

OOO UBS Bank

Financial statements

Year ended 31 December 2013

Together with Independent auditor's report

Contents

Independent auditor's report

Statement of financial position	1
Statement of comprehensive income	2
Statement of changes in net assets attributable to the shareholder	3
Statement of cash flows	4

Notes to financial statements

1. Principal activities	5
2. Basis of preparation	5
3. Summary of accounting policies	6
4. Significant accounting judgments and estimates	12
5. Cash and cash equivalents	13
6. Obligatory reserves with the Central Bank of the Russian Federation	14
7. Trading securities	14
8. Amounts due from other banks	14
9. Derivative financial instruments	14
10. Loans to customers	15
11. Property and equipment and intangible assets	15
12. Taxation	16
13. Other assets and liabilities	17
14. Amounts due to credit institutions	17
15. Amounts due to customers	17
16. Net assets attributable to the shareholder	18
17. Commitments and contingencies	18
18. Net fee and commission expense	19
19. Income from consulting services and other income	19
20. Personnel and other operating expenses	20
21. Risk management	20
22. Fair value of financial instruments	29
23. Related party transactions	30
24. Capital adequacy	32
25. Events after the reporting period	32

Independent auditor's report

To the Shareholder and Board of Directors of OOO UBS Bank

We have audited the accompanying financial statements of OOO UBS Bank, which comprise the statement of financial position as of 31 December 2013, and the statement of comprehensive income, of changes in net assets attributable to the shareholder and of cash flows for 2013, and a summary of significant accounting policies and other explanatory notes.

Audited entity's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on the fairness of these financial statements based on our audit.

We conducted our audit in accordance with the Russian federal standards on auditing and International Standards on Auditing. These standards require that we comply with applicable 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 financial statements. The audit procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fairness of the financial statements in order to select appropriate audit procedures, 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 of the audited entity, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of OOO UBS Bank as of 31 December 2013, its financial performance and cash flows for the year 2013 in accordance with International Financial Reporting Standards.



E.V. Zaichikova
Partner
Ernst & Young LLC

29 April 2014

Details of the audited entity

Name: OOO UBS Bank

Certificate of State Registration of Credit Institution No. 3463 issued by the Central Bank of the Russian Federation on 9 March 2006.

Record made in the State Register of Legal Entities on 9 March 2006, State Register Number 1067711001863.

Address: Russia 115054, Moscow, Paveletskaya square, 2/2.

Details of the auditor

Name: Ernst & Young LLC

Record made in the State Register of Legal Entities on 5 December 2002, State Registration Number 027739707203. Address: 115035 Russia, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.

Ernst & Young LLC is a member of Non Profit partnership "Russian Audit Chamber" ("NP APR"). Ernst & Young LLC is registered in the register of auditors and audit organizations of NP APR, number 3028, and also included in the control copy of the register of auditors and audit organizations, main registration number 10201017420.

Statement of financial position**As of 31 December 2013***(Thousands of Russian rubles)*

	Note	2013	2012
Assets			
Cash and cash equivalents	5	4,751,557	8,488,945
Obligatory reserves with the Central Bank of the Russian Federation	6	97,565	69,421
Trading securities	7	-	280,155
Amounts due from credit institutions	8	7,632	-
Derivative financial assets	9	-	151,258
Loans to customers	10	450,080	-
Property and equipment and intangible assets	11	111,877	6,886
Current income tax assets	12	90,507	92,028
Deferred income tax assets	12	-	43,005
Other assets	13	168,496	66,510
Total assets		5,677,714	9,198,208
Liabilities			
Amounts due to credit institutions	14	1,310,464	3,848,419
Derivative financial liabilities	9	-	199,796
Amounts due to customers	15	315,432	1,121,019
Other liabilities	13	320,503	198,000
Total liabilities, excluding net assets attributable to the shareholder		1,946,399	5,367,234
Net assets attributable to the shareholder			
Share capital	16	3,450,000	3,450,000
Additional paid-in capital		1,404,510	925,851
Accumulated loss		(1,123,195)	(544,877)
Total net assets attributable to the shareholder		3,731,315	3,830,974
Total liabilities		5,677,714	9,198,208

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

Chairman of the Management Board

P.E. Goldfinch

Chief Accountant

O.N. Rubashko

29 April 2014



Statement of comprehensive income
For the year ended 31 December 2013

(Thousands of Russian rubles)

	<i>Note</i>	2013	2012
Interest income			
Cash and cash equivalents		813	195,910
Amounts due from other banks		239,351	295
		240,164	196,205
Trading securities		48,217	208,262
		288,381	404,467
Interest expense			
Amounts due to credit institutions		(77,555)	(98,239)
Amounts due to customers		(590)	(687)
		(78,145)	(98,926)
		210,236	305,541
Net interest income			
Net fee and commission expense	18	(14,007)	(27,863)
Net losses from trading securities		(46,563)	(38,320)
Net (losses)/gains from foreign currencies:			
- dealing		287,915	(73,582)
- translation differences		(227,031)	186,647
Income from consulting services and other income	19	331,627	247,379
		331,941	294,261
Non-interest income			
Personnel expenses	20	(808,171)	(772,808)
Depreciation and amortization	11	(3,498)	(9,697)
Other operating expenses	20	(261,433)	(278,002)
Gain on sale on property and equipment		749	-
		(1,072,353)	(1,060,507)
Non-interest expense			
		(530,174)	(460,705)
Loss before income tax		(530,174)	(460,705)
Income tax expense	12	(48,142)	(18,892)
Loss for the year		(578,318)	(479,597)
Other comprehensive income			
		-	-
Total comprehensive loss		(578,318)	(479,597)

Statement of changes in net assets attributable to the shareholder**For the year ended 31 December 2013***(Thousands of Russian rubles)*

	<i>Note</i>	<i>Share capital</i>	<i>Additional paid-in capital</i>	<i>Accumulated loss</i>	<i>Net assets attributable to the shareholder</i>
31 December 2011		3,450,000	925,851	(65,280)	4,310,571
Loss for the year		-	-	(479,597)	(479,597)
Other comprehensive income		-	-	-	-
Total comprehensive loss for the year		-	-	(479,597)	(479,597)
31 December 2012		3,450,000	925,851	(544,877)	3,830,974
Loss for the year		-	-	(578,318)	(578,318)
Other comprehensive income		-	-	-	-
Total comprehensive loss for the year		-	-	(578,318)	(578,318)
Pecuniary aid	16	-	478,659	-	478,659
31 December 2013		3,450,000	1,404,510	(1,123,195)	3,731,315

Statement of cash flows**For the year ended 31 December 2013***(Thousands of Russian rubles)*

	<i>Note</i>	2013	2012
Cash flows from operating activities			
Interest received		295,693	422,261
Interest paid		(80,572)	(96,716)
Fees and commissions received		4,981	6,598
Fees and commissions paid		(18,988)	(34,461)
Gains less losses from trading securities		(47,995)	(45,566)
Realized gains less losses from dealing in foreign currencies		239,377	(39,507)
Other income received		331,627	247,379
Personnel expenses paid		(720,206)	(860,088)
Other operating expenses paid		(441,261)	(100,100)
Cash flows used in operating activities before changes in operating assets and liabilities		(437,344)	(500,200)
<i>Net (increase)/decrease in operating assets</i>			
Trading securities		277,469	2,277,948
Amounts due from credit institutions and obligatory reserves with the Central Bank of the Russian Federation		(16,393)	56,565
Loans to customers		(450,000)	-
Other assets		(101,659)	24,371
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to credit institutions		(2,764,265)	2,972,950
Amounts due to customers		(910,461)	935,809
Other liabilities		191,083	(204,504)
Net cash flows from/(used in) operating activities before income tax		(4,211,570)	5,562,939
Income tax paid		(3,616)	(6,160)
Net cash from/(used in) operating activities		(4,215,186)	5,556,779
Cash flows from investing activities			
Purchase of property and equipment		(85,352)	(2,767)
Proceeds from sale of property and equipment		884	-
Net cash used in investing activities		(84,468)	(2,767)
Cash flows from financing activities			
Pecuniary aid	16	478,659	-
Net cash from financing activities		478,659	-
Effect of exchange rates changes on cash and cash equivalents		86,881	(62,465)
Net increase/(decrease) in cash and cash equivalents		(3,734,114)	5,491,547
Cash and cash equivalents, beginning		8,485,671	2,994,124
Cash and cash equivalents, ending	5	4,751,557	8,485,671

(in thousands of Russian rubles, unless otherwise indicated)

1. Principal activities

LLC UBS Bank (hereinafter, the "Bank") was established on 22 July 2005 as a Limited Liability Company under the laws of the Russian Federation.

