

FOCUS



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Statement of the Chairman of the Management Board of the Bank

Dear shareholders, clients, partners and colleagues!

On behalf of the Management Board and Board of Directors, I am deeply honored to present to You the annual report of Absolut Bank for the year 2010.

For the global economy, this year was a period for the start of recovery from consequences of the financial crisis, while for Absolut Bank, it was a year for approval and first stage in implementation of the new strategy. Based on our 17-year experience of successful business conduct in the Russian market and best international practices of our shareholders, we have chosen the way for our development and we are sure that we will make our plans come true.

We decided to have a strict focus on those business areas, which we consider a priority for us, and intend to be leaders there. We plan to devise a new business approach, by offering our clients tailored financial solutions rather than finished products. Based on combined understanding of the Russian market fundamentals and best international technologies, we offer Russian products in conjunction with European technologies and service. Today, it is a unique business model for the Russian market.

Successful implementation of these changes requires expertise of the strongest professionals. And I am proud to tell You that the team is the major asset and valuable of Absolut Bank. That

is why, every chapter will be preceded by the statements from executives of the key departments, who will present to You our objectives and stages in their achievement. I would like to mention that in 2010 our team was reinforced, as many managers with working experience in large global companies both in Russia and abroad joined the bank. I am sure that their knowledge and experience will help us succeed in integration into the international financial group, as well as promptly launch the new programs and solutions, which were implemented in Europe to the best advantage. The experience of “old-timers” from our team allows us to keep the best practices and traditions of the bank, thanks to which Absolut Bank is always Absolut Bank with its traditions and originality. I am proud that over 100 employees of the bank have been with us for more than 10 years by now. With the team like ours, we will implement the chosen strategy and achieve our ambitious objectives, of which I am sure.

Finally, on behalf of the Board of Directors of Absolut Bank, I would like to express my profound gratitude to the shareholders for their support and faith in the bank, clients and partners of the bank for their trust and cooperation. I also would like to thank all employees of Absolut Bank for their dedication, devotion, industry and professionalism in achieving perfection in service and management of strategic challenges. Enjoy the reading.

**Yours faithfully,
Chairman of the Management Board
of Absolut Bank
N.V. Sidorov**



Absolut Bank in Ratings

Customer Experience Index **Top-3** (PwC & Senteo, January 2011)

Top-20 of the most consumer-rich banks (Profile, December 2010)

30th place in 100 largest banks (Forbes, April 2010)

Financial Performance in Ratings

29th place in Top-500 banks in terms of liquid assets as of January 1, 2011 (RBC Rating)

30th place in terms of assets in the reliability rating of the largest Russian banks (Finance, #31 (362) August 30 – September 5, 2010)

38th place in Top-100 largest Russian banks in terms of capital (as of January 1, 2011), (Kommersant Money, #12 (819), March 28, 2011)

Retail Banking in Ratings

1st place among the Most popular BMMFs in September 2010 held by Absolut – Profitable BMMF (RBC Rating)

6th place in Top-100 banks in terms of mortgage loan portfolio as of January 1, 2011, (RBC Rating)

10th place among the Banks in terms of mortgage

loans granted in 2010, (RBC Rating)

13th place among the Banks in terms of auto loan portfolio as of January 1, 2011, (RBC Rating)

17th place among the Banks in terms of auto loans granted in 2010, (RBC Rating)

19th place among the most consumer-rich banks (as of January 1, 2011), (Kommersant Money, #12 (819), March 28, 2011)

Corporate Banking in Ratings

23rd place among the Banks in terms of loans to small and medium business granted in 2010, (RBC Rating)

The good standing of the bank is confirmed by the ratings from such international rating agencies, as Fitch Ratings and Moody's.

Moody's Investors Service,
November

Long-term deposit rating

Short-term deposit rating

Financial strength rating

National long-term rating

Fitch Ratings, December

Long-term IDR

Short-term IDR

Support rating

Bank's individual rating

National long-term rating

23, 2009

Ba3

Not Prime

E+

Aa3.ru

2, 2009

BB+

B

3

D/E

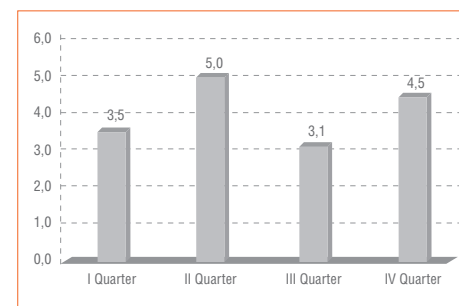
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Macroeconomic Situation

The year 2010 has become a period of post-crisis recovery for the Russian economy, by continuing the growth trend, which took shape as far back as 2009. The crisis decline was offset by two-thirds for the period in question. The Russian GDP growth amounted to 4% at the year-end

Russian GDP growth rates, in percentage against the similar quarter last year



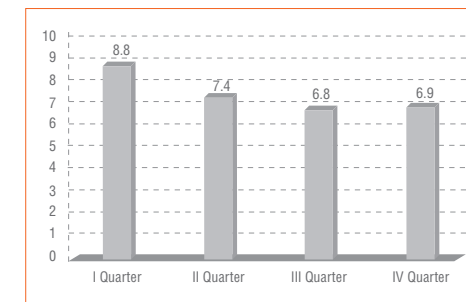
The recovery was largely contributed to by the improvement of the global economy, renewing external demand and growing prices for the Russian export commodities, recovery of the stock exchange indices and strengthened balance of payments.

The growth of economy allowed for improvement of the labor market situation: the unemployment rate dropped by 0.7 mln. people to 5.7 mln. people on average for a year.

According to estimates of the Ministry of Economic Development and Trade of the Russian Federation, in 2010 the ruble strengthening in real terms (given the external and internal inflation) made up 4% against US dollar and 14.4% against euro. The strengthening of the nominal effective ruble

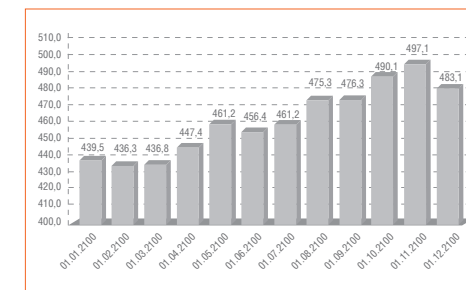
exchange rate amounted to 1.9%.

