

**OOO UBS Bank**  
**Financial statements**

*Year ended 31 December 2010*  
*Together with Independent Auditor's Report*

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## 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 at 31 December 2010, and the statement of comprehensive income, of changes in net assets attributable to shareholder and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### *Management's responsibility for the financial statements*

Management 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.

### *Auditors' responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### *Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of OOO UBS Bank as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



10 June 2011

**Statement of financial position****As of 31 December 2010***(Thousands of Russian Rubles)*

	Notes	2010	2009
<b>Assets</b>			
Cash and cash equivalents	5	4,089,032	2,121,107
Obligatory reserves with the Central Bank of the Russian Federation	6	128,480	21,859
Trading securities	7	3,402,707	1,965,150
Derivative financial assets	8	69,777	102,220
Property and equipment and intangible assets	9	20,376	29,847
Current income tax assets	10	103,760	109,840
Deferred income tax assets	10	27,423	31,406
Other assets	11	26,208	16,110
		<b>7,867,763</b>	<b>4,397,539</b>
<b>Total assets</b>			
<b>Liabilities</b>			
Amounts due to credit institutions	12	4,129,784	1,569,820
Derivative financial liabilities	8	54,770	111,990
Amounts due to customers	13	1,437,651	776,804
Current income tax liabilities	10	689	555
Other liabilities	11	206,950	206,321
<b>Total liabilities without net assets attributable to shareholder</b>		<b>5,829,844</b>	<b>2,665,490</b>
<b>Net assets attributable to shareholder</b>			
Share capital	14	1,250,000	1,250,000
Additional paid-in capital	14	736,471	440,162
Retained earnings		51,448	41,887
<b>Total net assets attributable to shareholder</b>		<b>2,037,919</b>	<b>1,732,049</b>
		<b>7,867,763</b>	<b>4,397,539</b>
<b>Total liabilities</b>			

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

Chairman of the Management Board

K. Schmid

Chief accountant

O. Rubashko

10 June 2011



**Statement of comprehensive income**  
**For the year ended 31 December 2010**

(Thousands of Russian Rubles)

	<i>Notes</i>	<i>2010</i>	<i>2009</i>
<b>Interest income</b>			
Cash and cash equivalents		26,311	721,431
Loans to customers		5,230	-
Trading securities		175,105	92,817
		<b>206,646</b>	<b>814,248</b>
<b>Interest expense</b>			
Amounts due to credit institutions		(26,032)	(704,041)
Amounts due to customers		(4,245)	(35,532)
		<b>(30,277)</b>	<b>(739,573)</b>
<b>Net interest income</b>			
		<b>176,369</b>	<b>74,675</b>
Net fee and commissions expense	16	(16,666)	(7,509)
Net gains/(losses) from trading securities		(24,857)	109,132
Net gains/(losses) from foreign currencies:			
- dealing		(33,972)	251,236
- translation differences		117,424	278,544
Income from consulting services	17	512,399	171,321
<b>Non-interest income</b>		<b>554,328</b>	<b>802,724</b>
Personnel expenses	18	(492,698)	(553,083)
Depreciation and amortization	9	(14,252)	(12,979)
Other operating expenses	18	(197,610)	(154,155)
<b>Non-interest expense</b>		<b>(704,560)</b>	<b>(720,217)</b>
<b>Profit before income tax expense</b>		<b>26,137</b>	<b>157,182</b>
Income tax expense	10	(16,576)	(91,608)
<b>Profit for the year</b>		<b>9,561</b>	<b>65,574</b>
<b>Other comprehensive income</b>		-	-
<b>Total comprehensive income for the year</b>		<b>9,561</b>	<b>65,574</b>

**Statement of changes in net assets attributable to shareholder****For the year ended 31 December 2010***(Thousands of Russian Rubles)*

	<i>Share capital</i>	<i>Additional paid-in capital</i>	<i>Retained earnings / (Accumulated loss)</i>	<i>Net assets attributable to shareholders</i>
<b>31 December 2008</b>	<b>1,250,000</b>	<b>183,743</b>	<b>(23,687)</b>	<b>1,410,056</b>
Profit for the year			65,574	65,574
<b>Pecuniary aid (Note 14)</b>	–	256,419	–	256,419
<b>31 December 2009</b>	<b>1,250,000</b>	<b>440,162</b>	<b>41,887</b>	<b>1,732,049</b>
Profit for the year			9,561	9,561
<b>Pecuniary aid (Note 14)</b>	–	296,309	–	296,309
<b>31 December 2010</b>	<b>1,250,000</b>	<b>736,471</b>	<b>51,448</b>	<b>2,037,919</b>

**Statement of cash flows****For the year ended 31 December 2010***(Thousands of Russian Rubles)*

	<b>Notes</b>	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities</b>			
Interest received		203,450	879,971
Interest paid		(30,693)	(833,715)
Fees and commissions received		6,593	7,601
Fees and commissions paid		(23,173)	(15,391)
Gains less losses from trading securities		11,429	86,249
Realized losses from dealing in foreign currencies		(58,749)	(110,324)
Other income received		512,399	171,321
Personnel expenses paid		(529,380)	(408,806)
Other operating expenses paid		(199,620)	(153,138)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>(107,744)</b>	<b>(376,232)</b>
<i>Net (increase)/decrease in operating assets</i>			
Trading securities		(1,471,741)	(1,768,789)
Amounts due from credit institutions and obligatory reserves with the Central Bank of the Russian Federation		(106,621)	837,982
Other assets		(9,968)	(7,993)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to credit institutions		2,710,406	(5,918,388)
Amounts due to customers		618,043	(264,147)
Other liabilities		34,875	20,831
<b>Net cash flows from operating activities before income tax</b>		<b>1,667,250</b>	<b>(7,476,736)</b>
Income tax paid		(6,379)	(93,594)
<b>Net cash from/(used in) operating activities</b>		<b>1,660,871</b>	<b>(7,570,330)</b>
Purchase of property and equipment	9	(4,781)	(6,366)
<b>Net cash from/(used in) investing activities</b>		<b>(4,781)</b>	<b>(6,366)</b>
<b>Cash flows from financing activities</b>			
Pecuniary aid	14	296,309	256,419
<b>Net cash from financing activities</b>		<b>296,309</b>	<b>256,419</b>
Effect of exchange rates changes on cash and cash equivalents		14,432	764
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>1,966,831</b>	<b>(7,319,513)</b>
<b>Cash and cash equivalents, beginning</b>		<b>2,121,103</b>	<b>9,440,616</b>
<b>Cash and cash equivalents, ending</b>	5	<b>4,087,934</b>	<b>2,121,103</b>

*(in thousands of Russian rubles, unless otherwise indicated)*

## 1. Principal activities

OOO UBS Bank (hereinafter, the "Bank") was formed on 22 July 2005 as 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 for national and foreign currency operations. The Bank also possesses licenses of a professional shareholder of the securities market from the Federal Service for the Securities Market issued on 8 August 2006 and 24 August 2006.

