |
| **Total Financial Liabilities** (by contractual due dates) | **14,501,988** | **9,826,030** | **16,709,065** | **2,701,711** | **18,540,005** | **1,677,531** | **63,956,330** |
| **Total Financial Assets** (by expected due dates) | **26,709,918** | **3,844,759** | **12,668,300** | **12,364,833** | **9,274,164** | **3,964,242** | **68,826,216** |

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 2009 | Less than one month | From 1 – 3 months | From 3 – 12 months | Over one Year | Total |
|---|---|---|---|---|---|
| Foreign currency swaps: | | | | | |
| Outflow | – | – | 64,154 | – | 64,154 |
| Inflow | – | – | 61,202 | – | 61,202 |
| | | | | | |
| **At 31 December 2008** | | | | | |
| Foreign currency swaps: | | | | | |
| Outflow | – | – | 5,757 | – | 5,757 |
| Inflow | – | – | 5,339 | – | 5,339 |

**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 2009 | Less than one month | From 1 – 3 months | From 3 – 12 months | Over one Year | Total |
|---|---|---|---|---|---|
| Interest rate swaps: | | | | | |
| Outflow | – | – | 4,416 | – | 4,416 |
| Inflow | – | – | – | – | – |
| | | | | | |
| **At 31 December 2008** | | | | | |
| Interest rate swaps: | | | | | |
| Outflow | – | – | 469 | – | 469 |
| 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 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** |

| At 31 December 2008 | 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 | 156,719 | 1,301 | – | – | 158,019 |
| Approved but unused overdraft limits for business clients | 1,433,317 | 12 | – | – | 1,433,329 |
| Approved but unused credit card limits | 335,737 | 244,786 | 6,720 | – | 587,244 |
| Payments and guarantees | 2,991,117 | 328,013 | 2,523,085 | 57,533 | 5,899,748 |
| Letters of credit | 233,011 | – | – | – | 233,011 |
| Performance guarantees | 445,500 | 1,728 | 844 | – | 448,072 |
| **Total** | **5,595,401** | **575,840** | **2,530,649** | **57,533** | **8,759,423** |

**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 | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| **Financial assets** | | | | |
| Loans and advances to customers | 40,671,768 | 38,901,355 | 41,515,967 | 38,696,404 |
| Business | 21,235,424 | 20,269,046 | 21,903,945 | 20,162,209 |
| Agro | 9,586,248 | 8,110,169 | 10,476,780 | 8,067,484 |
| Housing Loans | 3,834,506 | 3,300,953 | 4,027,293 | 3,283,519 |
| Consumer | 2,571,657 | 973,398 | 1,340,844 | 968,270 |
| Leasing | 1,349,394 | 3,357,081 | 2,428,961 | 3,339,394 |
| Other | 2,094,539 | 2,890,708 | 1,338,143 | 2,875,528 |
| Loans and advances to banks | 779,572 | 6,559,920 | 753,299 | 6,151,735 |
| **Total Financial Assets** | **41,451,340** | **45,461,275** | **42,269,266** | **44,848,139** |
| Financial liabilities | | | | |
| Deposits from banks | 349,697 | 3,204,000 | 341,252 | 3,002,221 |
| Due to customers | 37,645,140 | 30,422,765 | 37,791,032 | 30,688,844 |
| Corporate | 7,062,409 | 4,601,545 | 7,047,872 | 4,641,801 |
| SME | 10,533,415 | 9,676,996 | 10,554,413 | 9,761,608 |
| Private individuals | 20,049,316 | 16,144,224 | 20,188,747 | 16,285,435 |
| Due to IFI's and other borrowings | 16,543,430 | 21,159,635 | 16,585,310 | 23,130,830 |
| Subordinated debt | 2,621,912 | 2,438,021 | 2,162,599 | 2,169,245 |
| **Total Financial Liabilities** | **57,160,179** | **57,224,421** | **56,880,192** | **58,991,140** |

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 repricing 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 2009 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial assets | – | 4 | – | 4 |
| Available for sale financial assets | 13,973 | – | – | 13,973 |
| **Total Financial Assets** | **13,973** | **4** | – | **13,977** |
| | | | | |
| **Financial liabilities** | | | | |
| Derivative financial liabilities | – | 4,832 | – | 4,832 |
| **Total Financial Liabilities** | – | **4,832** | – | **4,832** |

In 2009. there was no transfer between level 1 and level 2 of the fair value hierarchy. There were no Lever 3 items as of 31 December 2009 and 2008.