Unemployment rate, % of the gainfully occupied population



The foreign exchange reserves of the Bank of Russia grew up by \$36.8 bln. in 2010 through transactions of the balance of payments.

Dynamics of the international reserves in 2010 (bln. USD)



In 2010, the annual inflation value reached 9.6%. The inflation growth peak fell on Q3 and Q4 of the reporting period, which was mostly due to the abnormal summer drought, resulting into crop failure and, as a consequence, price hikes for commodities.

Russian banking sector

In 2010, the Russian banking system partially recovered from the negative consequences of the global financial crisis, although these indices have been reached largely due to the drastic increase in concentration of the state-owned banks. Domination of the state-owned banks in the market in 2010 became absolute, in consequence of which the competition became stronger.

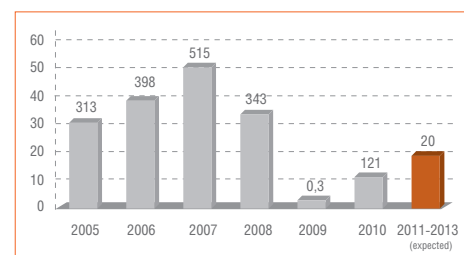
According to the Association of Russian banks, the share of banks with state participation grew up by 10% to 55% of the market. In 2010, their share in the total income of the banks amounted to 71%. Thus, the profitability of the Russian banking sector remained low (it might be red ink without state-owned banks), while the number of loss-making banks was still high. There were just fewer than 100 loss-making banks.

The reporting period was characterized by:

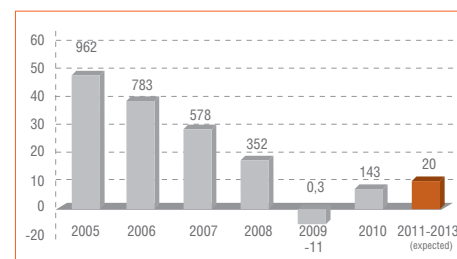
- Lower growth rates of the banks' loan portfolios

- Strengthened competition;
- Growing market share held by the state-owned banks;
- Decline in availability and affordability of foreign financing;
- Interest margin drop;

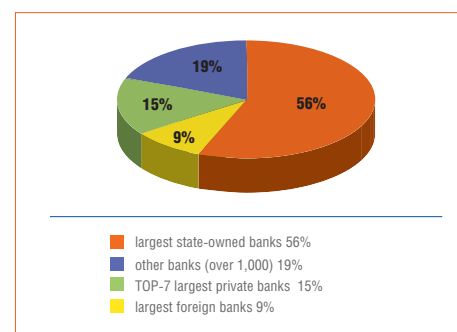
Growth rates of the portfolio of loans granted to nonfinancial organizations, % per year



Retail loan portfolio growth rates, % per year



Net asset structure of the Russian banking sector as of January 1, 2011



Under such conditions, one of the major issues, disturbing any banking community participant, was how to survive, how to keep efficiency and keep operating expenses under control. Certain players were back to active lending, by imposing minimum requirements for the borrowers, offsetting high risks with high rates and large amounts of loans granted.

Absolut Bank chose another path. In the circumstances concerned, one of the possible options to solve the problems encountered was the review of approaches to conduct of business. Therefore, the new strategy of Absolut Bank approved in 2010 matched the market trends well. Owing to the focus on the business segments, in which the bank was most efficient, the bank proved its competitive edge even under hard circumstances of the year 2010. It confirmed its status of one of the largest Russian banks with rich history and assured support from shareholders, holding leading positions in all the priority business areas, keeping confidence and loyalty of its clients.

Development Strategy

On June 4, 2010, Absolut Bank approved the new development strategy. Its principal provisions are as follows:

Absolut Bank remains a universal bank, which key priorities are retail banking services for middle class clients and corporate banking services for Mid/Large Cap Companies. The important development area is still cooperation with small and medium businesses. The bank has entirely modified the internal structure and processes, by focusing on the risks and service quality.

The bank's foundation, on which key business departments will be developed, is the team, which experience, personal qualifications and plans for their development correlate with the bank's strategy; maximum operating efficiency; expedient risk and customer relationship management. Today, Ab-

solut Bank is a balanced bank with clearly defined risk appetites across all levels, building long-term relations with clients and paying much attention to formation of an appropriate team.

Pursuant to the principles of the new strategy, corporate banking is one of two key business areas and an important income source. The bank focused on interaction with corporate clients – Mid/Large Cap Companies. But the emphasis was placed on the increase in F&C income share and development of trade finance, CMS, conversion and forward transactions.

In the retail segment, which is the second priority development area of the bank, Absolut Bank placed its stake on retail services for middle class and VIP clients. The flagship products are mortgage and auto loans. But for maximum comfort of the clients, the bank is ready to offer its clients a wide range of investment opportunities and bundled products.

Absolut Bank held the leading positions in the auto and mortgage lending market prior to crisis and maintained them in times of volatility. By using the accumulated experience and earned reputation, the bank plans to strengthen its positions in these markets and increase the share held in these markets as soon as the economic situation in Russia becomes stable.

In the SMB banking segment, which the bank considers to be an important growth area, Absolut Bank is focused on attraction of finance and receipt of F&C income. Furthermore, the lending programs are formed as part of a conservative approach to risk assessment.

In H2 2010, Absolut Bank started implementing a new strategy, by having prepared for achievement of the key tactical objectives:

- in retail banking, the bank intends to increase the client base; increase the share of F&C in-

come; increase the share of clients attracted via direct sales channels.

- in corporate banking, the strategy provides for more than twofold increase in the number of active clients; considerable improvement of the loan portfolio quality; increase in F&C income; enhancement of efficiency in managers' operations.
- in SMB banking, the bank will increase the number of its clients, by keeping the balance between the assets and liabilities raised from this segment.