The Bank operates under banking license No. 3463 issued by the Central Bank of Russia ("CBR") on 6 June 2006.

The Bank holds license No. 3463 issued by the Bank of Russia on 4 August 2010 for accepting public deposits denominated in Russian rubles and foreign currency.

The Bank also possesses licenses of a professional shareholder of the securities market issued by the Federal Service for the Securities Market:

- ▶ for custody services No. 177-12414-000100 dated 30 July 2009 – unlimited;
- ▶ for brokerage services No. 177-12405-100000 dated 30 July 2009 – unlimited;
- ▶ for dealing services No. 177-12408-010000 dated 30 July 2009 – unlimited.

Since August 2010, the Bank has been a member of the obligatory individual deposit insurance system applied to individual deposits with Russian banks and is included in the register of the banks participating in this system under registration number 982.

The Bank's strategic development area for 2013 was further consolidation of efforts aimed at the provision of integrated financial services.

In 2013 the following changes occurred in the Bank's Management Board: Kurt Robert Schmid left the Management Board of the Bank. Goldfinch Paul Andrew was appointed to the post of the Chairman of the management Board of the Bank.

As of 31 December 2013 and 2012, the Bank did not have its own credit ratings.

The Bank is located in Moscow and has no branches and affiliates. As of 31 December 2013, the actual headcount of the Bank was 95 employees (2012: 111 employees).

The Bank's registered address and principal place of business is 2/2 Paveletskaya Square, Moscow, 115054, Russia.

As of 31 December 2013 and 2012, UBS AG, the sole shareholder of the Bank, owned 100% of the Bank's share capital.

UBS AG is the ultimate parent of the Bank, incorporated and operating under the Swiss laws. The Bank conducts its activities and determines range of transactions, pricing policy and risk assessment techniques in compliance with the parent's requirements.

2. Basis of preparation

General

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

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in accordance with Russian accounting and banking legislation and related instructions ("RAL"). These financial statements are based on RAL, as adjusted and reclassified in order to comply with IFRS.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, trading securities and derivative financial instruments have been measured at fair value.

These financial statements are presented in thousands of Russian rubles ("RUB"), unless otherwise indicated.

(in thousands of Russian rubles, unless otherwise indicated)

2. Basis of preparation (continued)

Reconciliation of RAL and IFRS equity (net assets attributable to the shareholder) and profit (loss) for the year

Equity (net assets attributable to the shareholder) and profit/(loss) for the year are reconciled between RAL and IFRS as follows:

	2013		2012	
	<i>Equity (net assets attributable to the shareholder)</i>	<i>Profit (loss) for the year</i>	<i>Equity (net assets attributable to the shareholder)</i>	<i>Profit (loss) for the year</i>
Russian Accounting Legislation	3,948,985	(56,042)	4,005,027	(528,858)
Bonuses accrued	(256,148)	(91,201)	(164,947)	89,196
Pecuniary aid	-	(478,659)	-	-
Audit fees accrued	(3,401)	(177)	(3,224)	61
Recognition of and accounting for property and equipment	15,024	16,214	(1,190)	(3,573)
Fair value revaluation of securities	-	579	(579)	3,658
Fair value revaluatiuon of derivative assets and liabilities	-	46,560	(46,560)	(32,097)
Deferred tax	-	(43,005)	43,005	(13,039)
Income tax	-	-	-	212
Other	26,855	27,413	(558)	4,843
International Financial Reporting Standards	3,731,315	(578,318)	3,830,974	(479,597)

3. Summary of accounting policies

Changes in accounting policy

Certain new standards and interpretations became effective for the Bank from 1 January 2013.

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Bank.

Amendments to IAS 19 Employee Benefits

The IASB published amendments to IAS 19 *Employee Benefits*, which become effective for annual periods beginning on or after 1 January 2013. The amendments introduce major changes to the accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, these amendments limit changes in the net pension assets (liabilities) recognized in profit or loss to net interest income (expense) and service costs. The amendments have no impact on the Bank's financial position or performance.

Amendment to IAS 1 Presentation of Items of Other Comprehensive Income

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

(in thousands of Russian rubles, unless otherwise indicated)

3. Summary of accounting policies (continued)

Changes in accounting policy (continued)

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

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

The mentioned new or revised standards and interpretations effective from 1 January 2013 did not have any impact on the accounting policies, financial position or performance of the Bank.

Financial assets

Initial recognition

Financial assets are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition.

Date of recognition

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the statement of comprehensive income.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available for sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in the statement of comprehensive income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Determination of fair value

The Bank assesses fair value of financial instruments as trading securities and derivative instruments, at each reporting date.

Fair value is the price that would be received for selling an asset or paid for the transfer of obligations under the transactions made in the normal way between market participants as of the date the evaluation. Fair value measurement assumes that the transaction to sell an asset or transfer liability is:

- ▶ either on the principal market for the asset or liability;
- ▶ or, in the absence of a principal market, the most favorable market for the asset or liabilities.

The Bank must have access to the principal or most favorable market. The fair value of the asset or liability is measured using assumptions that would be used by market participants when pricing the asset or liability, assuming that market participants acting in their best interests. The estimated fair value of non-financial assets takes into account the possibility of market participant to generate economic benefits from the asset best and most effectively, or selling it to another market participant who will use the asset the best and most effective way.

(in thousands of Russian rubles, unless otherwise indicated)

3. Summary of accounting policies (continued)

Financial assets (continued)

The Bank uses valuation techniques that are appropriate in the circumstances and for which the data is available adequate for measuring fair value, while leveraging relevant observable inputs and the minimum use of unobservable data source. All assets and liabilities for which fair value is measured or disclosed in the financial statements, are classified under the following hierarchy of the sources of fair value at the basis of input data, the lowest level, which are important for measuring fair cost in General:

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

In the case of assets and liabilities that are recognized in the financial statements on a periodic basis, the Bank to determine whether the translation between the source level of the hierarchy, re-analyzing classification (on the basis of input data, the lowest level, which are important for measuring fair cost in General) at the end of each reporting period.

Offsetting

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

Cash and cash equivalents

Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents include cash on hand, amounts due from the CBR (net of obligatory reserves), interbank deposits, accounts in trade systems and repurchase agreements with original maturity up to 30 days. Amounts relating to funds that are of restricted nature are excluded from cash and cash equivalents.

Derivative financial instruments

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

Borrowings

Financial instruments are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions and amounts due to customers. After initial recognition, borrowings are measured at amortized cost using the effective interest method. Gains and losses are recognized in the statement of comprehensive income when the borrowings are derecognized as well as through the amortization process.

Leases

Operating – Bank as lessee

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

(in thousands of Russian rubles, unless otherwise indicated)

3. Summary of accounting policies (continued)

Impairment of financial assets

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

Amounts due from credit institutions

For amounts due from credit institutions carried at amortized cost, the Bank assesses individually whether objective evidence of impairment exists.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows. 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 statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the statement of comprehensive income.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If amounts due from credit institutions have a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

Financial liabilities

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

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

Taxation

The current income tax expense is calculated in accordance with the regulations of the Russian Federation.

Current tax is calculated based on the amounts expected to be paid to or recovered from the taxation authorities in respect of the taxable profits or losses for the current and prior periods. Tax expenses, other than income tax, are recorded within operating expenses.