### F) Operational Risk

In line with Basle 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), Key Risk Indicators 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), Key Risk Indicators 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 and Control*
- Process owners responsibility to monitor risks
- Key Risk Indicators (KRIs) and 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 2009, there were 23 cases in which the bank was prosecuted (2008: 17). Consequentially, based on its procedure the Group set aside reserves for estimated potential losses originating from the court cases in the amount of RSD 9.447 thousands (2008: RSD 7.663 thousands).

## 4. Net interest income

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| **Interest income** | | |
| Interest income from loans and advances to banks | 239,243 | 806,665 |
| Interest income from financial institutions | 1,016,315 | 285,405 |
| Interest income from loans and advances to customers | 6,817,942 | 6,287,023 |
| | **8,073,500** | **7,379,093** |
| **Interest expenses** | | |
| Interest expenses on liabilities to banks | 331,059 | 78,879 |
| Interest expenses on liabilities to customers | 1,939,214 | 1,853,234 |
| Interest expenses on liabilities to international financial institutions | 1,049,192 | 1,467,541 |
| Interest expenses on subordinated debt | 158,799 | 183,350 |
| | **3,478,264** | **3,583,004** |
| **Net interest income** | **4,595,236** | **3,796,089** |

## 5. Allowance for impairment losses on loans and advances

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Charge for the year on loans to customers (Note 14 ) | 2,204,661 | 1,545,511 |
| Expenses derived from write-offs | 11,749 | 14,724 |
| Release of provision on loans to customers (Note 14) | (1,281,319) | (935,343) |
| Recovery of written- off loans | (61,024) | (58,358) |
| **Total impairment provision** | **874,067** | **566,534** |

### 6. Net fee and commission income

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| **Fee and commission income** | | |
| Payment transfer and transactions | 598,176 | 488,682 |
| Account maintenance fee | 336,719 | 158,176 |
| Letters of credit and guarantees | 109,026 | 112,181 |
| Debit/credit cards | 143,146 | 141,615 |
| Other fees and commission income | 26,611 | 25,616 |
| | **1,213,677** | **926,270** |
| | | |
| **Fee and commission expense** | | |
| Payment transfers and transactions | 141,602 | 113,843 |
| Other fees and commission expenses | 16,675 | 17,604 |
| | 158,277 | 131,447 |
| **Net fee and commission income** | **1,055,400** | **794,823** |

Other fee income include fees and commissions from banks in the amount of RSD 5,288 thousand (2008:4,748 thousand), fees on travelers' cheques in the amount of RSD 1,503 thousand (2008: RSD 1,216 thousand) and other fees from customers in the amount of RSD 19,820 thousand (2008: RSD 19,651 thousand).
Other fees and commission expenses include fee expenses to banks in the amount of RSD 15,760 thousand (2008: RSD 16,596 thousand) and other fees to others in the amount of RSD 915 thousand (2008: RSD 1,008 thousand).

### 7. Net trading income

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Translation (losses)/ gains | 42,939 | (9,250) |
| Transaction losses from foreign exchange trading operations with banks | (36,320) | (57,140) |
| Transaction gains from foreign exchange trading operations with customers | 277,282 | 386,702 |
| **Total net trading income** | **283,901** | **320,312** |

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

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Losses from fair value changes for financial assets at fair value through profit and loss | (20,643) | (24,969) |
| Gains from fair value changes for financial assets at fair value through profit and loss | 1,206 | 22,299 |
| **Net result from financial assets at fair value through profit or loss** | **(19,437)** | **(2,670)** |

### 9. Operating income

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Insurance indemnity | 22,565 | 50,492 |
| Reimbursement of expenses for bills of exchange and safe bags for money | 14,093 | 13,959 |
| Net gains from disposal of property and equipment | 17 | 3,092 |
| Income from litigation settlements | 833 | 1,415 |
| Release of provision on guarantees (Note 28) | 86,145 | – |
| Release of provision on retirement benefit obligations (Note 28) | 1,807 | – |
| Other | 27,177 | 11,430 |
| **Total Other operating income** | **152,637** | **80,388** |