The global strategic objectives of Absolut Bank include considerable increase in income against gradual decrease in expenses; securing funding for further growth of the loan portfolio at the expense of the clients' deposits; considerable increase in return to capital.



Corporate Banking

Deputy Chairman of the Management Board of Absolut Bank Evgeny Retyunsky:

“Absolut Bank corporate banking is always an income driver. The bank has aggressively been growing, by focusing on 2 major areas, such as Real Estate and car dealerships, which suffered quite a lot during the crisis. It was one of the reasons for a global reorganization of the lending policy. The bank retired from several riskiest projects, by actively reducing the loan portfolio, and considerably slowed down the rates, at which loans were extended, until it developed the new risk assessment principles. As a result, the bank halved the portfolio for corporate clients compared to the end of the year 2008.

In 2011, the bank plans to get back to active lending provided that the portfolio is diversified. The bank does not extend collateral loans and pays special attention to the company’s cash flow analysis in the transaction restructuring to clearly

understand the sources for future loan repayment.

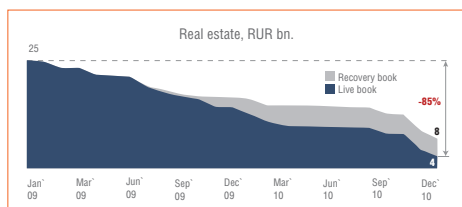
We are very well aware that we are operating in a different market today, which conditions are incomparable to what we were used to prior to crisis: stronger competition and reduced transaction marginality. Under these conditions, a clearer focus on a certain client segment will allow us to be more efficient. We also have to improve quality and efficiency of account managers and credit analysts and enhance the lending procedures. We can do it and I am sure trends of success in 2010 will find a worthy continuation in future.”

As part of the new development strategy, Absolut Bank decided to have its corporate banking divisions focused on the corporate banking for Mid/ Large Cap Companies. Absolut Bank may offer most appealing product terms and high quality service to business with the annual average turnover of about 40 billion roubles. Besides, the bank intends to keep on developing in the noncredit business segments: in trade finance, conversion transactions and cash management services.

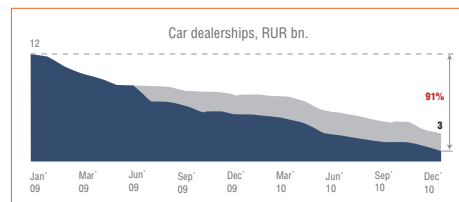
Lending

By diversifying the credit risks, Absolut Bank resolved to increase the share of finance for companies, rendering services to end users, which production is always in high demand. We increased the share of machine building, metals and food companies. These are industries, which feel very well and secure today and according to our expectations will be successful in future.

These sectors may also include food industry, extraction and processing of raw materials, including metals and service companies from the oil and gas sector. In 2010, the bank reduced concentration of the loan portfolio in real estate by 3 times compared to the end of the year 2008. According to the new lending policy of the bank, the real estate sector should have 15% of the portfolio at most. The bank intends to keep reducing this share in 2011.



As part of the development strategy of the bank, the portfolio structure will be quite balanced by the end of the year 2011.



F&C products

One of the most important tactical objectives of Absolut Bank for 2010-2011 is the increase in the share of F&C income: business margin has reduced considerably, risks are still high, competition became stronger. Therefore, the F&C income growth is the most important stage in business profitability increase.

Our competitive edge in corporate banking is offering such F&C products, as trade finance, guarantees, conversion and forward transactions, cash management services. We were strong in trade finance and guarantees even prior to crisis. This market is now expanding, especially against the retirement of insurers from the issue of guarantees. We also offer risk hedging to companies, such as Forex and other instruments.

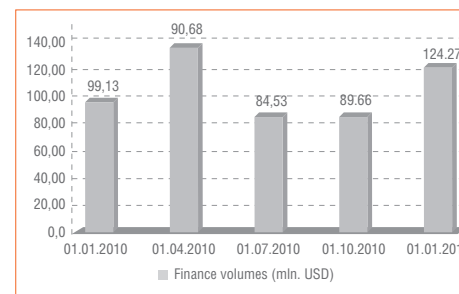
These are quality services, which help companies cut their losses. Derivatives are for nonfinancial clients, including customers, which borrow loans from Absolut Bank, and those who don't.

Trade Finance

Cooperation with international financial institutions allows Absolut Bank to provide a full range of financial services and offers, the use of which enables the bank's clients to easily manage and develop business.

By adhering to maintenance of the required and usable list of counterparties, which traditionally includes the KBC Group banks and market leading banks, such as Deutsche Bank AG, Commerzbank AG, Absolut Bank relied on deepening of cooperation in 2010 based on client transactions, which resulted into strengthened relations in the new trade finance areas.

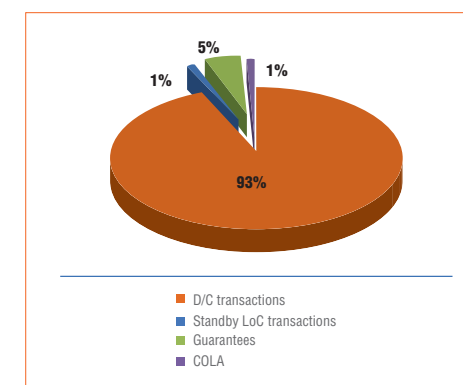
In 2010, Absolut Bank attracted the largest Russian companies involved in export and import activities as part of its trade finance services. The bank also facilitated its relations with European Export Credit Agencies, with many of which it signed agreements



Volume of trade finance transactions (dynamics throughout the year)

for insurance of business risks in finance arrangements and with several of which it worked out opportunities to sign exclusive agreements for insurance of the bank's direct risks. As a result, the growing volume of trade finance transactions exceeded 25% in 2010.