(in thousands of Russian rubles, unless otherwise indicated)

3. Summary of accounting policies (continued)

Taxation (continued)

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Russia also has various operating taxes that are assessed on the Bank's activities. These taxes are recorded as other operating expenses.

Property and equipment and intangible assets

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

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

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Office equipment	2-6
Computers and office appliances	3-4
Telecommunication equipment	3-4
Computer software	3-4
Motor vehicles	3-4

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

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

Expenditures incurred in developing or upgrading computer software are recognized as an asset when the related software meets the identifiability criterion and it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably. Internally developed software that meets the above criteria, and acquired software is classified into the "Computer Software" category.

Provisions

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

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. Apart from the above, the Bank has no significant post-retirement benefits.

Contingencies

Contingent liabilities are not recognized in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognized in the statement of financial position but disclosed when an inflow of economic benefits is probable.

(in thousands of Russian rubles, unless otherwise indicated)

3. Summary of accounting policies (continued)

Recognition of income and expenses

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

Interest and similar income and expense

For all financial instruments measured at amortized cost and interest bearing securities classified as trading, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

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

Fee and commission income

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

- ▶ *Fee and Commission income received for services during a certain period of time*

Fees earned for the provided services within a certain period of time are accrued in during this period.

- ▶ *Fee income from providing services to perform operations*

Fees or part of commission income that are linked to yield are recognized after fulfilling the corresponding criteria.

Foreign currency translation

The financial statements are presented in Russian rubles, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the statement of comprehensive income as net (losses)/gains arising from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as of the date of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of transactions in a foreign currency and the Central Bank exchange rate on the date of the transactions are included in gains less losses from dealing in foreign currencies.

The official CBR exchange rates at 31 December 2013 and 2012 were RUB 32.7292 and RUB 30.3727 to 1 USD, respectively.

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IFRS 9 Financial Instruments

IFRS 9, as issued, reflects two of the three phases of the IASB project on replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities and hedge accounting. The standard has no mandatory effective date and may be applied voluntarily. The adoption of IFRS 9 will have no impact on the classification and measurement of the Bank's financial assets and liabilities. The Bank will quantify the effect when the remaining part of the standard containing guidance on impairment of financial assets is issued.

(in thousands of Russian rubles, unless otherwise indicated)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

Amendments to IFRS 10, IFRS 12 and IAS 27 Investment Entities

The amendments become effective for annual periods beginning on or after 1 January 2014 and provide an exception from the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. The amendment is expected to have no impact on the Bank's financial position or performance.

Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities

These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. The amendments become effective for annual periods beginning on or after 1 January 2014. The amendments are not expected to have any impact on the Bank.

IFRIC Interpretation 21 Levies (IFRIC 21)

IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognized before the specified minimum threshold is reached. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. The Bank does not expect that IFRIC 21 will have a material impact on its financial statements.

Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. The amendments become effective for annual periods beginning on or after 1 January 2014. The amendment is expected to have no impact on the Bank's financial position or performance.

4. Significant accounting judgments and estimates

Estimation uncertainty

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements amounts of assets and liabilities and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that, in the opinion of management, are reasonable under the circumstances.

Professional judgements

In the process of applying accounting policies the Bank's management, besides the accounting estimates have been made the following judgments that have the most significant effect on the amounts recognised in the financial reporting:

Taxation

The Bank generally operates on the territory of the Russian Federation. Russian tax, currency and customs legislation as currently in effect is vaguely drafted and is subject to varying interpretations, selective and inconsistent application and changes, which can occur frequently, at short notice and may apply retrospectively. Management's interpretation of such legislation as applied to the transactions and activity of the Bank's companies may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities can take a more assertive position in their interpretation of the legislation and assessment and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and fines may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover early periods.

(in thousands of Russian rubles, unless otherwise indicated)

4. Significant accounting judgments and estimates (continued)

Taxation (continued)

Transfer pricing legislation were entered into force on 1 January 2012 in Russia and allows the tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all the "controlled" transactions (except for those conducted at state regulated prices and tariffs), if the transaction price differs upwards or downwards from the market price. "Controlled" transactions include transactions with related parties (under the Tax Code of the Russian Federation), all foreign trade transactions (regardless of whether the parties involved are related), transactions with unrelated parties with significant price fluctuations (i.e., if the price of such transactions differs from the prices on similar) and barter transactions. These rules don't just apply to transactions made in 2013, but also to transactions made in the previous tax periods, when the corresponding income and expenses were recognized in 2013 (except some types of transactions).

In 2013, the Bank has determined its tax liabilities arising from controlled transactions based on actual transaction prices. According to the Bank's management the Bank fully complied with the rules transfer pricing and the prices applied in the controlled transactions in 2013, correspond market price level. In the terms established by the Tax Code of the Russian Federation, will submitted to Banks duly completed notice of controlled transactions in Russian tax authorities, as well as related documentation prepared by transfer pricing respect to controlled transactions.

As of 31 December 2013, management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Deferred tax asset recognition

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Estimation of future taxable income and amount of tax offset is based on the Bank's Management's expectations considered to be reasonable at the current circumstances. In 2013 the Bank decided not to recognize deferred tax asset as the Management of the Bank doesn't have reliable estimation in respect to future taxable income and amount of tax offset.

Determination of fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, between knowledgeable, willing parties in an arm's length transaction other than forced sale or liquidation. The best measure of the fair value is market price. The Bank calculates fair value of financial instruments basing on available market information if there are any and appropriate valuation models. However interpretation of market data for fair value calculation requires professional judgement. Fair value of financial instruments not listed in an active market is determined by using appropriate valuation techniques. To the possible extent these techniques are based on available market information but some areas require management's estimations. Changes in assessment of these factors can influence fair value disclosed in the financial statements. Russian Federation still has signs of emergent markets and economic conditions limit activity on financial markets. Market quotes can be out of date or be indicative of asset sales forced by the crisis and therefore be not indicative of fair value of financial instruments. Management used all available market information for determination of fair value of financial instruments.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	<u>2013</u>	<u>2012</u>
Cash on hand	111	361
Current accounts with the CBR (other than obligatory reserves)	100,077	17,870
Current accounts with other banks		
- Russian Federation	262	4,207
- other countries	124,683	1,087,223
Settlement accounts with trading systems	1,314,424	986,010
Time deposits with credit institutions up to 30 days in other countries	3,212,000	6,390,000
	<u>4,751,557</u>	<u>8,485,671</u>
Interest receivable on time deposits with credit institutions up to 30 days in other countries	-	3,274
Total cash and cash equivalents	<u><u>4,751,557</u></u>	<u><u>8,488,945</u></u>

Current accounts with the CBR include deposits with the CBR placed to effectuate current settlements and other operations.

(in thousands of Russian rubles, unless otherwise indicated)

5. Cash and cash equivalents (continued)

As of 31 December 2013, balances on current accounts with banks in other countries comprise balances on current accounts with the parent bank in the amount of RUB 124,683 (2012: RUB 933,181) (Note 23).

As of 31 December 2013, RUB 3,212,000 was placed as short-term deposits with the parent bank (2012: RUB 6,390,000). As of 31 December 2013, interest receivable on time deposit with the parent bank amounted to null (2012: RUB 3,274) (Note 22).

6. Obligatory reserves with the Central Bank of the Russian Federation

Obligatory reserves with the Central Bank of the Russian Federation are the deposits with the CBR which may not be withdrawn by the Bank to finance its day-to-day operations. Credit institutions are required to maintain a non-interest earning deposit (as contributions to the obligatory reserve) with the CBR, the amount of which depends on the level of funds attracted by the credit institution. Those contributions are not included in cash and cash equivalents as such deposit withdrawal is significantly restricted by the statutory legislation.

As of 31 December 2013, obligatory reserves with the Central Bank of the Russian Federation amounted to RUB 97,565 (2012: RUB 69,421).

7. Trading securities

As of 31 December 2013, the Bank had no balances on trading securities.