### 10. Other operating expenses

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| **Staff costs** | | |
| Wages and salaries | 1,399,412 | 1,163,169 |
| State pension contributions | 408,497 | 341,070 |
| Taxes and contributions on salaries | 499,210 | 411,204 |
| Fringe benefits | 102,944 | 98,631 |
| Other staff costs | 474 | 17,931 |
| **Total staff costs** | **2,410,537** | **2,032,005** |
| | | |
| Office rent | 450,176 | 405,341 |
| Depreciation and amortization | 370,787 | 302,394 |
| Marketing and representation | 149,397 | 273,492 |
| Office supplies and other office utilities | 148,713 | 162,097 |
| Other service expenses | 144,246 | 120,143 |
| Communication expenses | 91,304 | 102,185 |
| Expenses for consulting services | 77,143 | 62,891 |
| Transport expenses | 51,343 | 57,795 |
| Legal and advisory expenses | 37,849 | 51,155 |
| Security | 54,403 | 49,661 |
| Other taxes | 92,739 | 41,857 |
| Training expenses | 21,299 | 41,318 |
| Expenses for royalties on software | 3,603 | 31,628 |
| Expenses for repairs and maintenance | 31,837 | 18,984 |
| Insurance expenses | 13,664 | 11,604 |
| One-time working contracts | 3,800 | 9,765 |
| Other administrative expenses | 791 | 1,463 |
| Expenses for deposit insurance fund | 128,276 | 75,974 |
| Expenses for provisions on guarantees (Note 28) | 4,194 | 25,985 |
| Expenses for litigation settlements | 1,190 | 7,718 |
| Expenses for disposal of property and equipment | 13,419 | 3,630 |
| Others | 22,985 | 4,247 |
| **Total Other operating expenses** | **1,913,158** | **1,861,327** |
| | **4,323,695** | **3,893,332** |

### 11. Income taxes

| | Year ended 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Current income tax expenses | (90,361) | (141) |
| Deferred income tax credit | 27,905 | 87,096 |
| **Total income tax expenses** | **(62,456)** | **86,955** |

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 | |
|---|---|---|
| | **2009** | **2008** |
| Profit before tax | 869,974 | 529,076 |
| Tax calculated at a tax rate of 10% (2008: 10%) | (86,997) | (52,908) |
| Fines and penalties | (5) | (29) |
| Accounting depreciation above tax depreciation | (10,960) | (9,246) |
| Other non-deductible expenses | (5,895) | (7,409) |
| Utilized tax credits | 13,496 | 69,592 |
| Unutilized tax credits brought forward | 27,905 | 86,955 |
| **Current tax expenses** | **(62,456)** | **86,955** |

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 | |
|---|---|---|
| | **2009** | **2008** |
| Cash on hand | 1,120,969 | 1,049,060 |
| Mandatory reserve | 20,735,686 | 16,936,900 |
| Other Balances with the Central Bank | 9,294 | 15,039 |
| Treasury bills | 500,264 | – |
| **Total included in Cash and cash equivalents (Note 32)** | **22,366,213** | **18,000,999** |

The National Bank of Serbia (NBS) regulations related to mandatory reserve has been changed few times during 2009. At the end of December mandatory reserve in local currency was calculated by applying the rate of 10% for deposits maturity up to 1 month and 5% for deposits maturity above 1 month 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 were calculated by applying the rate of 45% and for deposits in foreign currency were calculated by applying the rate of 40% 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 20 % 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.
At the end of December calculated dinar mandatory reserves are the sum of mandatory reserves calculated in dinars and 20% of the dinar equivalent of the sum of mandatory reserves calculated in euro. Calculated foreign currency mandatory reserves is the sum of 60% mandatory reserves calculated in euro. In October 2008 National bank of Serbia put into force decision to freeze calculated mandatory reserve on funds from abroad in local and foreign currency on the level of September 2008. This decision will be valid until December 2010. In March 2009 NBS put in force decision that bank can reduce the amount of deposits, credits and other obligations by loans approved to enterprises for investment purposes and consumer loans for the purchase of durable consumer goods manufactured in the Republic of Serbia in line with the Program of Measures for Easing the Negative Effects of the World Economic Crisis in the Republic of Serbia. In June 2009 NBS put in force decision the amount of obligation can be reduced by amount of loans approved under the Government Program after 30 April 2009 for the maintenance of liquidity and financing of long-term current assets. The base reduction could not exceed the increase in total lending to enterprises since April 30 2009.
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 | |
|---|---|---|
| | **2009** | **2008** |
| Nostro accounts (Note 32) | 118,635 | 2,565,321 |
| Money market placements (Note 32) | 660,937 | 3,994,599 |
| **Total loans and advances to banks** | **779,572** | **6,559,920** |