Diversification of trade finance instruments as of January 1, 2011



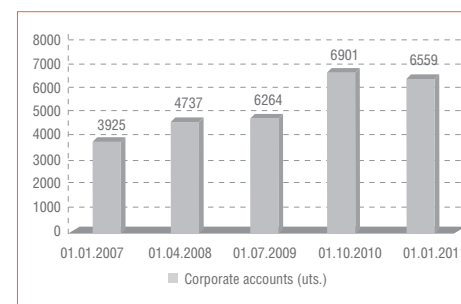
Absolut Bank financial opportunities became larger because most financial institutions resumed cooperation with foreign lending agencies and financial organizations and thanks to fullscope support of the KBC Group banks in structuring and exercise of transactions.



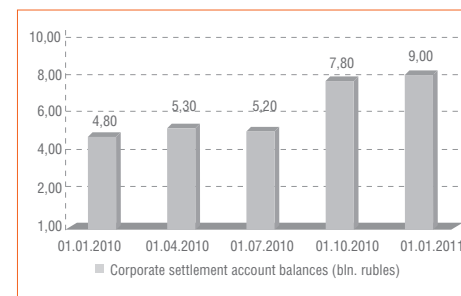
Cash Management Services

Absolut Bank offers advanced solutions as part of CMS aimed at personal needs of every client, which, in turn, contributes to long-term relations. The range of business CMS services includes the most up-to-date services of remote access to the bank accounts of the companies: Internet Bank system for management of company's accounts; SMS and e-mail notification system for information on account transactions and events in the Internet Bank system.

5-year dynamics of corporate accounts



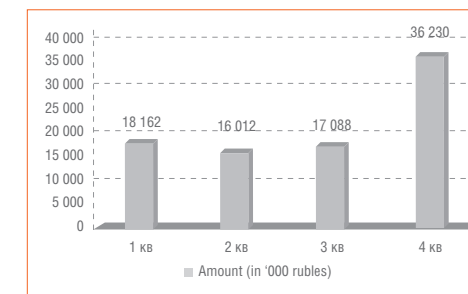
Corporate settlement account balances



Conversion transactions

The first three quarters of 2010 are characterized by a declining trend in business activity of corporate clients with respect to conversion transactions, which resulted both from the market situation and general reductions by the banks of their fees for such transactions. In Q4, the situation became more stable, which led to gradual increase in business volumes. The revision of the risk policy by Absolut Bank led to the reduction of opened working credit lines in the first half-year followed by the increase in new professional treasury lines in the second half-year. Thus, the bank opened 15 new professional treasury lines in Q3-Q4. Absolut Bank also attracted over 120 new clients for conversion as part of CMS.

Corporate Sales Desk flow of income in 2010



In 2011, the bank plans to increase fee revenues from treasury transactions with corporate clients owing to increase in the client base and opening of the new professional credit lines. Given the growing interest of clients towards derivatives, the bank plans to implement new products, such as interest swaps, options, which allow the clients to be more flexible in hedging their financial risks.

Foreign Exchange and Money Markets

In 2010, Absolut Bank carried out foreign exchange transactions in the ordinary course. The total volume of FX transactions slightly slid down from \$170 bln. in 2009 to \$130 bln. This decline resulted from smaller volumes of currency swaps. Over 90% of the total FX transactions were bank's own trading transactions like a year before. In 2010, Absolut Bank carried out transactions with the Russian rubles and principal foreign currencies. The bank's volume of client transactions was steady at \$250 mln. per month, most of which consisted of the corporate clients' transactions.

There was slightly higher business activity in the interbank lending market, resulting from a more comfortable situation with liquidity compared to 2009. Tier 2 and 3 banks resumed placement of their idle funds.

The turnover generated from interbank deposits in 2010 (excluding client transactions, ALM, Treasury) amounted to:

- in rubles – 911,099 mln. (5,291 transactions);

- in US dollars – 11,244 mln. (538 transactions);
- in euros – 2,573 mln. (192 transactions).

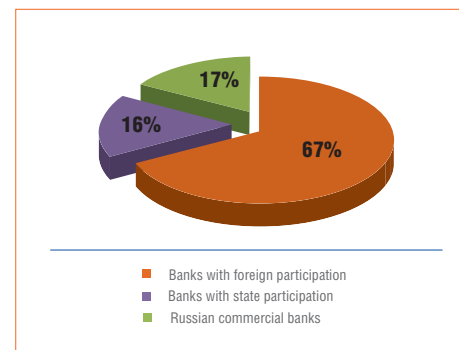
Cooperation with Financial Institutions

As part of its integration processes in 2010, Absolut Bank switched over to the limiting policy standards of the KBC Group.

The new procedure for opening and use of limits allowed assessing the level of accepted risks in a more efficient way.

The total amount of limits for deposit transactions made up about €1.2 bln. at the year-end, about €0.5 bln. of which falls onto the Russian banks. The volume of settlement limits for conversion transactions exceeded €4 bln., about €2 bln. of which falls onto the Russian banks. The total volume of commercial limits set for the financial institutions in 2010, under which Absolut Bank issued guarantees, including customs ones, against counter-guarantees of their counteragent banks, exceeded €50 mln.

Structure of limits opened by Absolut Bank



In 2010, Absolut Bank kept on developing relations with its traditional strategic partners, such as EBRD, NIB, DEG, KFW, IFC. Besides, the bank signed a contract for a loan from the Russian Bank for Development under the Co-financing program in support for SMB lending. In 2010, the bank put into effect new rates for accounts of nonresidents with more appealing service conditions. The correspondent accounts provide for accrual of interests on the credit balance and overdraft extension. Maintenance of the correspondent accounts is

improved on a continuous basis in line with needs of the respondent banks. Among other things, respondents may now send payment instructions in English and carry out fast payments via online real-time payment system.

In 2011, the bank plans to do the following in this field:

- to reinforce positions and business reputation of the bank in international and Russian business communities;
- to bring interbank cooperation contracts into compliance with the requirements of the KBC Group;
- to support effective functioning of the correspondent loro and nostro accounts as part of the policy maintained by the KBC Group;
- to raise funding in its best interests and in the best interests of the bank's clients, to cooperate with financial institutions with respect to existing borrowings.



Retail Banking

Deputy Chairman of the Management Board of Absolut Bank Ivan Anisimov:

“The major objective for us today is to increase retail banking value. The principal tactical steps we intend to take to achieve the said objective are implementation of the client-oriented business model, formation of the risk culture across all levels, maintenance and further strengthening of the firm positions in our key markets, in which Absolut Bank has always been a strong player – in the mortgage and auto loan markets, in the first place.