As of 31 December 2012, Trading securities owned by the Bank comprise Bonds of credit institutions in the amount of RUB 280,155. Bonds of credit institutions comprise debt securities issued by major Russian bank with nominal interest rate of 9.75% maturing in 2014-2021.

8. Amounts due from other banks

As of 31 December 2013, the balance of RUB 7,632 kRUB (2012, null) representing a funds placed on accounts with Trading systems as a security provide for bidding.

9. Derivative financial instruments

As of 31 December 2013, the Bank had no balances on Derivative financial instruments.

The Bank enters into derivative financial instruments for trading purposes. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2013			2012		
	Notional amount	Fair value		Notional amount	Fair value	
		Asset	Liability		Asset	Liability
Foreign exchange contracts						
Swaps – foreign	–	–	–	14,864,986	141,931	23,396
Swaps – domestic	–	–	–	16,534,422	–	176,377
Forwards – foreign	–	–	–	3,409,047	8,862	–
Forwards – domestic	–	–	–	197,440	465	23
Total derivative assets/ liabilities		<u>–</u>	<u>–</u>		<u>151,258</u>	<u>199,796</u>

Foreign and domestic in the table above stand for counterparties where foreign means non-Russian entities and domestic means Russian entities.

Foreign exchange derivative financial instruments are generally traded in an over-the-counter market with professional market counterparties on standardized contractual terms and conditions. Derivative financial instruments are either assets or liabilities depending on the foreign exchange fluctuations which can have either favorable or unfavorable effect on the underlying asset. The aggregate fair value of derivative financial instruments can change significantly over time.

(in thousands of Russian rubles, unless otherwise indicated)

9. Derivative financial instruments (continued)

Swaps

Swaps are contractual agreements to simultaneously buy and sell (or vice versa) a specified financial instrument. Swaps are settled on various dates. Swaps can be either spot/forward swaps or forward/forward swaps combining forward contracts entered for different maturities.

Forwards

Forwards are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

Derivative financial instruments held or issued for trading purposes

Most of the Bank's derivative trading activities relate to deals with clients which are normally laid off with counterparties. The Bank may also take positions with the expectation of profiting from favorable movements in prices, rates on indices. Included under this heading are derivatives which do not meet IAS 39 hedging requirements.

10. Loans to customers

As of 31 December 2013 a balance of RUB 450,080 representing a RUB-denominated loan provided to companies under common control is included in loans to customers. The above amount includes interest receivable totaling RUB 80 as of 31 December 2013. (Note 23)

11. Property and equipment and intangible assets

Movements in property and equipment and intangible assets were as follows:

	<i>Office equipment</i>	<i>Computers and office appliances</i>	<i>Telecommuni- cation equipment</i>	<i>Computer software</i>	<i>Vehicles</i>	<i>Total</i>
Cost						
31 December 2011	16,869	12,111	710	21,669	9,155	60,514
Additions	1,125	1,642	-	-	-	2,767
Disposals	-	(36)	-	-	-	(36)
31 December 2012	17,994	13,717	710	21,669	9,155	63,245
Additions	-	27,205	-	81,284	-	108,489
Disposals	-	(1,652)	-	-	(2,993)	(4,645)
31 December 2013	17,994	39,270	710	102,953	6,162	167,089
Accumulated depreciation						
31 December 2011	(13,342)	(7,585)	(710)	(21,191)	(3,870)	(46,698)
Depreciation charge	(2,431)	(1,503)	-	(478)	(5,285)	(9,697)
Disposals	-	36	-	-	-	36
31 December 2012	(15,773)	(9,052)	(710)	(21,669)	(9,155)	(56,359)
Depreciation charge	(1,003)	(2,495)	-	-	-	(3,498)
Disposals	-	1,652	-	-	2,993	4,645
31 December 2013	(15,773)	(9,895)	(710)	(21,669)	(6,162)	(55,212)
Net book value:						
31 December 2011	3,527	4,526	-	478	5,285	13,816
31 December 2012	2,221	4,665	-	-	-	6,886
31 December 2013	1,218	29,375	-	81,284	-	111,877

In 2013, Bank recognized in category "Computer Software" an intangible asset which is a new software that is necessary to improve the efficiency of many units of the Bank, developed with the participation of a large Russian company specializing in development of software for the banking sector. The total amount of capitalized costs associated with the development of the software in 2013 amounted to 81,284 thousand rubles (of which 23,137 thousand rubles represent the amount payable under the contract). The Bank plans to start use of the above software in 2014.

(in thousands of Russian rubles, unless otherwise indicated)

12. Taxation

The income tax expense comprises:

	<u>2013</u>	<u>2012</u>
Current tax expense	5,137	5,853
Deferred tax expense – origination and reversal of temporary differences	43,005	13,039
Income tax expense	<u>48,142</u>	<u>18,892</u>

Russian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state/municipal securities was 20% for 2013 and 2012. The tax rate for interest (coupon) income on state bonds and mortgage-backed bonds in 2013 and 2012 was 15%, while the tax rate the profit in respect of the interest (coupon) income on municipal bonds in 2013 and 2012 it was 9%. Dividends are subject to Russian profits tax at the standard rate of 9%, which under certain conditions can be reduced to 0%.

As of 31 December 2013, income tax overpayment amounted to RUB 90,507 (2012: RUB 92,028).

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	<u>2013</u>	<u>2012</u>
Loss before tax	(530,176)	(460,705)
Statutory tax rate	20%	20%
Theoretical income tax benefit at the statutory rate	106,035	92,141
Adjustments to financial results from securities	(393)	(3,337)
Interest (coupon) income on state securities taxed at different rates	1,206	1,951
Non-deductible expenditures	(12,308)	(7,118)
Change in unrecognized deferred tax assets/liabilities	(141,116)	(101,725)
Current tax expense (adjustment to prior year)	1,521	-
Other permanent differences	(3,087)	(804)
Income tax expense	<u>(48,142)</u>	<u>(18,892)</u>

Deferred tax assets and liabilities as of 31 December and their movements for the respective year comprise:

	<u>2011</u>	<i>Origination and reversal of temporary differences in the statement of comprehensive income</i>	<u>2012</u>	<i>Origination and reversal of temporary differences in the statement of comprehensive income</i>	<u>2013</u>
Tax effect of deductible temporary differences:					
Tax loss carried forward	2,615	101,725	104,340	91,159	195,499
Accrued employee bonuses	50,829	(17,840)	32,989	18,241	51,230
Fair value measurement of securities	1,765	(1,473)	292	(292)	-
Fair value measurement of derivative financial assets	2,893	6,419	9,312	(9,312)	-
Property and equipment	-	238	238	(238)	-
Other temporary differences	1,034	(860)	174	16,654	16,828
Deferred tax assets	59,136	88,209	147,345	116,212	263,557
Unrecognized deferred tax assets	(2,615)	(101,725)	(104,340)	(159,217)	(263,557)
Deferred tax asset, net	<u>56,521</u>	<u>(13,516)</u>	<u>43,005</u>	<u>(43,005)</u>	<u>-</u>
Tax effect of taxable temporary differences:					
Fair value measurement of securities	-	-	-	-	-
Property and equipment	(477)	477	-	(18,101)	(18,101)
Fair value measurement of derivative financial assets	-	-	-	-	-
Deferred tax liability	(477)	477	-	(18,101)	(18,101)
Unrecognized deferred tax liabilities	-	-	-	18,101	18,101
Deferred tax liability, net	<u>(477)</u>	<u>477</u>	<u>-</u>	<u>-</u>	<u>-</u>

(in thousands of Russian rubles, unless otherwise indicated)

12. Taxation (continued)

As of 31 December 2013, the Bank's tax losses to be carried forward to future tax periods amount to RUB 977,494 (2012: RUB 521,698). Such tax losses are allowed to be carried forward within a 10-year period from the end of the tax period in which such losses were incurred.