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

| | **2009** | **2008** |
|---|---|---|
| Legal entities | 14,051,592 | 13,410,916 |
| Small and medium enterprises | 10,119,363 | 11,339,457 |
| Agricultural | 10,256,561 | 8,610,765 |
| Private individuals | 8,620,706 | 7,468,862 |
| **Total loans and advances to customers** | **43,048,222** | **40,830,000** |
| Unearned future finance income on finance leases | (422,854) | (527,285) |
| Deferred fee income | (370,680) | (420,561) |
| Allowance for impairment | (1,582,920) | (980,799) |
| **Net loans to customers** | **40,671,768** | **38,901,355** |

Accrued interest amounts RSD 474,036 thousand (2008: RSD 321,580 thousand).

| | **2009** | **2008** |
|---|---|---|
| Current | 18,820,757 | 17,447,121 |
| Non-current | 21,851,011 | 21,454,234 |
| | **40,671,768** | **38,901,355** |

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

| | **2009** | **2008** |
|---|---|---|
| **Balance at 1 January** | **980,799** | **757,916** |
| Provision charge for loans and advances impairment (Note 5) | 923,342 | 610,168 |
| Loans written off | (395,106) | (499,683) |
| Exchange rate differences | 73,885 | 112,398 |
| **Balance 31 December** | **1,582,920** | **980,799** |

Loans and advances to customers include finance lease receivables:

| | 2009 | 2008 |
|---|---|---|
| Gross investment in finance leases: | | |
| No later than 1 year | 1,273,715 | 1,203,349 |
| Later than 1 year and no later than 5 years | 1,779,714 | 2,269,691 |
| Later than 5 years | 2,613 | 25,449 |
| | **3,056,042** | **3,498,489** |
| Unearned future finance income on finance leases | (406,720) | (527,285) |
| Net investment in finance leases | **2,649,322** | **2,971,204** |

Net investment in finance lease is analyzed as follows:

| | 2009 | 2008 |
|---|---|---|
| No later than 1 year | 1,066,285 | 962,514 |
| Later than 1 year and no later than 5 years | 1,580,493 | 1,984,410 |
| Later than 5 years | 2,544 | 24,280 |
| | **2,649,322** | **2,971,204** |

## 15. Derivative financial assets

Derivative financial assets in the amount of RSD 4 thousand (2008: null) include currency swaps with Barclays bank of Euro 1,130 thousand. 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 2009 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 12,174 thousand and SWIFT shares in amount RSD 1,799 thousand.

| | At 31 December | |
|---|---|---|
| | 2009 | 2008 |
| Shares in companies situated in OECD countries | 13,973 | 6,882 |
| **Total available-for-sale financial assets** | **13,973** | **6,882** |

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

**Movements in revaluation reserve (AFS)**

| | 2009 | 2008 |
|---|---|---|
| As at January 1 | 998 | – |
| Fair value remeasurement | 4,873 | 1,109 |
| Deferred taxes | (487) | (111) |
| **As of December 31** | **5,384** | **998** |

## 17. Other financial investments

| | At 31 December | |
|---|---|---|
| | 2009 | 2008 |
| 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 2009 and 2008 is presented in table below:

| **Software** | |
|---|---|
| **Cost** | |
| Balance, 1 January 2008 | 40,072 |
| Additions | 21,111 |
| Balance, 31 December 2008 | **61,183** |
| **Accumulated amortization** | |
| Balance, 1 January 2008 | 22,535 |
| Charge for the year | 5,302 |
| Balance, 31 December 2008 | 27,837 |
| **Net Book Value 31 December 2008** | **33,346** |
| **Cost** | |
| Balance, 1 January 2009 | 61,183 |
| Additions | 239,640 |
| Disposals | (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** |