The Bank engages in currency exchange transactions, performs lending and deposit transactions in the interbank market and with the CBR, trades in securities and derivative financial instruments, and provides other banking services to its corporate customers, such as accepting deposits from corporate customers, opening and maintaining accounts, making settlements on behalf of the corporate customers, including correspondent banks. In 2010 the Bank also provided brokerage services to its individual customers.

In the middle of 2010, the Bank continued the development of its investment banking business providing significant additional staff resources to its Consulting Services Department. Within this business line the Bank provides M&A, debt restructuring and other consulting services across the capital market.

The Bank is located in Moscow and it has no branches and affiliates. The Bank had an average of 80 employees during the reporting period (2009 – 74 employees).

The Bank's registered legal address is 2/2 Paveletskaya Square, Moscow, Russia.

As of 31 December 2010 and 2009, 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 Russian Rubles in accordance with Russian accounting and banking legislation and related instructions ("RAL"). These financial statements are based on the Bank's RAL books and records, 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 and profit (loss) for the year

Equity and profit/(loss) for the year are reconciled between RAL and IFRS as follows:

	2010		2009	
	Equity	Profit (loss) for the year	Equity	Profit (loss) for the year
<b>Russian Accounting Legislation</b>	<b>2,126,457</b>	<b>254,907</b>	<b>1,871,550</b>	<b>170,599</b>
Effect of accrued interest	–	–	–	–
Bonuses accrued	(132,880)	41,140	(174,020)	(143,606)
Pecuniary aid	–	(296,309)	–	(256,419)
Audit fees accrued	(2,717)	243	(2,960)	(2,960)
Recognition of and accounting for property and equipment	10,274	(8,937)	19,211	977
Fair value re-measurement of securities	(5,109)	(2,028)	(3,081)	(2,647)
Fair value re-measurement of derivative assets and liabilities	15,007	24,777	(9,770)	362,052
Deferred tax	27,423	(3,983)	31,406	(62,149)
Other	(536)	(249)	(287)	(273)
<b>International Financial Reporting Standards</b>	<b>2,037,919</b>	<b>9,561</b>	<b>1,732,049</b>	<b>65,574</b>

## 3. Summary of accounting policies

### Changes in accounting policies

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

#### *IAS 24 Related party disclosures (Revised)*

The revised IAS 24, issued in November 2009, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The revised IAS 24 is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The Bank is not controlled by government therefore this amendment didn't influence on the Bank's financial statements.

#### *Amendment to IAS 39 Financial Instruments: recognition and measurement – Eligible Hedged Items*

The amendment to IAS 39 was issued in August 2008, and became effective for annual periods beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. The amendment had no impact on the Bank's consolidated financial statements as the Bank Group has not entered into any such hedges.

#### *IFRS 3 Business Combinations (revised in January 2008) and IAS 27 Consolidated and Separate Financial Statements (revised in January 2008)*

The revised standards were issued in January 2008 and became effective for financial years beginning on or after 1 July 2009. Revised IFRS 3 introduces a number of changes in the accounting for business combinations that impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. Revised IAS 27 requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change has no impact on goodwill, nor it gives rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. These amendments had no impact on the Bank's financial statements.

*(in thousands of Russian rubles, unless otherwise indicated)*

### 3. Summary of accounting policies (continued)

#### Changes in accounting policies (continued)

##### *IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions*

The amendment to IFRS 2 was issued in June 2009 and became effective for financial years beginning on or after 1 January 2010. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. This amendment also supersedes IFRIC 8 and IFRIC 11. This amendment had no impact on the Bank's financial statements.

##### *IFRIC 17 Distribution of Non-Cash Assets to Owners*

IFRIC Interpretation 17 was issued on 27 November 2008 and is effective for annual periods beginning on or after 1 July 2009. IFRIC 17 applies to pro rata distributions of non-cash assets except for common control transactions and requires that a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity; an entity should measure the dividend payable at the fair value of the net assets to be distributed; an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. The Interpretation also requires an entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation. This interpretation had no impact on the Bank's financial statements.

##### Improvements to IFRS

In April 2009 the IASB issued the second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. There are separate transitional provisions for each standard. Amendments included in April 2009 "Improvements to IFRS" had no impact on the accounting policies, financial position or performance of the Bank.

#### Financial assets

##### *Initial recognition*

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised 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 recognised 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.

##### *'Day 1' profit*

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

##### *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 and are effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the statement of comprehensive income.

*(in thousands of Russian rubles, unless otherwise indicated)*

### **3. Summary of accounting policies (continued)**

#### **Financial assets (continued)**

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

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

##### *Offsetting*

Financial assets and liabilities are offset and the net amount is reported in the 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 interbank deposits, accounts in trade systems and repurchase agreements with original maturity up to 30 days. Amounts which relate to funds that are of restricted nature, are excluded from cash and cash equivalents.

#### **Repurchase and reverse repurchase agreements and securities lending**

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities purchased under agreements to resell ("reverse repo") are recorded as cash and cash equivalents, amounts due from credit institutions or loans to customers as appropriate.

The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

#### **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 recognized 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.

*(in thousands of Russian rubles, unless otherwise indicated)*

### 3. Summary of accounting policies (continued)

#### Leases

##### *Operating – Bank as lessee*

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

#### Impairment of financial assets

The Bank assesses at each reporting date whether there is any 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 retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- ▶ the 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 or cancelled or expires.

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

*(in thousands of Russian rubles, unless otherwise indicated)*

### 3. Summary of accounting policies (continued)

#### Taxation

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

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 included as a component of 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 recognized when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are 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 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.

*(in thousands of Russian rubles, unless otherwise indicated)*

### **3. Summary of accounting policies (continued)**

#### **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.

#### **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 and expenses*

Fees and commission income and expenses are recognized on an accrual basis in the moment the service is provided.

#### **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 gains less losses 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 at the dates 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 a certain transaction in a foreign currency and the Central Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official CBR exchange rates at 31 December 2010 and 2009 were RUB 30.48 and RUB 30.24 to 1 USD, respectively.

#### **Capital adequacy**

Capital adequacy ratio is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (adopted in July 1988, revised in November 2005) (or Basel Capital Accord) requirements. Those requirements are subject to varying interpretations and therefore management should apply judgment as to which value is to be included, eliminated and/or classified when calculating the capital adequacy ratio.

#### **Future changes in accounting policies**

##### *Standards and interpretations issued but not yet effective*

##### *Amendments to IAS 32 Financial instruments: Presentation: Classification of Rights Issues*

In October 2009, the IASB issued amendment to IAS 32. Entities shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The Bank expects that this amendment will have no impact on the Bank's financial statements.