13. Other assets and liabilities

Other assets comprise:

	<u>2013</u>	<u>2012</u>
Settlements on information and advisory services	152,594	43,516
Settlements with suppliers	9,376	3,821
Prepayments	3,057	8,617
Advances issued	2,538	797
Prepaid taxes other than income tax	909	2,257
Settlements on custody services	22	355
Spot deals	-	7,147
Total other assets	<u>168,496</u>	<u>66,510</u>

Other liabilities comprise:

	<u>2013</u>	<u>2012</u>
Settlements with employees on year-end bonuses, unused vacation and accountable amounts	245,703	166,437
Taxes payable other than income tax	48,486	28,236
Settlements for software development	23,137	
Audit fees	1,699	1,577
Settlements on other operations	1,478	1,269
Spot deals	-	481
Total other liabilities	<u>320,503</u>	<u>198,000</u>

14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	<u>2013</u>	<u>2012</u>
Settlements on corporate cards	1,296	1,074
Time deposits and loans	1,309,168	3,847,345
Amounts due to credit institutions	<u>1,310,464</u>	<u>3,848,419</u>

As of 31 December 2013, the Bank received an equivalent of RUB 1,309,168 in US dollars from the parent bank (2012: null), with date of maturity 9 January 2014 (2012, null). As of 31 December 2012, time deposits and loans include placements from four Russian banks in the amount of RUB 3,847,345.

15. Amounts due to customers

Amounts due to customers comprise:

	<u>2013</u>	<u>2012</u>
Corporate customers		
- current/settlement accounts	308,226	1,108,195
Individuals		
- current/settlement accounts	7,206	642
- term deposits	-	12,182
Amounts due to customers	<u>315,432</u>	<u>1,121,019</u>

(in thousands of Russian rubles, unless otherwise indicated)

15. Amounts due to customers (continued)

As of 31 December 2013, included in current accounts of corporate customers are amounts due to companies related to the Bank in the amount of RUB 308,226 (100% of total amounts due to customers) (2012: RUB 1,108,195 (100% of total amounts due to customers)) (see Note 23).

As of 31 December 2013, included in current accounts of individuals are amounts of RUB 6,528 (91% of total amounts due to customers) in the current accounts opened by a member of key management personnel.

As of 31 December 2013, the estimated fair value of amounts due to customers was RUB 315,432 (2012: RUB 1,121,019).

16. Net assets attributable to the shareholder

The Bank was founded as a limited liability company with a sole shareholder. As of 31 December 2013, the share capital of the Bank amounted to RUB 3,450,000 (2012: RUB 3,450,000) comprising one share contributed by UBS AG. The latest increase in the share capital in the amount of RUB 2,200,000 was made in November 2011. The funds were contributed by the Bank's sole shareholder UBS AG that owns 100% of the share capital. All changes to the charter documents were duly registered.

In 2013, the Bank received pecuniary aid from the parent bank in the amount of RUR 478,659 (2012: null). The funds were not registered as an increase in the share capital.

In accordance with the Bank's charter, shareholders of limited liability companies may unilaterally withdraw from the company. In such cases the Bank shall pay the withdrawing shareholder the actual amount of its interest in the Bank's share capital as reported in the statutory accounting reports of the Bank for the year of withdrawal, or, subject to the withdrawing shareholder's consent, transfer the equivalent in kind. The payment should be made within six months following the end of the financial year of the withdrawal notice.

17. Commitments and contingencies

Operating environment

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in uncertainty regarding further economic growth, availability of financing and cost of capital, which could negatively affect the Bank's financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Commitments and contingencies

As of 31 December, the Bank's commitments and contingencies comprised:

	<u>2013</u>	<u>2012</u>
Credit-related commitments		
Undrawn loan commitments	500,000	950,000
	<u>500,000</u>	<u>950,000</u>
Operating lease commitments		
Up to 1 year	92,357	85,788
	<u>92,357</u>	<u>85,788</u>
Commitments and contingencies	<u>592,357</u>	<u>1,035,788</u>

Undrawn loan commitments were represented by liabilities to a related party.

(in thousands of Russian rubles, unless otherwise indicated)

17. Commitments and contingencies (continued)

Commitments and contingencies (continued)

In 2006, the Bank entered into an office sublease agreement with a related party. The agreement had a term of one year renewable upon mutual consent of the parties. The agreement was renewed for one year in November 2007 and in the subsequent years including November 2013. Annual lease payments under the lease agreement, including maintenance fees are disclosed in the table above.

18. Net fee and commission expense

Net fee and commission expense comprises:

	<u>2013</u>	<u>2012</u>
Depository	3,110	3,684
Execution of transaction passports	1,640	2,361
Settlement operations	231	237
Securities operations	-	316
Fee and commission income	<u>4,981</u>	<u>6,598</u>
Foreign currency operations	(10,172)	(19,164)
Settlement operations	(7,967)	(13,433)
Depository	(658)	(1,230)
Other	(191)	(634)
Fee and commission expense	<u>(18,988)</u>	<u>(34,461)</u>
Net fee and commission expense	<u>(14,007)</u>	<u>(27,863)</u>

19. Income from consulting services and other income

Income from consulting services comprises:

	<u>2013</u>	<u>2012</u>
Income from consulting services	331,627	247,359
Other	-	20
	<u>331,627</u>	<u>247,379</u>

Income from consulting services in the amount of RUB 326,764 (2012: RUB 206,190) represents the consideration received for consulting services provided to the parent bank.

(in thousands of Russian rubles, unless otherwise indicated)

20. Personnel and other operating expenses

Personnel expenses, other employee benefits and other operating expenses comprise:

	<u>2013</u>	<u>2012</u>
Salaries and bonuses	706,052	697,785
Social security costs	73,853	61,753
Other	28,266	13,270
Salaries and other benefits	<u>808,171</u>	<u>772,808</u>
Occupancy and rent	94,034	92,008
Outsourcing	37,269	33,284
Operating taxes	37,002	38,372
Business travel and related expenses	15,721	16,864
Information services	12,557	22,873
Entertainment	8,909	7,040
Office appliances repair and maintenance	8,308	4,649
Communications	8,044	7,321
Computer software	7,102	12,840
Transportation expenses	4,854	7,812
Recruitment	4,161	338
Office supplies	3,299	3,833
Translation and interpreting	3,199	3,022
Audit services	2,957	3,040
Lease, repair, insurance and maintenance of vehicles	2,201	3,096
Legal and consultancy	752	6,561
Periodicals	743	779
Charity	710	1,998
Post and courier services	468	403
Penalties	93	163
Advertising and marketing	-	-
Other	9,050	11,706
Other operating expenses	<u>261,433</u>	<u>278,002</u>

21. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other internal controls. This process of risk management is critical to the Bank's continuing profitability, and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operational risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Management Board

The Management Board is responsible for monitoring the overall risk process within the Bank.

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Risk controlling

The Risk Controlling Unit has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

The Risk Controlling Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Internal audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using models which reflect both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from past experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyze, control and identify risks early. This information is presented and explained to the Management Board, Credit Risk Department and heads of business units concerned. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, VaR, liquidity ratios and risk profile changes. Reporting of industry risks takes place on a regular basis. Senior management regularly assesses the appropriateness of the allowance for credit losses. The Management Board receives a risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A regular briefing is given to the Management Board and all other relevant employees of the Bank on the utilization of market limits, analysis of VaR, proprietary investments and liquidity, plus any other risk developments.

Risk mitigation

As part of its overall risk management, the Bank uses derivatives to manage exposures resulting from changes in foreign currencies.

Excessive risk concentration

Concentrations occur when a number of counterparties are engaged in similar business activities, or their activities in the same geographic region, or have similar economic characteristics, and as a result of changes in economic, political or other conditions have a similar effect on the ability to meet contractual obligations. Concentrations indicate the relative sensitivity of the Bank to changes in conditions which affect to a particular industry or geographic region.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on diversification of asset allocation. Identified concentrations of risk is controlled.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Credit risk (continued)

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action. The Bank continuously monitors credit risks and limits on risks set for different counterparties.