**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 2008 | – | 266,290 | 899,504 | 167,211 | 1,333,005 |
| Additions | 688,685 | 75,654 | 381,535 | 44,357 | 1,190,231 |
| Disposals | – | – | (26,525) | (5,555) | (32,080) |
| **Balance, 31 December 2008** | **688,685** | **341,944** | **1,254,514** | **206,013** | **2,491,156** |
| | | | | | |
| **Accumulated Depreciation** | | | | | |
| Balance, 1 January 2008 | – | 70,780 | 394,688 | 53,049 | 518,517 |
| Disposals | – | – | (24,745) | (2,797) | (27,542) |
| Charge for the year | – | 51,533 | 218,479 | 27,080 | 297,092 |
| **Balance, 31 December 2008** | – | **122,313** | **588,422** | **77,332** | **788,067** |
| | | | | | |
| **Net Book Value 31 December 2008** | **688,685** | **219,631** | **666,092** | **128,681** | **1,703,089** |
| | | | | | |
| **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** |

**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% (2008: 10%).

Deferred tax assets are attributable to the following items:

| | At 31 December | |
|---|---|---|
| | **2009** | **2008 restated** |
| Tax credit carried forward (expiring in the period over 5 years) | 246,449 | 271,554 |
| Accelerated tax depreciation | 24,442 | 17,101 |
| **As of 31 December** | **270,891** | **288,655** |

The movement in deferred income tax account is as follows:

| | At 31 December | |
|---|---|---|
| | **2009** | **2008 restated** |
| As of 1 January | 288,655 | 201,669 |
| IIncome statement charge | 27,905 | 87,096 |
| Fair value measurement of available for sale securities | (488) | (111) |
| Deferred tax on tax credit | (45,180) | – |
| **As of 31 December** | **270,891** | **288,655** |

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

| | At 31 December | |
|---|---|---|
| | **2009** | **2008 restated** |
| Tax credit on investment in property and equipment | 20,562 | 81,202 |
| Accelerated tax depreciation | 7,343 | 5,894 |
| **As of 31 December** | **27,905** | **87,096** |

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

**21. Other assets**

*(a)*

| | At 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Accounts receivables | 50,694 | 11,563 |
| Pre-payments | 361,033 | 56,385 |
| Repossessed properties | 28,413 | 1,553 |
| Deferred items | 85,412 | 128,134 |
| Claims on insurances | 48 | 79,536 |
| Claims from customs and taxes | 6 | 29,084 |
| Inventory items | 14,632 | 17,712 |
| Others | 503 | 221 |
| | **540,741** | 324,188 |

Prepayments mostly relate to Interest expenses paid in advance to the clients using Pro Advance deposit in the amount of 284,983RSD thousand (2008: RSD 17,742 thousand).

Deferred items consist of following:

- Deferred expenses that are related to marketing and rent in the amount of RSD 56,944 thousand (2008: RSD 74,203 thousand);
- Deferred invoice from ProCredit group in the amount of RSD 3,431 thousand (2008: RSD 37,995 thousand);
- Other deferred expenses in the amount of RSD 25,037 thousand (2008:RSD 15,936 thousand).

Others represent losses in cash box and litigated receivables in the amount of RSD 503 thousand (2008: RSD 221 t thousand).

*(b) Financial and non-financial assets*

| | 2009 | 2008 |
|---|---|---|
| Financial | 112,080 | 169,765 |
| Non-financial | 428,661 | 154,423 |
| | **540,741** | **324,188** |

*(c) All other assets are current assets*

**22. Deposits from banks**

| | At 31 December | |
|---|---|---|
| | 2009 | 2008 |
| Money market deposits | – | 2,379,098 |
| Liabilities for term transactions | 349,683 | 797,724 |
| Other banks deposits | 14 | 27,178 |
| | **349,697** | **3,204,000** |

Liabilities for term transactions as of 31 December 2009 consist of spot transactions in the amount of RSD 307,424 thousand (2008: RSD 714,750 thousand), fx deals in the amount of RSD 42,259 thousand.(2008: RSD 82,974 thousand).

Other bank deposits as of 31 December 2009 consist of deposits from banks in process of bankruptcy in the amount of RSD 14 thousand(2008: RSD 27,178 thousand).

All deposits from banks are current liabilities.

**23. Derivative financial liabilities**

Derivative financial liabilities in the amount of RSD 4,832 thousand (2008: RSD 1,830 thousand) include interest rate swaps. Interest rate swap is used to change commitments with floating interest rates for commitments with fixed interest rates.

As of 31 December 2009 the Group had Fixed-for-Floating Interest Rate Swap with Commerzbank AG of Euro 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).