(in thousands of Russian rubles, unless otherwise indicated)

### 3. Summary of accounting policies (continued)

#### Future changes in accounting policies (continued)

##### *IFRS 9 Financial Instruments*

In November 2009 and 2010 the IASB issued the first phase of IFRS 9 *Financial instruments*. This Standard will eventually replace IAS 39 *Financial Instrument: Recognition and Measurement*. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. Entities may adopt the first phase for reporting periods ending on or after 31 December 2009. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial assets. In particular, for subsequent measurement all financial assets are to be classified at amortised cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. The Bank now evaluates the impact of the adoption of new Standard and considers the initial application date.

##### *IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments*

IFRIC Interpretation 19 was issued in November 2009 and is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies the accounting when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor to extinguish all or part of the financial liability. IFRIC 19 is not expected to have any impact on the Bank's financial statements.

##### *Improvements to IFRS*

In April 2009, the IASB issued the second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. There are separate transitional provisions for each standard. Amendments included in the April 2009 "Improvements to IFRS" will have no impact on the accounting policies, financial position or performance of the Bank, except the following amendments resulting in changes to accounting policies, as described below.

- ▶ IFRS 3 *Business Combinations*: limits the scope of the measurement choices that only the components of non-controlling interest that are present ownership interests that entitle their holders to a proportionate share of the entity's net assets, in the event of liquidation, shall be measured either at fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. The Bank considers that this amendment don't have impact on financial statement as the Bank doesn't have such transactions.
- ▶ IFRS 7 *Financial instruments: Disclosures*; introduces the amendments to quantitative and credit risk disclosures. The additional requirements are expected to have minor impact as information is expected to be readily available.
- ▶ IAS 34 *Interim Financial Reporting*: adds disclosure requirements about the circumstances affecting fair values and classification of financial instruments, about transfers of financial instruments between levels of the fair value hierarchy, changes in classification of financial assets and changes in contingent liabilities and assets. Additional disclosures will have no impact as the Bank doesn't prepare interim financial statements.
- ▶ Amendments to IFRS 1, IAS 1, IAS 27 and IFRIC 13 will have no impact on the accounting policies, financial position or performance of the Bank

##### *Amendments to IFRS 7 Financial Instruments: Disclosures*

The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The Amendments introduce additional disclosure requirements for transferred financial assets that are not derecognized. The Bank expects that these amendments will have no impact on the Bank's financial position.

##### *Amendments to IAS 12 Income Taxes – Deferred tax: Recovery of underlying assets*

In December 2010 the IASB issued amendments to IAS 12 effective for annual periods beginning on or after 1 January 2012. IAS 12 has been updated to include a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale and a requirement that deferred tax on non-depreciable assets, measured using the revaluation model in IAS 16, should always be measured on a sale basis. The Bank expects that these amendments will have no impact on the Bank's financial position.

##### *IFRS 11 Joint Arrangements*

IFRS 11 Joint Arrangements improves the accounting for joint arrangements by introducing a principle-based approach that requires a party to a joint arrangement to recognise its rights and obligations arising from the arrangement. The classification of a joint arrangement is determined by assessing the rights and obligations of the parties arising from that arrangement. There are only two types of arrangements provided in the standard – joint operation and joint venture. IFRS 11 also eliminates proportionate consolidation as a method to account for joint arrangements. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions* by Venturers and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently the Bank evaluates possible effect of the adoption of IFRS 11 on its financial position and performance.

*(in thousands of Russian rubles, unless otherwise indicated)*

### **3. Summary of accounting policies (continued)**

#### **Future changes in accounting policies (continued)**

##### *IFRS 12 Disclosure of Interests in Other Entities*

IFRS 12 *Disclosure of Interests in Other Entities* issued in May 2011 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Adoption of the standard will require new disclosures to be made in the financial statements of the Bank but will have no impact on its financial position or performance.

##### *IFRS 13 Fair Value Measurement*

IFRS 13 *Fair Value Measurement* defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. The standard applies when other IFRSs require or permit fair value measurements. It does not introduce any new requirements to measure an asset or a liability at fair value, change what is measured at fair value in IFRSs or address how to present changes in fair value. IFRS 13 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The adoption of the IFRS 13 may have effect on the measurement of the Group's assets and liabilities accounted for at fair value. Currently the Bank evaluates possible effect of the adoption of IFRS 13 on its financial position and performance.

### **4. Significant accounting judgments and estimates**

#### **Estimation uncertainty**

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

##### **Taxation**

Russian tax, currency and customs legislation is subject to varying interpretations and changes, which can occur frequently. 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 may take a more assertive position in their interpretation of the legislation and assessments 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 interest 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 longer periods.

Transfer pricing legislation in Russia allows the tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all "controlled" transactions (except for those conducted at state regulated prices and tariffs), if the transaction price differs upwards or downwards from the market price by more than 20 percent. Under current transfer pricing legislation "controlled" transactions include transactions with related parties, barter transactions, foreign trade transactions and transactions with unrelated parties characterized by significant price fluctuations (i.e. if the price applied under these transactions differs from the price applied under similar transactions by more than 20 percent within a short period of time). Special transfer pricing rules apply to transactions with securities and derivatives. Transfer pricing rules as currently in effect are vaguely drafted, generally leaving wide scope for their interpretation by the tax authorities and courts in practice.

As of 31 December 2010, management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.



(in thousands of Russian rubles, unless otherwise indicated)

## 5. Cash and cash equivalents

Cash and cash equivalents comprise:

	<u>2010</u>	<u>2009</u>
Current accounts with the CBR (other than obligatory reserves)	318,815	10,862
Current accounts with other banks		
- Russian Federation	23,083	25,265
- other countries	20,873	19,442
Settlement accounts with trading systems	794,640	829,429
Time deposits with credit institutions up to 30 days in other countries	–	1,236,105
Reverse repo deals up to 30 days	–	–
- with credit institutions	2,088,089	–
- with commercial entities	842,434	–
	<u>4,087,934</u>	<u>2,121,103</u>
Interest receivable on time deposits with credit institutions up to 90 days in other countries	–	4
Interest receivable on reverse repo deals up to 30 days	1,098	–
<b>Total cash and cash equivalents</b>	<u><u>4,089,032</u></u>	<u><u>2,121,107</u></u>

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

As of 31 December 2010, balances on current accounts with banks in other countries comprise balances on current accounts with the parent bank in the amount of kRUB 20,873 (31 December 2009 – kRUB 19,442).

As of 31 December 2009 kRUB 1,236,105 were placed as a short-term deposit with the parent bank. Interest receivable on time deposits with the parent bank as of 31 December 2009 amounted to kRUB 4.