The Bank has traditionally been utterly prudent in setting its risk management policy. Credit risk accepted by the Bank in transactions arises primarily from interbank loans and placements on nostro accounts. The Bank takes a conservative position when placing temporarily available funds and chooses the CBR for placements in Russian rubles and UBS AG for placements in foreign currencies as correspondent banks. Insignificant portion of funds is placed to secure settlements with NKO NSD.

When participating in the interbank lending market, the Bank is to strictly comply with the limits set and approved by the credit risk department of UBS AG Group and the Bank's Credit Committee. The Bank set the limits for counterparty banks, either representing subsidiaries of foreign financial organizations or having strong individual credit ratings affirmed by international rating agencies. Besides, the Bank has set limits for many counterparties under reverse repo agreements and foreign exchange transactions for a period of up to one year. The Bank may not enter into transactions (unless fully prepaid) with counterparties (except for UBS AG) for which no limits have been set. In addition to concentration risks, the Bank limits portfolio risks by monitoring sensitivity of change in aggregate position to interest rates on assets and liabilities.

Conversion transactions and foreign currency transactions are conducted mainly at MICEX and with UBS AG. Transactions with other counterparties are conducted only if there is a corresponding limit available and strictly within such limit. The Bank does not accept currency risk arising from foreign currencies other than US dollar – all conversion transactions involving other currencies are fully hedged via UBS AG. The Bank limits aggregate currency risk exposure by monitoring sensitivity of change in position to volatility of currency pairs in which assets and liabilities are denominated.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, which is recognized in the statement of financial position.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of asset for related credits in the statement of financial position, based on the Bank's credit rating system.

The table below due from credit institutions with high ratings represents funds with minimal credit risk, generally having a credit rating close to the sovereign. Other borrowers with good financial position and good debt service included in loans with standard rating. Rating below standard implies a lower than standard credit quality, but loans are included in this category are not individually impaired.

	Notes	Neither past due nor impaired			Total 2013
		High rating 2013	Standard rating 2013	Sub-standard rating 2013	
Cash and cash equivalents	5	4,751,557	–	–	4,159,189
Obligatory reserves with the Central Bank of the Russian Federation	6	97,565	–	–	97,565
Amounts due from credit institutions	8	7,632	–	–	7,632
Loans to customers	10	450,080	–	–	450,080
Total		5,306,834	–	–	5,306,834

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)**Credit risk (continued)**

	Notes	Neither past due nor impaired			Total 2012
		High rating 2012	Standard rating 2012	Sub-standard rating 2012	
Cash and cash equivalents	5	8,488,945	-	-	8,488,945
Obligatory reserves with the Central Bank of the Russian Federation	6	69,421	-	-	69,421
Trading securities	7	280,155	-	-	280,155
Derivative financial assets	9	151,258	-	-	151,258
Total		8,989,779	-	-	8,989,779

According to its policy, the Bank must carefully and consistently assign risk ratings to counterparties. This provides the possibility of focused management of the applicable risks and allows the comparison of credit exposures across all sectors of business, geographic regions and products. The rating system is supported by a variety of financial analytics, and on processed market information to provide the main inputs for the assessment of counterparty risk. All internal risk categories defined in accordance with the policy assignment rating of the Bank. The attributable ratings are assessed and updated regularly.

Geographical concentration

The geographical concentration of the Bank's monetary assets and liabilities is set out below:

	2013			
	Russia	OECD	Other countries	Total
Assets				
Cash and cash equivalents	1,414,874	3,336,683	-	4,751,557
Obligatory reserves with the CBR	97,565	-	-	97,565
Amounts due from credit institutions	7,632	-	-	7,632
Loans to customers	450,080	-	-	450,080
Current income tax assets	90,507	-	-	90,507
Other assets	7,574	160,922	-	168,496
	2,068,231	3,497,605	-	5,565,837
Liabilities				
Amounts due to credit institutions	1,296	1,309,168	-	1,310,464
Amounts due to customers	279,316	6,722	29,394	315,432
Other liabilities	320,503	-	-	320,503
	601,115	1,315,890	29,394	1,946,399
Net position	1,467,117	2,181,715	(29,394)	3,619,438
	2012			
	Russia	OECD	Other countries	Total
Assets				
Cash and cash equivalents	1,008,449	7,480,496	-	8,488,945
Obligatory reserves with the CBR	69,421	-	-	69,421
Trading securities	280,155	-	-	280,155
Derivative financial assets	465	150,793	-	151,258
Current income tax assets	92,028	-	-	92,028
Other assets	16,098	50,412	-	66,510
	1,466,616	7,681,701	-	9,148,317
Liabilities				
Amounts due to credit institutions	3,848,419	-	-	3,848,419
Derivative financial liabilities	176,400	23,396	-	199,796
Amounts due to customers	1,060,217	12,883	47,919	1,121,019
Current income tax liabilities	-	-	-	-
Other liabilities	197,989	11	-	198,000
	5,283,025	36,290	47,919	5,367,234
Net position	(3,816,409)	7,645,411	(47,919)	3,781,083

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its existing core deposit base. It also manages assets with liquidity in mind and monitors future cash flows and liquidity on a daily basis.

The Bank maintains a portfolio of diverse marketable assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed an additional overdraft limit that it can access to meet liquidity needs. In addition, the Bank maintains a cash deposit (obligatory reserve) with the CBR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the CBR. As of 31 December, these ratios were as follows:

	<u>2013, %</u>	<u>2012, %</u>
N2 "Instant Liquidity Ratio" (assets receivable or realizable within one day/liabilities repayable on demand)	440.7	101.6
N3 "Current Liquidity Ratio" (assets receivable or realizable within 30 days/liabilities repayable within 30 days)	1,153.6	176.9
N4 "Long-term Liquidity Ratio" (assets receivable in more than one year/sum of capital and liabilities repayable in more than one year)	0.0	0.0

The CBR requirements set the minimum permissible value of N2 and N3 ratios at 15% and 50%, respectively, and the maximum permissible value of N4 at 120%.

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank's financial liabilities as of 31 December 2013 and 2012 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

<i>Financial liabilities as of 31 December 2013</i>	<i>Less than 3 months</i>	<i>Total</i>
Amounts due to credit institutions	1,310,551	1,310,551
Amounts due to customers	315,432	315,432
Other liabilities	320,503	320,503
Total undiscounted financial liabilities	<u>1,946,486</u>	<u>1,946,486</u>

<i>Financial liabilities as of 31 December 2012</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>Total</i>
Amounts due to credit institutions	3,851,735	-	3,851,735
Derivative financial instruments		-	
- Contractual amounts payable	31,842,697	3,163,198	35,005,895
- Contractual amounts receivable	(31,900,147)	(3,108,839)	(35,008,986)
Amounts due to customers	1,121,037	-	1,121,037
Other liabilities	198,000	-	198,000
Total undiscounted financial liabilities	<u>5,113,322</u>	<u>54,359</u>	<u>5,167,681</u>

The table below analyzes the contractual expiry by maturity of the Bank's lease commitments (including commitments related to maintenance of the leased premises).

	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>Total</i>
2013	27,707	64,650	92,357
2012	25,736	60,052	85,788

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Market risk

Market risk is the risk of financial loss which the Bank may suffer due to unfavorable changes in market parameters. The Bank distinguishes two main groups of market parameters which include general and specific factors. General factors of the market risk are the parameters which depend on macroeconomic, geopolitical and other market conditions unrelated to any individual instruments or issuers. The indicators of general market risk factors include the level of interest rates and market indices, foreign exchange rates, prices for energy, metals and commodities and overall credit spread which is the excess of the effective loan interest rate over the interest rate on risk-free securities. Interdependence among the market risk indicators is taken into the account as well. Specific components are factors which cannot be attributed to general changes in market conditions. These components comprise quotes of debt and equity instruments, derivative financial instruments (including imbedded derivatives) linked to these debt and equity instruments.