**24. Due to customers**

| | At 31 December | |
|---|---|---|
| | 2009 | 2008 |
| **Current accounts** | | |
| private individuals | 1,858,013 | 1,357,092 |
| corporate | 7,840,979 | 4,876,451 |
| other customers | 274,362 | 266,545 |
| **Saving accounts** | | |
| private individuals | 2,061,617 | 1,924,338 |
| **Term deposits** | | |
| private individuals | 14,190,691 | 12,862,794 |
| corporate | 6,373,552 | 5,848,004 |
| ProCredit Holding | 2,397,220 | – |
| other customers | 154,262 | 216,890 |
| **Deposit as collateral for credit commitment** | 4,722 | 2,306,941 |
| | | |
| Other liabilities | 335,554 | 356,036 |
| | **37,406,156** | **30,015,091** |
| Accrued interest on deposits | 238,984 | 407,674 |
| **Total deposits** | **37,645,140** | **30,422,765** |

| | 2009 | 2008 |
|---|---|---|
| Current | 36,164,697 | 28,603,088 |
| Non-current | 1,480,443 | 1,819,677 |
| | **37,645,140** | **30,422,765** |

Other liabilities as of 31st December consist of pending client transfers the amount of RSD 334,789 thousand (2008: RSD 355,981) and other liabilities in the amount of RSD 765 thousand (2008: RSD 55 thousand).

## 25. Other borrowed funds

Other borrowed funds include long term borrowed funds from International Financial Institutions and foreign banks. The table bellow summarizes other borrowed funds as of 31 December 2009:

| | Initial loan in EUR | Carrying value in EUR | Maturity | Interest rate | RSD thousand | RSD thousand |
|---|---|---|---|---|---|---|
| | | 2009 | | | 2009 | 2008 |
| European Bank for Reconstruction and Development (EBRD) | 21,000,000 | – | 2005-2009 | ERBR + 2.45% | – | 132,902 |
| Kreditanstalt für Wiederaufbau (KfW) | 36,800,000 | 30,185,714 | 2006-2015 | ERBR + 2.45% | 2,894,472 | 1,874,544 |
| International Finance Corporation | 25,000,000 | 20,000,000 | 2007-2014 | ERBR + 3.60% | 1,917,776 | 2,215,025 |
| Instituto de Credito Oficial | 15,000,000 | 15,000,000 | 2004-2015 | ERBR + 2.34% – 3.50% | 1,438,332 | 1,329,015 |
| Financierings - Maatschappij voor Ontwikkelingslanden (FMO) | 63,000,000 | 42,800,000 | 2005-2013 | ERBR + 2.30% – 2.90% | 4,104,040 | 5,471,112 |
| EFSE | 17,383,333.34 | 8,800,000 | 2006-2015 | ERBR + 2.4% – 4.20% | 843,821 | 1,098,652 |
| Dexia Micro credit fund | 7,000,000 | 7,000,000 | 2009-2012 | 6mERBR + 3.50% | 671,222 | – |
| PC Finance B.V. | 125,000,000 | 47,000,000 | 2007-2012 | 6% | 4,506,774 | 8,594,297 |
| | **310,183,333.34** | **170,785,714** | | | **16,376,437** | **20,715,547** |
| Accrued interest | | | | | 330,701 | 676,419 |
| Deferred fees | | | | | (163,708) | (232,331) |
| **Total** | | | | | **16,543,430** | **21,159,635** |

| | 2009 | 2008 |
|---|---|---|
| Current | 3,951,725 | 7,134,199 |
| Non-current | 12,591,705 | 14,025,436 |
| | **16,543,430** | **21,159,635** |

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 2009 was as follows:

| | Required (higher than) | Actual |
|---|---|---|
| International Finance Corporation | 12% | 19.42% |
| FMO (loan to ProCredit Bank) | 12% | 18.28% |
| FMO (loan to ProCredit Leasing) | 10% | 19.37% |
| European Bank for Reconstruction and Development | 13% | 19.42% |

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 2009 and 2008 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 waiver from KfW (lender) based on which the lender declares that they do not have intend to exercise their rights to require additional securities, or to terminate the loan agreement until 31 December 2010, 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 47,000,000 EUR, Interest rate is 6% per annum and payable annually, Interest rate is fixed for the period of five years.