The Bank had entered into reverse repurchase agreements with a number of credit institutions. The subject of these agreements are bonds issued by a Russian companies with a fair value of kRUB 3,329,670 (2009 – RUB 0).

## 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 2010 the obligatory reserve with the Central Bank of the Russian Federation amounted to kRUB 128,480 (31 December 2009 – kRUB 21,859).

(in thousands of Russian rubles, unless otherwise indicated)

## 7. Trading securities

Trading securities owned comprise:

	<u>2010</u>	<u>2009</u>
Corporate bonds	2,160,011	1,090,001
Russian State bonds (OFZ)	729,997	279,682
Bonds of credit institutions	512,699	393,271
Moscow government bonds	–	202,196
<b>Trading securities</b>	<b><u>3,402,707</u></b>	<b><u>1,965,150</u></b>

All trading securities owned by the Bank are denominated in Russian Rubles.

OFZs are state securities issued by the Russian Ministry of Finance.

Bonds of credit institutions comprise debt securities issued by major Russian banks.

Corporate bonds are debt securities issued by major Russian food, ferrous, oil, mining, engineering and energy companies.

Nominal interest rates and maturities of these securities are as follows:

	<u>2010</u>		<u>2009</u>	
	%	Maturity	%	Maturity
Corporate bonds	7.15%-13.5%	2011-2019	8.4%-15%	2012-2018
Russian State bonds (OFZ)	6.85%-10%	2011-2016	8%	2016
Bonds of credit institutions	7.2%-9%	2011-2013	10.1%-12%	2013-2019
Moscow government bonds	–	–	10%	2010

## 8. 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.

	<u>2010</u>			<u>2009</u>		
	<u>Notional principal</u>	<u>Fair value</u>		<u>Notional principal</u>	<u>Fair value</u>	
		Asset	Liability		Asset	Liability
<b>Foreign exchange contracts</b>						
Swaps – foreign	7,139,589	20,927	4,969	7,304,884	–	109,608
Swaps – domestic	12,130,579	40,350	49,801	5,885,837	45,083	2,123
Forwards – foreign	–	–	–	729,460	1,226	259
Forwards – domestic	922,238	8,500	–	662,550	55,911	–
<b>Total derivative assets/liabilities</b>		<b><u>69,777</u></b>	<b><u>54,770</u></b>		<b><u>102,220</u></b>	<b><u>111,990</u></b>

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.

As of 31 December 2010, the Bank has positions in the following types of derivatives:

### 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.

(in thousands of Russian rubles, unless otherwise indicated)

## 8. 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.

### Derivative financial instruments held or issued for trading purposes

Most of the Bank's derivative trading activities relate to deals with customers 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.

## 9. Property and equipment and intangible assets

The movements in property and equipment and intangible assets were as follows:

	Office equipment	Computers and office appliances	Telecommuni- cation equipment	Computer software	Motor vehicles	Total
<b>Cost</b>						
31 December 2008	13,136	6,448	710	19,494	4,762	44,550
Additions	2,930	1,261	–	2,175	–	6,366
31 December 2009	16,066	7,709	710	21,669	4,762	50,916
Additions	444	1,283	–	–	3,054	4,781
31 December 2010	16,510	8,992	710	21,669	7,816	55,697
<b>Accumulated depreciation</b>						
31 December 2008	(3,748)	(2,549)	(240)	(54)	(1,499)	(8,090)
Depreciation charge	(3,093)	(1,772)	(178)	(6,746)	(1,190)	(12,979)
31 December 2009	(6,841)	(4,321)	(418)	(6,800)	(2,689)	(21,069)
Depreciation charge	(3,237)	(1,885)	(177)	(7,223)	(1,730)	(14,252)
31 December 2010	(10,078)	(6,206)	(595)	(14,023)	(4,419)	(35,321)
<b>Net book value:</b>						
31 December 2008	9,388	3,899	470	19,440	3,263	36,460
31 December 2009	9,225	3,388	292	14,869	2,073	29,847
31 December 2010	6,432	2,786	115	7,646	3,397	20,376

## 10. Taxation

The corporate income tax expense comprises:

	2010	2009
Current tax charge	12,593	29,459
Deferred tax charge – origination and reversal of temporary differences	3,983	62,149
<b>Income tax expense</b>	<b>16,576</b>	<b>91,608</b>

Russian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state/municipal securities was 20% for 2010 and 2009. The tax rate for interest income on state securities was 0%, 9% and 15% for Federal taxes in 2010 and 2009.

As of 31 December 2010 income tax and income tax on state/municipal securities overpayment amounted to RUB 103,760 (31 December 2009 – RUB 109,840). Income tax on coupon interest earned on state securities payable as of 31 December 2010 amounted to RUB 689 (31 December 2009 – RUB 555).

(in thousands of Russian rubles, unless otherwise indicated)

## 10. Taxation (continued)

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>2010</u>	<u>2009</u>
<b>Profit before tax</b>	<b>26,137</b>	<b>157,182</b>
Statutory tax rate	20%	20%
<b>Theoretical income tax expense at the statutory rate</b>	<b>5,227</b>	<b>31,436</b>
Adjustments to financial results from securities	3,220	2,760
Non-deductible interest expense on deposits from other banks	–	37,961
Income on state securities taxed at different rates	(2,167)	(2,011)
Non-deductible expenditures	9,159	6,411
Previously recognized tax losses written off	–	13,870
Other permanent differences	1,137	1,181
<b>Income tax expense</b>	<b>16,576</b>	<b>91,608</b>

Differences between IFRS and Russian tax legislation give rise to permanent and temporary differences between accounting and tax values of certain assets and liabilities.

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

	<u>2008</u>	<i>Origination and reversal of temporary differences in the statement of comprehensive income</i>	<u>2009</u>	<i>Origination and reversal of temporary differences in the statement of comprehensive income</i>	<u>2010</u>
<b>Tax effect of deductible temporary differences</b>					
Accrued employee bonuses	6,083	28,721	34,804	(8,228)	26,576
Tax losses carried forward	13,870	(13,870)	–	–	–
Fair value measurement of securities	1,191	(1,191)	–	3,854	3,854
Other temporary differences	1,070	(265)	805	(31)	774
<b>Deferred tax assets</b>	<b>22,214</b>	<b>13,395</b>	<b>35,609</b>	<b>(4,405)</b>	<b>31,204</b>
<b>Tax effect of taxable temporary differences</b>					
Fair value measurement of securities	–	(3,382)	(3,382)	3,382	–
Property and equipment	(3,024)	249	(2,775)	1,995	(780)
Fair value measurement of derivative financial assets	74,365	(72,411)	1,954	(4,955)	(3,001)
<b>Deferred tax liability</b>	<b>71,341</b>	<b>(75,544)</b>	<b>(4,203)</b>	<b>422</b>	<b>(3,781)</b>
<b>Deferred tax asset</b>	<b>93,555</b>	<b>(62,149)</b>	<b>31,406</b>	<b>(3,983)</b>	<b>27,423</b>

In the prior reporting periods the Bank had tax losses (RUB 52,045 as of 31 December 2008) that could have been carried forward (for 10 years from the occurrence) if duly claimed by the Bank. The Bank however elected not to claim carry forward of such losses unless supported by the results of a field tax audit covering the periods in which the losses occurred. If the Bank's tax loss position is not challenged by the tax authorities the Bank will claim carry forward of such losses by filing adjusted tax returns for the respective tax periods. As of December 31, 2010 field tax audit are not carried out.