The Bank discloses details of possible financial loss calculated using the Value-at-Risk (VaR) model. For the purpose of internal control, management also uses the worst scenarios data or stress-testing, risk concentration analysis, monitoring of qualitative and quantitative parameters.

All activities related to assessment and monitoring of the market risk level and control over compliance with the set risk limits are performed by the Bank's functions independent from the Bank's front-office functions (commercial units) that enter into transactions involving acceptance of market risk. Such segregation of the risk acceptance and risk assessment powers between the Bank's functions complies with the standards of UBS AG, existing international practice and is designed to eliminate any potential conflict of interests.

In securities transactions, the Bank does not invest in equity financial investments, confining itself to debt instruments only. The Bank cautiously chooses issuers of securities and tries to ensure a reasonable balance between the yield and risk levels attributable both to the whole portfolio and its segments.

Limits on the nominal value and limits in the form of credit delta serve as instruments of hands-on management of the portfolio structure. Credit delta shows the maximum change in the market value of the portfolio if the risk-free yield rate changes (risk-free yield curve shifts) by 1 basis point. Thus, the use of credit delta helps control the volatility of the portfolio and makes its behavior predictable. Moreover, even with low volatility, the aggregate limit of the portfolio cannot exceed the nominal value of USD 200 million. The maximum credit delta of the whole portfolio is limited to USD 75 thousand; within this limit, the Bank also sets individual limits on credit delta by issuer and issuer category (as a rule, at or below USD 25 thousand and USD 50 thousand, respectively) and this rules out excessive concentration of investment in debt instruments of one issuer (these limits, in turn, may further be narrowed by the maximum risk per borrower or a group of related borrowers set by the CBR).

UBS AG Chief Risk Officer is responsible for developing control procedures over market risk and for independent control over implementation of these procedures. The market risk assessment unit of UBS Investment Bank provides support to all business units within the UBS AG Group in assessing and reporting market risks.

Risk assessment

The Bank applies two main methods of assessing market risk – the VaR model and stress-testing. These assessment methods are supplemented by risk concentration analysis and additional controls. The Bank sets limits on the level of accepted exposure. For the purpose of regulating specific exposure when the standard limits do not meet the complex control criteria, the Bank sets additional limits for individual securities portfolios, portfolio segments, classes of assets and financial products.

Value-at-Risk (VaR) methodology

The Bank applies VaR methodology to assess the market risk positions held and to estimate a potential economic loss based upon a number of parameters and assumptions for various changes in market conditions. VaR is a statistical method used in measuring financial risk by estimating the potential negative change in the market value of a portfolio under the influence of general and specific risk factors, at a given confidence level and over a specified time horizon.

The Bank estimates VaR with a 10-day horizon for the purpose of internal control and with a 1-day horizon for additional analysis. VaR is a hypothetical loss attributable to a portfolio, which may be incurred as a result of changes in market factors during a given time period subject to a certain confidence level (99%). Thus, there is a statistical probability of 1% that the actual loss, which the Bank may theoretically suffer, will exceed the amount derived by applying the VaR model.

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Market risk (continued)

VaR models are based on the historical simulation method and assume that market fluctuations in the next 10 days or 1 day will meet the scenario of market fluctuations over the previous 10 days or 1 day, respectively. For the general market risk, the Bank applies historical data for the past 5 years. This period usually corresponds to a market cycle and contains maximum and minimum levels of market indicators. Historical information for the period is applied to an existing securities portfolio. This method is known as a Historical Simulation Method.

To evaluate the adequacy of the calculation model applied, the market risk assessment unit of UBS Investment Bank performs back-testing on a regular basis by comparing simulated and actual losses.

Although VaR helps to assess the risk, it is necessary to consider disadvantages of this method, such as:

- ▶ Applying past changes in prices to assess future changes does not help to assess the full extent of possible future price fluctuations;
- ▶ Estimation of changes in financial market indicators for a 10-day period assumes that during this period all of the Bank's positions may be closed (or hedged). This estimate may inaccurately reflect the exact amount of market risk during the periods of lower market liquidity when the period of closing (hedging) the Bank's positions may increase;
- ▶ Applying the 99% confidence level does permit assessing the losses whose probability is below 1%; and
- ▶ VaR calculation is based on the Bank's positions exposed to market risk as of the end of the day and may not reflect the Bank's intraday risk.

Taking into account the disadvantages of the VaR method and for the purpose of obtaining more detailed information on market risk, the Bank uses, in addition to VaR calculation, market risk assessment based on scenario analysis and stress-testing.

Stress-testing is an imitation (scenario) modeling method designed to assess portfolio stability against irregular, sudden and highly adverse market fluctuations and obtain more detailed picture of the risk. This method is a supplement to the VaR models as it helps to obtain scenario assessment of losses which remain beyond VaR calculated based on the stated probability and historical data. By applying stress-testing, the Bank seeks to define a broad range of possible scenarios, assess portfolio sensitivity to sudden market fluctuations and determine control environment which enables total, transparent and timely control over changes in market conditions.

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework, and monitoring and responding to potential risks the Bank is able to manage these risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on CBR regulations. Positions are monitored on a daily basis.

The Bank's exposure to currency risk on monetary assets and liabilities is as follows:

	2013					
	RUB	USD	EUR	CHF	GBP	Total
Assets						
Cash and cash equivalents	3,317,713	1,432,743	446	602	53	4,751,557
Obligatory reserves with the CBR	97,565	-	-	-	-	97,565
Amounts due from credit institutions	7,632	-	-	-	-	7,632
Loans to customers	450,080	-	-	-	-	450,080
Current income tax assets	90,507	-	-	-	-	90,507
Other assets	15,862	152,634	-	-	-	168,496
Total monetary assets	3,979,359	1,585,377	446	602	53	5,565,837
Liabilities						
Amounts due to credit institutions	1,296	1,309,168	-	-	-	1,310,464
Amounts due to customers	30,866	284,566	-	-	-	315,432
Other liabilities	320,503	-	-	-	-	320,503
Total monetary liabilities	352,665	1,593,734	-	-	-	1,946,399
Net monetary assets and liabilities	3,626,694	(8,357)	446	602	53	3,619,438
	2012					
	RUB	USD	EUR	CHF	GBP	Total
Assets						
Cash and cash equivalents	6,780,048	1,707,858	1,033	4	2	8,488,945
Obligatory reserves with the CBR	69,421	-	-	-	-	69,421
Trading securities	280,155	-	-	-	-	280,155
Current income tax assets	92,028	-	-	-	-	92,028
Other assets (without spot deals)	22,513	36,850	-	-	-	59,363
Total monetary assets	7,244,165	1,744,708	1,033	4	2	8,989,912
Liabilities						
Amounts due to credit institutions	3,848,419	-	-	-	-	3,848,419
Amounts due to customers	54,713	1,066,306	-	-	-	1,121,019
Other liabilities (without spot deals)	197,514	5	-	-	-	197,519
Total monetary liabilities	4,100,646	1,066,311	-	-	-	5,166,957
Net monetary assets and liabilities	3,143,519	678,397	1,033	4	2	3,822,955
Derivative financial instruments and spot deals	516,370	(556,294)	(1,948)	-	-	(41,872)

(in thousands of Russian rubles, unless otherwise indicated)

21. Risk management (continued)

Currency risk (continued)

The table shows the analysis which calculates the effect of a reasonably possible movement in a currency rate against the Russian ruble on the statement of comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of comprehensive income. A negative amount in the table reflects a potential net reduction in statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

Currency	Change in currency rate 2013	Effect on pre-tax profit and equity 2013	Change in currency rate 2012	Effect on pre-tax profit and equity 2012
Stronger USD	20.00%	(1,671)	10.72%	13,089
Weaker USD	10.21%	853	10.72%	(13,089)
Stronger CHF	20.00%	120	13.09%	1
Weaker CHF	13.07%	(120)	13.09%	(1)
Stronger GBP	20.00%	11	10.05%	-
Weaker GBP	9.18%	(11)	10.05%	-
Stronger EUR	20.00%	89	9.49%	(87)
Weaker EUR	98.63%	(89)	9.49%	87

Interest rate risk

The Bank takes on exposure in relation to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes, but may also reduce or create losses in the event that unexpected movements arise.