We have a long-term development strategy, because today we build a foundation for 5-7 years ahead, which will allow the bank to enjoy sustainable development both against its existing scale and in the event of any changes. It will enable the bank to implement and launch the new services and provide maximum reliability for all products and processes.

In 2010, we resumed active development of our retail programs, by offering our clients appealing terms, first-rate service conditions and adhering to the balanced decision-making and formation of a quality portfolio.

Understanding our priority development areas is unaffected. We focus on services for middle class clients, by building long-term relations with them and offering them full service banking. But we realize that mortgage and auto loans, saving and payment instruments, day-to-day transactions, including electronic banking, are in highest demand among our clients. We also consider cooperation with small and medium businesses, whose representatives make use of services with Absolut Bank both as private clients and entrepreneurs and later on as corporate clients, to be an important perspective development area for our business.

Looking back to our performance in 2010, I am sure all actions the bank undertook were right and efficient, which is confirmed by the results of the reporting period. In our key segments, we are still a competition to the largest state-owned banks, first of all, thanks to our clear understanding of what we do, why we do it and whom we do it for. We know our client and all our efforts are meant to become a partner and a consultant for the client, which will choose the optimum solution of financial matters and help the client form and implement the strategy for cash flow management throughout their life, rather than just a bank for service, a sort of “a financial supermarket”, selling finished services.”

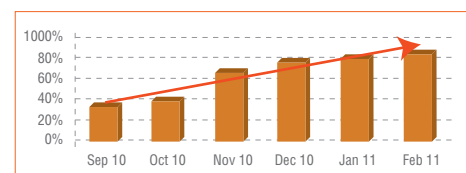
Strategy for Long-Term Cooperation with Middle Class Clients

One of the key provisions of the new development strategy of Absolut Bank is building long-term relations with clients. To that end, the bank has already launched the implementation of a new operating model.

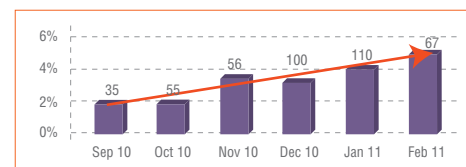
It is designed to increase successful sales of the bank's products and services in order to expand the client base and improve service quality. It is also essential that the bank accounted for preferences and needs of the target audience, i.e. middle class representatives, in its development. As a pilot project, the new operating model was launched in the Head Office of Absolut Bank in June 2010. There are administrators in the operating room, who amiably greet the clients and help them meet their financial needs as fast and comfortable as possible. The major changes affected client service areas, distribution of client flows and employees' functionality. There is now a client meeting area, a fast service area and a sales area. The sales managers became "most important" employees in the Business center. They may provide consultations, sell and execute any banking products right away.

The emphasis was placed on efficiency of all operating areas: sales, expenses, processes, competitive solutions, innovative products, risk control. The implementation of the new operating model in the Head Office allowed us to simplify the subdivision structure, detail areas of responsibility for the staff, hold training sessions in new sales approaches for the bank employees. As a result, the subdivision efficiency improved considerably.

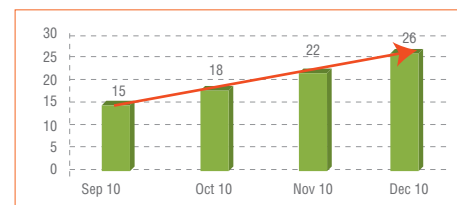
% of successfully forwarded contacts



% of the successful sales to the incoming client flow



Sales amount per employee



The model passed tests. It was found successful and recommended for stage-by-stage implementation in other offices of Absolut Bank.

It will allow us to achieve the objective in view – to achieve the increase in retail banking value, by expanding the client base and income, as well as by using a balanced approach to risk and operating expense management.

Comprehensive Financial Solutions for Clients

Absolut Bank believes implementation and development of the system of comprehensive financial solutions for clients to be one of the retail banking development priorities for the coming years.

In 2010, the bank completed the first stage of this project. The bank offers its clients comprehensive saving solutions, combining instruments with different return and risk level, accounting for the needs and personal characteristics of clients.

This is a bundle, which may include deposits, investment products, among which there may be gold coins and BMMF. It was the first experience of the bank in launching comprehensive solutions, based on which Absolut Bank tested methods and technologies in handling nonconventional offers.

This practice gave its positive results, having received high estimates from clients and allowed the bank to increase the volume of funds raised for BMMF, as well as to expand the client base.

Our objective is to make Private banking technologies available to all of our clients. In 2010, the bank offered comprehensive solutions in investments, but it is essential to launch similar opportunities in all the segments for the next 5 years. Another objective under this project is to implement the bundled solutions scheduled for H1 2011. In the reporting period, the bank made all necessary preparations, carried out market research, developed IT technologies and formed internal processes.



Loan Program Development

The year 2010 proved to be the time, when Absolut Bank resumed its active development in the lending segment. In 2010, the mortgage lending market became stable, after having returned to pre-crisis levels. According to CBR, in the reporting period, the banks extended a total of 379 bln. rubles in mortgage loans, which exceeds the 2009 figures by almost 2.5 times. Following the 2010 results, the average mortgage loan rose by 7.6% from 1.17 mln. rubles (2009) to 1.26 mln. rubles according to the Agency for Housing Mortgage Lending (AHML). The increased loan amount reflects both recovery of the household income and housing prices.

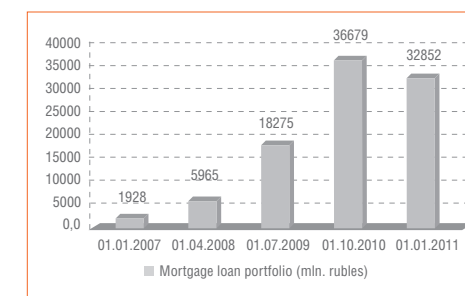
Absolut Bank was back on track in the mortgage market, having confirmed its position in TOP-10 largest mortgage banks. In 2010, the bank granted 2,865 mortgage loans to the amount far exceeding 4 bln. rubles. But the share of mortgage loans in the loan portfolio hit 74%, having increased by almost 4% compared to the last year. The average loan amount made up 1.5 mln. rubles in 2010. Noteworthy to mention that most mortgage loans were granted in 2010 through bank offices.