(in thousands of Russian rubles, unless otherwise indicated)

## 11. Other assets and liabilities

Other assets comprise:

	<u>2010</u>	<u>2009</u>
Spot deals	8,501	169
Settlements with suppliers	7,989	6,736
Settlements on operations with securities	6,581	2,230
Prepayments	2,581	1,532
Advances issued	309	13
Settlements on custody services	138	970
Prepaid taxes other than income tax	109	4,314
Settlements on medical insurance contracts with employees' family members	–	146
<b>Total other assets</b>	<b><u>26,208</u></b>	<b><u>16,110</u></b>

Other liabilities comprise:

	<u>2010</u>	<u>2009</u>
Settlements with employees on year-end bonuses and unused vacation	134,621	172,128
Taxes payable other than income tax	59,381	30,196
Spot deals	5,314	661
Audit fees	1,388	1,688
Settlements on other operations	6,246	1,648
<b>Total other liabilities</b>	<b><u>206,950</u></b>	<b><u>206,321</u></b>

## 12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	<u>2010</u>	<u>2009</u>
Current accounts	190	28,240
Time deposits and loans	4,129,594	1,541,580
<b>Amounts due to credit institutions</b>	<b><u>4,129,784</u></b>	<b><u>1,569,820</u></b>

Included in current accounts is a balance of RUB 190 placed in Russian rubles on the current account with the parent bank (2008 – RUB 28,240).

As of 31 December 2010, the Bank received equivalent of RUB 42,136 in Swiss francs (2009 – RUB 31,092 in Swiss francs), RUB 1,323 in British pounds (2009 – RUB 0), RUB 3,977,236 in USD (2009 – RUB 0), RUB 108,899 in EURO (2009 – 0) from the parent bank, and equivalent of RUB 0 in Russian rubles (2009 – RUB 1,538,728 in Russian rubles) from Russian banks.

As of 31 December 2010, the estimated fair value of amounts due to credit institution was RUB 4,129,784 (2009 – RUB 1,569,820)

(in thousands of Russian rubles, unless otherwise indicated)

### 13. Amounts due to customers

The amounts due to customers include the following:

	<u>2010</u>	<u>2009</u>
Corporate customers		
- current/settlement accounts	937,582	252,856
- time deposits	500,069	500,000
Individuals		
- current/settlement accounts	–	23,948
<b>Amounts due to customers</b>	<b><u>1,437,651</u></b>	<b><u>776,804</u></b>

As of 31 December 2010 amounts due to individuals of RUB 0 represent amounts due to customers under brokerage transactions (2009 – RUB 23,948 (3.1%)). Included in current accounts and time deposits of corporate customers are amounts due to companies related to the Bank of RUB 937,582 and RUB 0 (96.9% of the total amount due to customers), respectively (2009 – RUB 252,856 and RUB 500,000, respectively (96.9% of the total amount due to customers) – (see Note 21).

As of 31 December 2010, the estimated fair value of amounts due to customers was RUB 1,437,651 (2009 – RUB 776,804) – (see Note 21).

### 14. Net assets attributable to shareholder

The Bank was founded as a limited liability company with a sole shareholder. As of 31 December 2010 and 2009 the share capital of the Bank amounted to RUB 1,250,000 contributed by the sole shareholder – UBS AG.

To strengthen the Bank's financial stability, in 2009 the Bank received pecuniary aid from the parent bank in the amount of RUB 296,309 (2009 – RUB 256,419). This amount was not registered as an increase in the share capital.

In accordance with rules and regulations of the bank, 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 financial statements of the Bank for the year of withdrawal, or, subject to the consent of the withdrawing shareholder, transfer the equivalent in kind. The payment should be made within six months from following the financial year of the withdrawal notice.

### 15. 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.

During 2010 Russian Government has introduced a range of stabilization measures for the purposes of overcoming of global financial crisis of 2008. Progressive recovery of economy was accompanied by stabilization in financial sphere and decrease of unemployment. Demand on loans from corporate clients began to grow starting the second quarter of 2010. Progressive growth of income of individuals contributed to increase of demand on loan products from individuals.

Liquidity ratios of financial sector returned to pre-crisis level that contributed to increase of competition between credit institutions and decrease of loan interest rates. Despite the above factors there continues to be uncertainty regarding the access to capital and cost of capital for the Bank, which could affect the Bank's financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

(in thousands of Russian rubles, unless otherwise indicated)

## 15. Commitments and contingencies (continued)

### 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.

### Lease commitments

In 2006 the Bank entered into 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 the same period in November 2007 and in the subsequent years including November 2010. Annual lease payments under this lease agreement, including maintenance fees, are as follows:

	<u>2010</u>	<u>2009</u>
Up to one year	77,799	66,316
<b>Lease commitments</b>	<b><u>77,799</u></b>	<b><u>66,316</u></b>

## 16. Net fee and commission income and expense

Net fee and commission income and expense comprise:

	<u>2010</u>	<u>2009</u>
Depository	3,603	4,103
Securities operations	1,072	2,977
Settlement operations	166	93
Brokerage services	57	180
Other	1,695	248
<b>Fee and commission income</b>	<b><u>6,593</u></b>	<b><u>7,601</u></b>
Currency conversion operations	(12,574)	(8,551)
Settlement operations	(8,503)	(5,777)
Depository	(1,362)	(728)
Other	(820)	(54)
<b>Fee and commission expense</b>	<b><u>(23,259)</u></b>	<b><u>(15,110)</u></b>
<b>Net fee and commission expense</b>	<b><u>(16,666)</u></b>	<b><u>(7,509)</u></b>

## 17. Income from consulting services

Income from consulting services comprises:

	<u>2010</u>	<u>2009</u>
Income from consulting services	512,303	171,321
Other	96	-
	<b><u>512,399</u></b>	<b><u>171,321</u></b>

Income from consulting services in the amount of RUB 417,813 (2009 – RUB 157,897) represents the consideration received for consulting services provided to the parent bank.