## 26. Subordinated debt

| | Initial loan in EUR | Carrying value in EUR | Maturity | RSD thousand | RSD thousand |
|---|---|---|---|---|---|
| | | 2009 | | 2009 | 2008 |
| EFSE-subordinated debt | 27,000,000 | 27,000,000 | 2008-2013 | 2,588,998 | 2,392,227 |
| Accrued interest | | | | 35,251 | 49,289 |
| Deferred fees | | | | (2,337) | (3,495) |
| **Total** | | | | **2,621,912** | **2,438,021** |

| | 2009 | 2008 |
|---|---|---|
| Current | 32,914 | 49,290 |
| Non-current | 2,588,998 | 2,388,731 |
| | **2,621,912** | **2,438,021** |

## 27. Tax liabilities

Tax liabilities consist current income tax in the amount of RSD 10,814 thousand (2008: null) which Group is obligated to pay for 2009th.

## 28. Provisions

| | At 31 December | |
|---|---|---|
| | 2009 | 2008 |
| Retirement benefit obligations | 37,581 | 39,388 |
| Provision for losses on guarantees | – | 81,952 |
| Provision for losses on pending transactions | 9,448 | 11,962 |
| Provision for untaken vacation | 37,119 | 36,644 |
| Other provisions | _ | 6,060 |
| **Total provisions** | **84,148** | **176,006** |

Retirement benefit obligations are paid after regularly retirement of employee. The right on this benefit is conditioned with keeping employee until the right on 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:

| | 2009 | 2008 |
|---|---|---|
| **Balance at 1 January** | **176,006** | **120,128** |
| Charge for the year | 37,119 | 84,945 |
| Releases | (129,591) | (29,067) |
| Other | 594 | – |
| **Balance 31 December** | **84,128** | **176,006** |

Movement in provision for retirement benefit obligations:

| | 2009 | 2008 |
|---|---|---|
| **Balance at 1 January** | **39,388** | **34,202** |
| Charge for the year | – | 5,186 |
| Release | (1,807) | – |
| **Balance 31 December** | **37,581** | **39,388** |

Movement in provision for losses on guarantees is as follows:

| | 2009 | 2008 |
|---|---|---|
| **Balance at 1 January** | **81,952** | **55,965** |
| Charge for the year | 4,193 | 25,985 |
| Release | (86,145) | – |
| **Balance 31 December** | **–** | **81,952** |

## 29. Other liabilities

| | At 31 December | |
|---|---|---|
| | 2009 | 2008 |
| Liabilities to employees | 26 | 13 |
| Taxes, contributions and other charges | 6,615 | 18,470 |
| Liabilities to suppliers | 201,302 | 117,206 |
| Received prepayments for credit installments | 189,502 | 213,149 |
| Liabilities to Credit Bureau | 3,616 | 2,031 |
| Deferred income from subvention | 95,221 | – |
| Received prepayments | 55,575 | – |
| Others | 9,775 | 10,964 |
| | **561,632** | **361,833** |

| | 2009 | 2008 |
|---|---|---|
| Financial | 219,890 | 142,809 |
| Non-financial | 341,742 | 219,024 |
| | **561,632** | **361,833** |

| | 2009 | 2008 |
|---|---|---|
| Current | 424,934 | 321,519 |
| Non-current | 136,697 | 40,314 |
| | **561,632** | **361,833** |

Position others includes: other due payments RSD 9,754 thousand (2008: RSD 10,857 thousand), liabilities for surplus in cash box RSD 21 thousand (2008: RSD 107 thousand).

### 30. Share Capital

The ownership structure of the ProCredit Bank a.d. Belgrade as at 31 December 2009 and 2008 is as follows:

| | Number of shares | | Share in % | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| 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% owns 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 (2008: 1,000 RSD per share). In 2009. 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).
In 2009 Group paid dividends in the amount of RSD 335,800 thousand. Dividend per share was RSD 91,62 (2008: 84,65 RSD in total 310,103,500 RSD).

### 31. 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 2009, the special banking risk reserves under Central Bank's regulations amounted to RSD 1,345,592 thousand (31 December 2008: RSD 1,076,186 thousand), During 2009 the Bank has allocated to special account reserves the amount of RSD 269,407 thousand (2008: 412,982), after approval of the Bank's shareholders, in order to reach the level prescribed by the Central Bank.