Another positive trend in 2010 was the reduction of overdue amounts both in the Russian market, in general and Absolut Bank, in particular. As for the market, this was due to the fact that new loans were extended faster than old loans were repaid, which is a sure sign of the post-crisis mortgage market recovery. Absolut Bank improved the loan portfolio quality chiefly at the expense of amendments to the evaluation of the borrower's business solvency and a more conservative approach to lending.

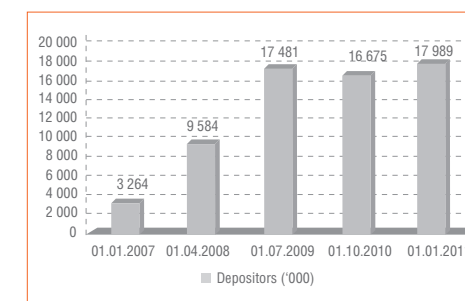
These results allowed the bank to confirm its position among the mortgage market leaders, having secured the 6th place in 2010.

By having gained successful experience in lending in the crisis environment, Absolut Bank came back to market with new programs and a new business model, which will allow it to make the loan portfolio much more qualitative in future. The bank expects it at 11,583 mln. rubles in 2011, which will exceed the similar figure of the previous year by 2.5 times.

5-year dynamics of mortgage loan portfolio



5-year dynamics of borrowers, at the end of each year



Auto Lending

The major 2010 trend was the arrival of many specialized loan programs from captive banks of car makers. Following the 2010 results, every fourth auto loan for a new car was extended under a special promotion program of a car maker. On the other hand, there was a drastic growth in demand for cars in combination with a reduction of car dealerships. Unreadiness of car makers for a fast recovery in demand led to long lines of customers, waiting for the most marketable models and became an artificial restraint for a volume of purchased cars, including against a loan. This market is also characterized by the domination of loan offers from state-owned banks. The loans for purchase of new foreign cars were in the highest demand among clients. The auto loan interest rates were gradually declining for the entire year 2010. The rates of some banks reached the pre-crisis values.

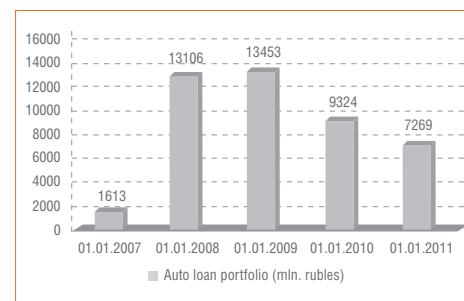
According to our expectations, the competition between the banks in the coming years will most likely take place by means of more convenient programs, prompt terms for loan application processing, service quality and probably partner programs rather than reduction of rates. In 2011, the subdivi-

sions of Absolut Bank will pinpoint attention upon improvement of our positions in these areas.

In general, speaking of auto lending, we may single out the following trends:

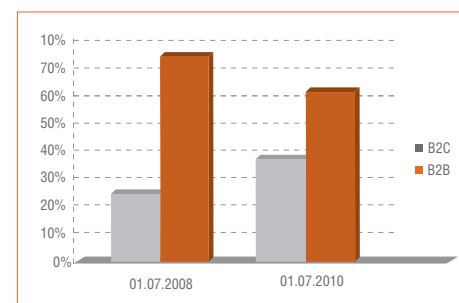
- softened requirements for borrowers;
- reduction of interest rates;
- increase in lending terms

In such a situation, Absolut Bank decided to focus on keeping its own share in the market and leading positions in this lending segment among its target



audience. Following the 2010 results, the bank came off with flying colors, as it maintained its positions in TOP-20 banks in terms of auto loan portfolio volumes, by extending loans to middle class clients.

5-year dynamics of auto loan portfolio



The bank believes it to be essential in the next 2-3 years to increase the sales of auto loans through the network of its own offices rather than partners. The bank aspires to increase the level of financial literacy of its clients, conveying a message to them that it is better to come for a purchase with a clear idea of what finance they may get and what

terms they may expect. The year 2010 brought the first results in achievement of this objective. We see a certain increase in the share of sales channels in the bank offices.

Changes in sales channels relation

In 2010, Absolut Bank, placed emphasis on the risk minimization and improvement of the loan portfolio quality, operating under the new business strategy. The bank has employed a new, more conservative approach to the possible risk assessment since the turn of 2010, but in the meantime it maintained the client-oriented approach, by outlining its well defined requirements for the borrowers and using understandable assessment procedures, which are convenient for the clients.

As a result, the bank accomplished the 2010 objective successfully. It maintained its positions, while improving the portfolio quality. As of January 1, 2011, Absolut Bank extended 3,860 loans to the total amount of 2,290,815,000 rubles according to new standards. Thus, the auto loan portfolio of the bank exceeded 7 bln. rubles at the end of the reporting period.

Investment Opportunities

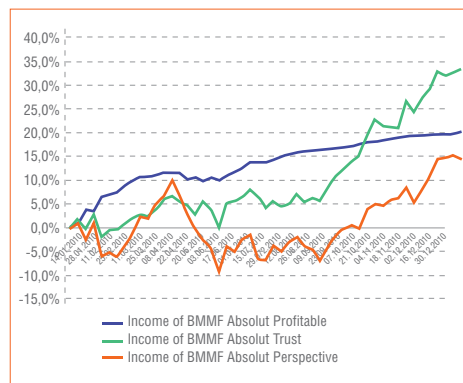
In 2010, Absolut Bank strengthened its positions in the market of collective investments. Bank-Managed Mutual Funds (BMMF) have been and still are bank's priority number one.