(in thousands of Russian rubles, unless otherwise indicated)

## 18. Personnel and other operating expenses

Personnel and other operating expenses comprise:

	<u>2010</u>	<u>2009</u>
Salaries and bonuses	454,730	526,567
Social security costs	15,327	20,939
Other	22,641	5,577
<b>Salaries and other benefits</b>	<b><u>492,698</u></b>	<b><u>553,083</u></b>
Occupancy and rent	83,814	81,482
Information services	17,576	18,418
Computer software	14,877	6,794
Legal and consultancy	13,963	8,046
Recruitment	12,192	5,295
Outsourcing	11,052	1,750
Communications	9,795	5,407
Business travel and related	9,650	3,741
Transport	5,164	2,677
Audit services	3,186	6,264
Repair, insurance and maintenance of property and equipment	3,560	938
Entertainment	2,027	3,937
Office supplies	1,809	1,247
Operating taxes	888	225
Periodicals	672	504
Post and courier services	500	403
Office appliances repair and maintenance	197	389
Penalties	58	25
Advertisement and marketing	–	2,245
Other	6,630	4,368
<b>Other operating expenses</b>	<b><u>197,610</u></b>	<b><u>154,155</u></b>

## 19. 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 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 operating 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 has the responsibility to monitor the overall risk process within the Bank.

### *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.



*(in thousands of Russian rubles, unless otherwise indicated)*

## 19. Risk management (continued)

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 historical 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 as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries.

Information compiled from all the businesses is examined and processed in order to analyze, control and early identify risks. 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. On a regular basis reporting of industry risks takes place. 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.

## **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.

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 MICEX CH.

(in thousands of Russian rubles, unless otherwise indicated)

## 19. Risk management (continued)

### Credit risk (continued)

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 HCF Bank, Citibank, Sberbank, VTB, Vnesheconombank, Raiffeisenbank, Alfa Bank, MDM Bank, Eurofinance Bank, either representing subsidiaries of foreign financial organizations or having strong individual credit ratings affirmed by international rating agencies. 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.

The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including derivatives.

	<i>Notes</i>	<i>Maximum exposure 2010</i>	<i>Maximum exposure 2009</i>
Cash and cash equivalents (excluding cash on hand)	5	4,089,032	2,121,107
Trading securities	7	3,402,707	1,965,150
Obligatory reserves with the Central Bank of the Russian Federation	6	128,480	21,859
Derivative financial assets	9	69,777	102,220
Other assets	11	26,208	16,110
<b>Total credit risk exposure</b>		<b>7,716,204</b>	<b>4,226,446</b>

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

#### 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 loan-related items of the statement of financial position, based on the Bank's credit rating system.

All financial assets that include Cash and cash equivalents (Note 5), Trading securities (Note 7), Obligatory reserves with the Central Bank of the Russian Federation (Note 6) and Derivative financial assets (Note 9) have high rating, they are not impaired and there is no overdue.

According to the Bank's internal credit rating scale, a counterparty financial position is evaluated as: "good" if its internal rating is "9" or less (high grade); "average or worse" if its internal rating is from "10" through "12" (standard grade); "poor" if its internal rating is above "12" (sub-standard grade).

(in thousands of Russian rubles, unless otherwise indicated)

## 19. Risk management (continued)

### Geographical concentration

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

	<b>2010</b>			<b>Total</b>
	<b>Russia</b>	<b>OECD</b>	<b>Other countries</b>	
<b>Assets</b>				
Cash and cash equivalents	4,068,159	20,873	–	4,089,032
Obligatory reserves with the CBR	128,480	–	–	128,480
Trading securities	3,402,707	–	–	3,402,707
Derivative financial assets	48,850	20,927	–	69,777
Current income tax assets	103,760	–	–	103,760
Other assets	11,297	14,911	–	26,208
	<b>7,763,253</b>	<b>56,711</b>	<b>–</b>	<b>7,819,964</b>
<b>Liabilities</b>				
Amounts due to credit institutions	–	4,129,784	–	4,129,784
Derivative financial liabilities	49,801	4,969	–	54,770
Amounts due to customers	1,437,027	23	601	1,437,651
Current income tax liabilities	689	–	–	689
Other liabilities	206,035	915	–	206,950
	<b>1,693,552</b>	<b>4,135,691</b>	<b>601</b>	<b>5,829,844</b>
<b>Net position</b>	<b>6,069,701</b>	<b>(4,078,980)</b>	<b>(601)</b>	<b>1,990,120</b>

  

	<b>2009</b>		
	<b>Russia</b>	<b>OECD</b>	<b>Total</b>
<b>Assets</b>			
Cash and cash equivalents	865,556	1,255,551	2,121,107
Obligatory reserves with the CBR	21,859	–	21,859
Trading securities	1,965,150	–	1,965,150
Derivative financial assets	100,994	1,226	102,220
Current income tax assets	109,840	–	109,840
Other assets	8,629	7,481	16,110
	<b>3,072,028</b>	<b>1,264,258</b>	<b>4,336,286</b>
<b>Liabilities</b>			
Amounts due to credit institutions	1,510,487	59,333	1,569,820
Derivative financial liabilities	2,122	109,868	111,990
Amounts due to customers	576,557	200,247	776,804
Current income tax liabilities	555	–	555
Other liabilities	206,259	62	206,321
	<b>2,295,980</b>	<b>369,510</b>	<b>2,665,490</b>
<b>Net position</b>	<b>776,048</b>	<b>894,748</b>	<b>1,670,796</b>

### 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.

(in thousands of Russian rubles, unless otherwise indicated)

## 19. Risk management (continued)

### Liquidity risk and funding management (continued)

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>2010, %</u>	<u>2009, %</u>
N2 "Instant Liquidity Ratio" (assets receivable or realizable within one day / liabilities repayable on demand)	108.0	100.1
N3 "Current Liquidity Ratio" (assets receivable or realizable within 30 days / liabilities repayable within 30 days)	116.0	142.1
N4 "Long-Term Liquidity Ratio" (assets receivable in more than one year / sum of capital and liabilities repayable in more than one year)	–	–

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 2010 and 2009 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.