### 32. Cash and cash equivalents

| | At 31 December | |
|---|---|---|
| | **2009** | **2008** |
| Cash and balances with Central Bank (Note 12) | 22,366,213 | 18,000,999 |
| Nostro accounts with other banks (Note 13) | 118,635 | 2,565,321 |
| Money market placements (Note 13) | 660,937 | 3,994,599 |
| | **23,145,785** | **24,560,919** |

### 33. 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 | |
|---|---|---|
| | **2009** | **2008** |
| Payments and guarantees | 4,996,178 | 5,899,748 |
| Acceptances and endorsements | 4,862 | 9,362 |
| Loan commitments | 1,884,115 | 2,178,592 |
| Letters of credit | 43,036 | 233,011 |
| Credit related commitments (Note 3.B.3) | 6,928,191 | 8,320,713 |
| Performance guarantees | 605,823 | 448,072 |
| **Balance as at 31 December** | **7,534,014** | **8,768,785** |

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

| | At 31 December | |
|---|---|---|
| | **2009** | **2008** |
| No later than 1 year | 44,499 | 8,162 |
| Later than 1 year and no later than 5 years | 188,588 | 344,787 |
| Later than 5 years | 1,453,393 | 2,000,773 |
| | **1,686,480** | **2,353,722** |

### 34. 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 Hoding AG, other than the payment of dividends on ordinary shares.

| | | At 31 December | |
|---|---|---|---|
| | Terms and conditions 2009 | 2009 | 2008 |
| **Nostro accounts** | | | |
| Commerzbank AG | | 63,578 | 794,343 |
| ProCredit bank Bulgaria | | 2,647 | 15,054 |
| | | | |
| **Loans and advances to banks** | | | |
| ProCredit Bank Moldova | | – | 62,900 |
| | | | |
| **Share in equity** | | | |
| ProCredit Academy Eastern Europe | | 7,923 | 7,923 |
| | | | |
| **Other receivables** | | | |
| ProCredit Holding | | 261 | 37,487 |
| PC Finance II | | 3,171 | 1,013 |
| ProCredit Bank Moldova | | – | 507 |
| | | | |
| **Liabilities to group co,** | | | |
| PC Finance II | Sight deposit | 2,049,684 | 686,751 |
| PC Finance II | Accrued interest on sight deposit | 3,372 | 2,178 |
| ProCredit Holding | Short term deposit with variable interest rate | 2,397,220 | – |
| ProCredit Holding | Accrued interest on short term deposit | 3,113 | – |
| PC Finance B.V. | Note 25 | 4,506,774 | 8,594,297 |
| **Liabilities for dividends** | | | |
| Liabilities for dividends PCH | | – | 63,030 |
| | | | |
| **Off balance sheet items** | | | |
| Guarantees issued to PC Finance II | | 244,516 | 79,741 |

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

| | 2009 | 2008 |
|---|---|---|
| **Deposits from banks** | | |
| Outstanding at 1 January | – | – |
| Deposits collected during year | 11,358,304 | – |
| Deposits returned during the year | (8,961,084) | – |
| **Outstanding at 31 December** | **2,397,220** | **–** |
| | | |
| **Other borrowed funds** | | |
| Loans outstanding at 1 January | 8,594,297 | 9,904,524 |
| Loans repayments during the year | (4,087,523) | (1,310,227) |
| **Loans outstanding at 31 December** | **4,506,774** | **8,594,297** |

| | 2009 | 2008 |
|---|---|---|
| Interest income from associates | 1,708 | 14,092 |
| Interest expenses from subsidiaries | 32,573 | 59,101 |
| Interest expenses from associates | 32,502 | 37,100 |

Paid salaries and other short term employee benefits to the Members of Executive Board as of 31 December 2009 amounted RSD 15,769 thousand (2008: RSD 15,066 thousand). No other benefits have been paid to the key management.

## 35. Events after balance sheet date

On January 27, 2010 the Bank received loan in the amount of Euro 10 million from EBRD, with maturity of 5 years and interest rate of ERBR + 4%. No post balance sheet events have occurred which have any substantial impact on the consolidated financial statements for the year ending 31 December 2009.

## 36. Exchange Rates

The official exchange rates as of 31 December 2009 and 2008 are as follows:

| | 2009 | 2008 |
|---|---|---|
| USD | 66.7285 | 62.9000 |
| EUR | 95.8888 | 88.6010 |
| CHF | 64.4631 | 59.4040 |

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