Income generated by BMMFs for their depositors greatly varied contingent upon the strategies, which were implemented as part of each specific fund. Thus, income from the most conservative fund BMMF Absolut Profitable, which investment strategy suggests investments into Russian bonds only, amounted to 17.46% in 2010. Meanwhile, income from the balanced fund BMMF Absolut Trust, which is focused on investments into precious metals and shares of the gold mining and nonferrous metals companies, amounted to 38.71%. The index fund of the Russian equities BMMF Absolut Perspective yielded a 19.89% income in 2010. The fund of active management shares BMMF Absolut Tactics, the investment portfolio structure of which suggests investments into shares of the Russian power companies, showed an 18.75% income.

BMMF Absolut Trust, which investment strategy suggests placement of most funds of the BMMF portfolio into precious metals, such as gold, silver, platinum and palladium, showed highest income.

Investments into precious metals and shares of the gold mining companies provided for more than half of income demonstrated by the fund. The prices for gold, which is a universal inflation hedge, have grown remarkably thanks to growing inflationary expectations, which in turn resulted from the growth of liquidity injected by the central banks worldwide. Silver and platinum also showed strong growth backed by the news about recovery of the global economy and demand of the developing countries, especially China.

Dynamics of income from the funds under management of Absolut Bank



Last year proved to be rather successful for collective investments of Absolut Bank. The value of net assets under its management reached 500 mln. rubles in 2010, which allowed the bank to enter Top-30 largest asset managers of open-end mutual funds (mutual funds and BMMFs) and Top-5 banks, managing BMMF assets. Furthermore, the number of clients, investing into assets of Absolut Bank went up to 800, which may undoubtedly be called a success in the collective investments market (given the general reduction of the collective investments market). In 2010, Absolut Bank was holding the first place in terms of net equity attracted into open-end mutual funds for 6 months.

The collective investments market has gradually been recovering from crisis and the OEMF market growth may arguably continue in 2011, which is witnessed both by the slowdown of money retirement from funds in 2010 compared to 2009 and recovery of the equity and debt markets.

Noteworthy to mention that the key indicators of the Russian stock market recovered after financial turmoil from 2008 to 2009 almost entirely. No wonder the progressive growth of the Russian economy will support the Russian stock indicators. Low deposit interest rates offered by the larg-

est Russian banks will contribute to the growth of investors' interest towards alternative approaches to long-term capital saving and accrual, one of which is the Bank-Managed Mutual Funds.

In 2010, the volume of transactions with precious metals effected by Absolut Bank was stable and high. The bank offered its clients a wide range of commemorative and investment gold and silver coins minted by the Bank of Russia from 2009 to 2010.

The high demand for precious counts resulted from record high growth of prices for silver and gold. In the reporting period, the gold and silver prices went up by 29% and 81%, respectively, which in turn contributed to the increased appeal and income of investments into precious metals, inter alia, by purchasing coins made from them.

The investment coins were in the highest demand. In 2010, Absolut Bank sold a total of 15,500 silver (58%) and 11,200 gold coins (42%). Moreover, the share of gold coins in the structure of sales proceeds amounted to 84%. In the reporting period, the bank sold commemorative and investment coins to the total amount of 140 mln. rubles. In 2010, Absolut Bank sold 26,700 coins with the total mass of about 585 kg.

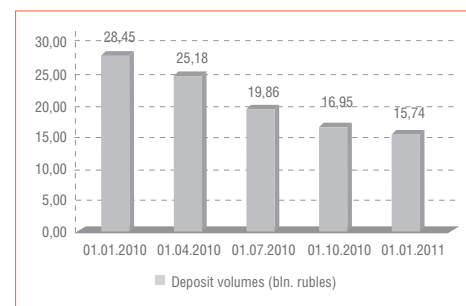
Deposits

During the intensive development of the banking business, Absolut Bank attracted funds from population as a stable funding source. The bank offered appealing and popular deposit products, which is confirmed by the rapid growth of retail deposits from 2006 to 2009 by an average of 88% per year.

However, in 2010, the situation changed dramatically. The funding costs declined and there were a plenty of opportunities for borrowings in the external markets and interbank loan market, therefore, many banks, including Absolut Bank, decided to reduce volumes of household deposit portfolios, as household deposits happened to be one of the most expensive funding sources. Absolut Bank gradually reduced the deposit returns, by replacing the expensive deposits with cheaper one. As a result, the volume of retail deposits in 2010 reduced by 11.8 bln. rubles to 15.74 bln. rubles as of January 1, 2011. This policy allowed the bank to handle excessive liquidity and cut interest

expenses, which had a positive impact on its final financial performance.

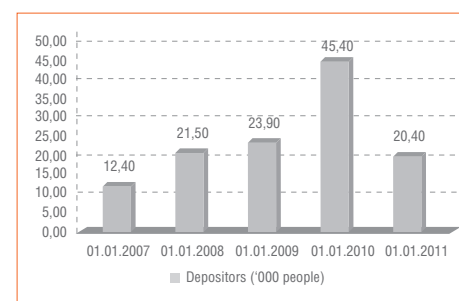
Deposit portfolio volume in 2010



TSuch a reduction in the deposit portfolio volume also arose from decrease in the deposit interest rates. For example, in the early reporting period the maximum income was 12% per annum, while in the later reporting period it slid down to only 7%-7.5% per annum. As a result, depositors

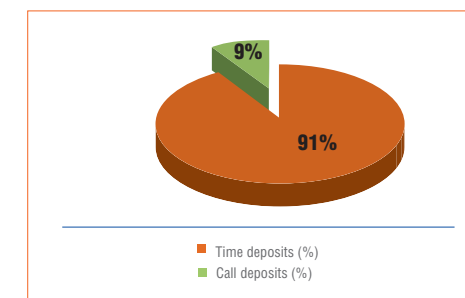
retired. Among other factors conducive to the said reduction, we may also mention total restriction on replenishments applied to the entire line of products offered by Absolut Bank. The maximum deposit outflow fell onto Q2, as it was the time when Sure interest deposits opened from March to April 2009 were closed. The total deposit outflow in 2010 amounted to 12.7 bln. rubles.