<b>Financial liabilities As of 31 December 2010</b>	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>Total</b>
Amounts due to credit institutions	4,129,784	–	4,129,784
Derivative financial instruments		–	
- Contractual amounts payable	20,231,457	–	20,231,457
- Contractual amounts receivable	(20,246,464)	–	(20,246,464)
Amounts due to customers	1,437,651	–	1,437,651
Other liabilities	206,950	–	206,950
<b>Total undiscounted financial liabilities</b>	<b>5,759,378</b>	<b>–</b>	<b>5,759,378</b>

  

<b>Financial liabilities As of 31 December 2009</b>	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>Total</b>
Amounts due to credit institutions	1,569,820	–	1,569,820
Derivative financial instruments		–	
- Contractual amounts payable	14,561,940	–	14,561,940
- Contractual amounts receivable	(14,571,711)	–	(14,571,711)
Amounts due to customers	776,804	–	776,804
Other liabilities	205,714	607	206,321
<b>Total undiscounted financial liabilities</b>	<b>2,542,567</b>	<b>607</b>	<b>2,543,174</b>

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

	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
2010	23,340	54,459	–	–	77,799
2009	19,895	46,421	–	–	66,316

(in thousands of Russian rubles, unless otherwise indicated)

## 19. Risk management (continued)

### Liquidity risk and funding management (continued)

The following tables provide an analysis of monetary assets and liabilities grouped on the basis of the remaining period from the reporting date to the expected maturity date.

	2010				
	<i>On demand and less than 1 month</i>	<i>1 to 3 months</i>	<i>3 months to 1 year</i>	<i>Overdue</i>	<i>Total</i>
<b>Assets</b>					
Cash and cash equivalents	4,089,032	–	–	–	4,089,032
Obligatory reserves with the Central Bank of the Russian Federation	128,480	–	–	–	128,480
Trading securities	3,402,707	–	–	–	3,402,707
Derivative financial assets	62,677	7,100	–	–	69,777
Current income tax assets	103,760	–	–	–	103,760
Other assets	26,208	–	–	–	26,208
<b>Total</b>	<b>7,812,864</b>	<b>7,100</b>	<b>–</b>	<b>–</b>	<b>7,819,964</b>
<b>Liabilities</b>					
Amounts due to credit institutions	4,129,784	–	–	–	4,129,784
Derivative financial liabilities	49,801	4,969	–	–	54,770
Amounts due to customers	1,437,651	–	–	–	1,437,651
Current income tax liabilities	689	–	–	–	689
Other liabilities	69,734	137,216	–	–	206,950
<b>Total</b>	<b>5,687,659</b>	<b>142,185</b>	<b>–</b>	<b>–</b>	<b>5,829,844</b>
<b>Net position</b>	<b>2,125,205</b>	<b>(135,085)</b>	<b>–</b>	<b>–</b>	<b>1,990,120</b>
<b>Cumulative gap</b>	<b>2,125,205</b>	<b>1,990,120</b>	<b>1,990,120</b>	<b>1,990,120</b>	
	2008				
	<i>On demand and less than 1 month</i>	<i>1 to 3 months</i>	<i>3 months to 1 year</i>	<i>Overdue</i>	<i>Total</i>
<b>Assets</b>					
Cash and cash equivalents	2,121,107	–	–	–	2,121,107
Obligatory reserves with the Central Bank of the Russian Federation	21,859	–	–	–	21,859
Trading securities	1,956,150	–	–	–	1,956,150
Derivative financial assets	73,482	28,738	–	–	102,220
Current income tax assets	109,840	–	–	–	109,840
Other assets	16,017	93	–	–	16,110
<b>Total</b>	<b>4,298,455</b>	<b>28,831</b>	<b>–</b>	<b>–</b>	<b>4,327,286</b>
<b>Liabilities</b>					
Amounts due to credit institutions	1,569,820	–	–	–	1,569,820
Derivative financial liabilities	83,452	28,538	–	–	111,990
Amounts due to customers	776,804	–	–	–	776,804
Current income tax liabilities	555	–	–	–	555
Other liabilities	31,436	174,278	607	–	206,321
<b>Total</b>	<b>2,462,067</b>	<b>202,816</b>	<b>607</b>	<b>–</b>	<b>2,665,490</b>
<b>Net position</b>	<b>1,836,388</b>	<b>(173,985)</b>	<b>(607)</b>	<b>–</b>	<b>1,661,796</b>
<b>Cumulative gap</b>	<b>1,836,388</b>	<b>1,662,403</b>	<b>1,661,796</b>	<b>1,661,796</b>	

All trading securities are included in the 'on demand' category as this portfolio is highly liquid and, in management's opinion, this approach better reflects the Bank's liquidity position.

*(in thousands of Russian rubles, unless otherwise indicated)*

## 19. 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 instruments, 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.

(in thousands of Russian rubles, unless otherwise indicated)

## 19. Risk management (continued)

### Market risk (continued)

#### 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.

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.

The results of interest rate risk calculation by applying the VaR method as of 31 December 2009 are presented in the table below (including comparative financial information as of 31 December 2008).

Type of risk	As of			As of				
	Minimum for 2010	Maximum for 2010	Average for 2010	31 December 2010	Minimum for 2009	Maximum for 2009	Average for 2009	31 December 2009
Interest rate risk related to debt securities	33	481,993	175,915	242,190	874	187,089	71,415	185,661

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

(in thousands of Russian rubles, unless otherwise indicated)

## 19. Risk management (continued)

### 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.

### 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:

	2010					Total
	RUB	USD	EUR	CHF	GBP	
<b>Assets</b>						
Cash and cash equivalents	3,286,220	796,480	6,065	247	20	4,089,032
Obligatory reserves with the CBR	128,480	–	–	–	–	128,480
Trading securities	3,402,707	–	–	–	–	3,402,707
Current income tax assets	103,760	–	–	–	–	103,760
Other assets (without spot deals)	10,989	6,718	–	–	–	17,707
<b>Total monetary assets</b>	<b>6,932,156</b>	<b>803,198</b>	<b>6,065</b>	<b>247</b>	<b>20</b>	<b>7,741,686</b>
<b>Liabilities</b>						
Amounts due to credit institutions	191	3,977,235	108,899	42,136	1,323	4,129,784
Amounts due to customers	814,316	623,335	–	–	–	1,437,651
Current income tax liabilities	689	–	–	–	–	689
Other liabilities (without spot deals)	201,607	29	–	–	–	201,636
<b>Total monetary liabilities</b>	<b>1,016,803</b>	<b>4,600,599</b>	<b>108,899</b>	<b>42,136</b>	<b>1,323</b>	<b>5,769,760</b>
<b>Net monetary assets and liabilities</b>	<b>5,915,353</b>	<b>(3,797,401)</b>	<b>(102,834)</b>	<b>(41,889)</b>	<b>(1,303)</b>	<b>1,971,926</b>
<b>Derivative financial instruments and spot deals</b>	<b>(3,938,513)</b>	<b>3,830,255</b>	<b>100,832</b>	<b>(1)</b>	<b>–</b>	<b>(7,427)</b>
	2009					Total
	RUB	USD	EUR	CHF	GBP	
<b>Assets</b>						
Cash and cash equivalents	565,972	1,551,752	1,391	1,292	700	2,121,107
Obligatory reserves with the CBR	21,859	–	–	–	–	21,859
Trading securities	1,965,150	–	–	–	–	1,965,150
Current income tax assets	109,840	–	–	–	–	109,840
Other assets (without spot deals)	9,129	2,520	–	4,292	–	15,941
<b>Total monetary assets</b>	<b>2,671,950</b>	<b>1,554,272</b>	<b>1,391</b>	<b>5,584</b>	<b>700</b>	<b>4,233,897</b>
<b>Liabilities</b>						
Amounts due to credit institutions	1,538,728	–	–	31,092	–	1,569,820
Amounts due to customers	545,319	225,350	2,019	2,443	1,673	776,804
Current income tax liabilities	555	–	–	–	–	555
Other liabilities (without spot deals)	203,910	1,750	–	–	–	205,660
<b>Total monetary liabilities</b>	<b>2,288,512</b>	<b>227,100</b>	<b>2,019</b>	<b>33,535</b>	<b>1,673</b>	<b>2,552,839</b>
<b>Net monetary assets and liabilities</b>	<b>383,438</b>	<b>1,327,172</b>	<b>(628)</b>	<b>(27 951)</b>	<b>(973)</b>	<b>1,681,058</b>
<b>Derivative financial instruments and spot deals</b>	<b>1,338,354</b>	<b>(1,348,651)</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>(10,297)</b>