The Bank is exposed to interest rate risk, principally as a result of lending at fixed interest rates, in amounts and for periods which differ from those of term borrowings secured at fixed interest rates. In practice, interest rates are generally fixed on a short-term basis. Also, interest rates that are contractually fixed on both assets and liabilities are often renegotiated to reflect current market conditions.

The Bank sets limits on the level of mismatch of interest rate repricing that may be undertaken and controls the compliance with the set limits on daily basis. In the absence of any available hedging instruments, the Bank seeks to match its interest rate positions.

The results of calculating interest rate risk on debt securities by applying the VaR method as of 31 December 2013 are presented in the table below (including comparative information as of 31 December 2012).

Type of risk	Minimum for 2013	Maximum for 2013	Average for 2013	As of 31 December 2013	Minimum for 2012	Maximum for 2012	Average for 2012	As of 31 December 2012
Interest rate risk on debt securities	0	272,578	58,457	0	16,948	391,990	195,053	21,595

According to the Bank, market risks related to non-traded assets are minimal.

22. Fair value of financial instruments

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

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

(in thousands of Russian rubles, unless otherwise indicated)

22. Fair value of financial instruments (continued)

As of 31 December 2013, the Bank had no financial instruments recorded at fair value requiring disclosure of analysis by level of the fair value hierarchy.

31 December 2012	Level 1	Level 2	Level 3	Total
Financial assets				
Trading securities	280,155	-	-	280,155
Derivative financial instruments	-	151,258	-	151,258
	280,155	151,258	-	431,413
Financial liabilities				
Derivative financial instruments	-	199,796	-	199,796
	-	199,796	-	199,796

Financial instruments carried at fair value. Trading securities, other assets, the movement in fair value of which is designated at fair value through profit or loss. All derivative financial instruments are carried at fair value as assets when their fair value is positive and as liabilities when their fair value is negative.

Cash and cash equivalents are carried at amortized cost, which approximates their current fair value.

Loans and receivables carried at amortized cost. Interest rates on loans issued shortly before the reporting date do not differ materially from interest rates applicable to new instruments with similar credit risk and maturity. If the Bank determines that interest rates on previously issued loans differ materially from those applicable to similar instruments at the reporting date, the Bank estimates the fair value of these loans. The estimate is based on the discounted cash flow method and uses interest rates applicable to new instruments with similar credit risk and maturity. The use of interest rates is subject to instrument currency and maturity and credit risk of the counterparty.

Liabilities carried at amortized cost. The estimated fair value of these liabilities is based on market prices, if available. The estimated fair value of fixed-rate and maturity financial instruments that do not have quoted market prices is based on expected cash flows discounted at interest rates for new instruments with similar credit risk and maturity.

As of 31 December 2013 and 2012, the Bank's financial assets and financial liabilities are liquid or have a short-term maturity (less than three months), which results in their fair value being approximately equal to their carrying amount recorded in the statement of financial position.

23. Related party transactions

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

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

(in thousands of Russian rubles, unless otherwise indicated)

23. Related party transactions (continued)

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

	2013		2012	
	Parent bank	Entities under common control	Parent bank	Entities under common control
Cash and cash equivalents	3,336,683	-	7,326,455	-
Contractual interest rate on cash and cash equivalents: (2013: 0.0%-5.75%; 2012: 0.0%-6.25%)				
Due from other banks, beginning of the period	-	-	41,808	-
Issued for the period	259,214	-	91,211	-
Repaid for the period	(259,214)	-	(133,019)	-
Due from other banks, end of the period	-	-	-	-
Loans to customers, beginning of the period	-	-	-	-
Issued for the period	-	1,450,249	-	-
Repaid for the period	-	(1,000,169)	-	-
Loans to customers, end of the period (2013: 6.5%)	-	450,080	-	-
Other assets	153,349	40	43,568	344
Amounts due to credit institutions, beginning of the period	-	-	811,582	-
Received for the period	73,678,895	-	44,425,372	-
Repaid for the period	(72,369,727)	-	(45,236,954)	-
Amounts due to credit institutions, end of the period	1,309,168	-	-	-
Contractual interest rate on amounts due to credit institutions: (2013: 0.00%-2.7%)				
Derivative financial liabilities	-	-	23,397	23
Amounts due to customers	194	308,032	687	1,107,508
Contractual interest rate on amounts due to customers: (2013: 0.0%; 2012: 0.0%-6.1%)				

In table below income and expenses from transactions with related parties is presented:

	2013		2012	
	Parent bank	Entities under common control	Parent bank	Entities under common control
Interest income on amounts due to customers	-	249	-	-
Interest expense on amounts due to customers	-	-	-	(74)
Interest expense on amounts due to credit institutions	(696)	-	(4,625)	-
Fee and commission income	343	4,637	162	62
Net gains from trading securities	-	-	1,566	-
Net gains/(losses) from dealing in foreign currencies	390,580	(10,016)	(883,349)	83,231
Income from consulting services and other income	326,764	-	206,190	-
Rent and maintenance expenses	-	(90,499)	-	(87,313)
Other expenses	(373)	-	(264)	-

(in thousands of Russian rubles, unless otherwise indicated)

23. Related party transactions (continued)

In 2006, the Bank entered into a sublease agreement with a related party, with an annual rate in rubles equal to USD 600 per 1 sq. m; as of 1 November 2009, this rate was increased to USD 1,000 per 1 sq. m.

Compensation to key management personnel comprised the following:

	<u>2013</u>	<u>2012</u>
Salaries	55,900	40,816
Bonuses	44,817	41,121
Social security contributions	1,853	1,671
Other social charges	427	204
Compensation to key management personnel	<u>102,997</u>	<u>83,812</u>

This amount of compensation represents short-term compensation only.

One of the members of key management personnel has balances on current accounts included in amounts due to customers (individuals) (Note 15).

24. Capital adequacy

The objectives of the Bank's capital management are to ensure: (i) that the Bank complies with regulatory capital requirements established by the CBR and (ii) that the Bank is able to continue as a going concern. The compliance with the capital adequacy ratio established by the CBR is controlled through monthly reports with respective calculations submitted to the CBR.

According to effective capital requirements established by the CBR, banks should maintain a ratio of capital to risk-weighted assets ('capital adequacy ratio') at a level exceeding the mandatory minimum ratio. The CBR requires that banks should maintain an equity (capital) adequacy ratio of at least 10%. As of 31 December 2013, the Bank's regulatory capital adequacy ratio was 115.7% (2012: 98.7%). Regulatory capital is shown per the Bank's reports prepared under RAL and as of 31 December 2013 amounted to RUB 3,914,474 (2012: RUB 4,001,670).

25. Events after the reporting period

In February 2014, the Bank paid year-end bonuses for 2013 to its employees in the amount of RUB 238.5 million (including personal income taxes and excluding payroll taxes). Year-end bonuses for 2011 were paid in March 2013 in the amount of RUB 158.7 million (including personal income taxes and excluding payroll taxes).

After 31 December 2013 political and economic uncertainty in Ukraine significantly increased. International rating agencies decreased the sovereign debt rating of Ukraine. These factors led to the contraction of lack of liquidity and tighter conditions on the debt markets.

International rating agencies decreased the sovereign credit rating of Russia in local and foreign currency to negative from stable due to the political instability in Ukraine, and also increased geopolitical risk in connection with the prospect of economic sanctions from the USA and the EU due to the joining of Crimea to Russia, which may also lead to a reduced level of potential investments, capital outflow and other negative economic consequences.

The management monitors the development of the current situation and takes necessary measures. The current situation in Ukraine and its further possible development could adversely affect results of operations and the Bank's financial position and it is currently difficult to determine the effect of such influence.