(in thousands of Russian rubles, unless otherwise indicated)

## 19. 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 the statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

<b>Currency</b>	<b>Change in currency rate 2010</b>	<b>Effect on pre-tax profit and equity 2010</b>	<b>Change in currency rate 2009</b>	<b>Effect on pre-tax profit and equity 2009</b>
Stronger USD	8.9%	3,377	14.8%	(3,539)
Weaker USD	8.9%	(3,377)	14.8%	3,539
Stronger CHF	10.85%	(4,545)	15.4%	(4,304)
Weaker CHF	10.85%	4,545	15.4%	4,304
Stronger GBP	9.65%	(126)	17.4%	(169)
Weaker GBP	9.65%	126	17.4%	169
Stronger EUR	11.05%	(217)	14%	(88)
Weaker EUR	11.05%	217	14%	88

### 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 exposure on debt securities by applying the VaR method are presented in the table above as part of market risk calculation.

## 20. Fair values 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: 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)

## 20. Fair values of financial instruments (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

<b>31 December 2010</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
Trading securities	3,402,707	–	–	3,402,707
Derivative financial instruments	–	69,777	–	69,777
	<b>3,402,707</b>	<b>69,777</b>	<b>–</b>	<b>3,472,484</b>
<b>Financial liabilities</b>				
Derivative financial instruments	–	54,770	–	54,770
	<b>–</b>	<b>54,770</b>	<b>–</b>	<b>54,770</b>
<b>31 December 2009</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
Trading securities	1,965,150	–	–	1,965,150
Derivative financial instruments	–	102,220	–	102,220
	<b>1,965,150</b>	<b>102,220</b>	<b>–</b>	<b>2,067,370</b>
<b>Financial liabilities</b>				
Derivative financial instruments	–	111,990	–	111,990
	<b>–</b>	<b>111,990</b>	<b>–</b>	<b>111,990</b>

*Financial instruments carried at fair value.* Trading securities, other assets at fair value through profit or loss, and derivative financial instruments are recorded at fair value in the statement of financial position.

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.

*Derivative financial instruments.* All derivative financial instruments are carried at fair value as assets when the fair value is positive and as liabilities when the fair value is negative. Refer to Note 9.

As of 31 December 2010 and 2009, 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.

## 21. 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, and 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)

## 21. 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:

	2010		2009	
	Parent bank	Entities under common control	Parent bank	Entities under common control
<b>Cash and cash equivalents</b>	<b>20,873</b>	<b>–</b>	<b>1,255,547</b>	<b>–</b>
Contractual interest rate on cash and cash equivalents: (2010: 0.0%; 2009: 0.0% - 6%)				
Due from credit institutions, beginning of the period	–	–	<b>843,893</b>	–
Issued for the period	–	–	3,050,000	–
Repaid for the period	–	–	(3,893,893)	–
<b>Due from credit institutions, end of the period</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Derivative financial assets</b>	<b>20,927</b>	<b>8,500</b>	<b>1,226</b>	<b>55,911</b>
<b>Other assets</b>	<b>9,659</b>	<b>113</b>	<b>2,659</b>	<b>–</b>
<b>Amounts due to credit institutions, beginning of the period</b>	<b>59,332</b>	<b>–</b>	<b>2,176,257</b>	<b>–</b>
Received for the period	529,910,785	–	21,172,714	–
Repaid for the period	(525,840,333)	–	(23,289,639)	–
<b>Amounts due to credit institutions, end of the period</b>	<b>4,129,784</b>	<b>–</b>	<b>59,332</b>	<b>–</b>
Contractual interest rate on amounts due to credit institutions: (2010: 0.0% - 1.0%; 2009: 0.0% - 14.0%)				
<b>Derivative financial liabilities</b>	<b>4,969</b>	<b>–</b>	<b>109,868</b>	<b>–</b>
<b>Amounts due to customers</b>	<b>23</b>	<b>937,560</b>	<b>39,723</b>	<b>711,877</b>
Contractual interest rate on amounts due to customers: (2010: 0.0% - 2.5%; 2009: 0.0% - 4.0%)				
<b>Other liabilities</b>	<b>37</b>	<b>15</b>	<b>–</b>	<b>18</b>
Interest income on amounts due from credit institutions	4,736	–	721,261	–
Interest expense on amounts due to customers	–	801	–	1,738
Interest expense on amounts due to credit institutions	17,507	–	63,672	–
Fees and commission income	984	–	1,020	–
Fee and commission expense	–	–	–	25
Gains less losses from trading securities	2,898	–	1,492	–
Gains less losses from dealing in foreign currencies	41,432	177,516	(113,891)	130,949
Other income	417,813	–	157,897	–
Rent and maintenance expenses	–	80,416	–	67,160

(in thousands of Russian rubles, unless otherwise indicated)

## 21. 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>2010</u>	<u>2009</u>
Salaries	18,217	21,298
Bonuses	23,330	21,228
Unified social tax	299	184
Other social charges	235	163
<b>Compensation to key management personnel</b>	<b><u>42,081</u></b>	<b><u>42,873</u></b>

This amount of compensation represents short-term compensation only.

## 22. 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 Bank also performs on-going control of its capital adequacy ratio computed in accordance with the Basel Capital Accord to maintain it at no less than 8%. 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 2010, the Bank's regulatory capital adequacy ratio was 42.6% (2009: 60.7%). Regulatory capital is shown per the Bank's reports prepared under RAL and as of 31 December 2010 amounted to RUB 2,123,876 (2009: RUB 1,869,959).