In the reporting period, Absolut Bank had three deposits in effect: Profitable, Rentier, Capital. In H1



2010, the bank canceled acceptance of Absolute, Guaranteed, Sure interest and Convenient deposits. They were replaced with the new saving programs, such as Accumulative, Replenishable and with-drawable and Investment deposits.

5-year dynamics of depositors



In future, Absolut Bank intends to focus on expansion of its client base, inter alia, by implementing new saving programs, including most popular additional options.



Plastic Cards

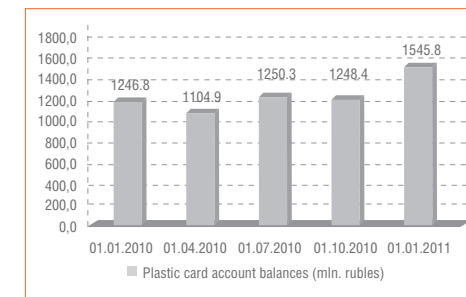
The Russian market of bank cards (in money terms) returned to the pre-crisis level by the amount and volume of transactions effected with plastic cards – over 2 bln. transactions to the amount of about 8 trillion rubles. Sberbank access to the credit card market, acquisition by VTB of the Bank of Moscow and Transcreditbank; energetic promotion of the National payment system; launch of Visa Money Transfer in QIWI payment terminals; mass implementation by the Russian banks of systems for secure payments with Visa 3D Secure and MasterCard SecureCode; commencement of the PayPass implementation in Russia, a joint RZD and Sberbank project are only a few events, which have key importance for the market of plastic cards. The banks are still highly dependent on the payroll projects, as over 80% of the cards in Russia are issued under the payroll projects.

The major event of the year for Absolut Bank was the approval of a new development strategy, which gave a key role to plastic cards in attraction of clients and provision them with banking services. In the reporting period, the bank launched several projects aimed at developing plastic card business, including:

- migration to a new IT card platform (Way4)
- implementation of bundled products of different levels
- switchover to a direct service channel with Visa and MasterCard

This policy resulted into increase of the cards issued by the bank by 35.4% compared to the previous year. In 2010, Absolut Bank issued Visa International (CMEA) international bank cards. The type of issued cards is Visa Electron, Visa Classic, Visa Gold, Visa Platinum.

Plastic card account balances of individual clients in 2010



In 2010, the holders of Absolut Bank cards had an access to a wide range of additional services, including:

- SMS notification
- Internet bank
- The bank provides International SOS program and IAPA and Priority Pass cards, providing a full-fledged system of discounts and additional services in worldwide journeys and a free international insurance to the amount of up to \$50,000 for VISA Gold and Platinum cards.
- Participation in the discount program of the bank
- Participation in Visa Premium discount program

The clients may connect to Absolute On-Line system at any office of Absolut Bank free of charge. Its capabilities allow our clients to make money transfers between cards of Absolut Bank, transfers from a card account to a current account, pay cell bills, utilities, long-distance and international phone calls without visiting the office of the bank 24/7. It also allows them to repay the loans, form and review plastic card account statements and block a card if lost. In 2010, Absolute On-Line system was recognized as

one of the best Russian Internet banking services.

In 2009, Absolut Bank decided to join the United Settlement System. It allowed it to fundamentally increase the network of automatic teller machines with minimum costs, with which clients of Absolut Bank may use on the same terms Absolut Bank offers at its own ATMs. In 2010, we became convinced that our decision was right and efficient. As of January 1, 2009, there were a total of 170 Absolut Bank automatic teller machines, but now the USS network has over 10,000 automatic teller machines with minimum costs on such a considerable expansion. The holders of Absolut Bank plastic cards had

access to a wide range of banking transactions via ATMs, including:

- Cash withdrawals from the bank cards
- Account deposits via cash-in ATMs
- Payment for services of cell carriers/ISPs, etc.

In future, the bank plans to considerably expand the functionality of the bank's ATM network, which will include money transfers from one card to another, current account deposits, expanded list of service providers, etc.

Payroll Projects

By expanding the client base and offering its corporate clients a full range of banking programs, Absolut Bank kept on developing the payroll projects in 2010. In 2010, the bank issued over 40,000 payroll bank cards.

In 2010, the bank developed only debit payroll projects. Upon subscription to a payroll project, a company is connected to the Internet bank and all information is transferred in a digital form via secure communications channels. The cards are issued on the basis of the provided register. The

cardholders could withdraw cash from ATMs of the bank and USS network without any fees.

In H2 2010, the bank started developing a new product – a payroll project, under which the issued cards might have an overdraft limit for payroll cards. The said options will be available to card users in 2011.

Under the payroll projects, the bank issues Visa Electron, Visa Classic, Visa Gold cards. Visa Electron cards are issued free. Absolut Bank also issues a certain amount of free Visa Gold cards for business executives, members of payroll projects.

Small and Medium Business Lending

In 2010, effects of the crisis factors weakened, which gave some strength to the recovery trend and further growth of the national economy. People's consumption increased. Companies ramped up production of commodities. As a result, the revenues grew up and there was an opportunity to perform long-term planning for the financial and investment activities of organizations. The strengthening of the financial standing and increase in SMB solvency led to growing demand for borrowed funds for business development. Noteworthy to say that in 2010 the lending resources became cheaper and more affordable. Thus, loan products offered by the banks also underwent certain changes.

There was a drastic reduction in rates for almost all loan programs in 2010, which brought down the lending rates below the pre-crisis level. The banks softened up requirements for the risk level and extended lending terms. Consequently, the products became more appealing to clients. The loan product lines of the banks had such products with long lending terms, as commercial mortgage.

Absolut Bank formed a special department dedicated to small and medium business service. Despite the fact that the bank does not plan to considerably increase the share of this client business area in the asset structure, it is still one of the most important development sector, including increase in the client base both for the retail banking and corporate banking in the long term.

Our objective is to be a prominent player in this market. We highly appreciate its perspectives, as small business will become a good corporate client in future and Absolut Bank considers it essential to support these development trends and business growth.

The year 2010 heralded determination of SMB interaction methods. We were aimed at improving client quality. The bank developed an updated product line, meeting the needs of small businesses and a new risk policy of Absolut Bank.

In 2010, Absolut Bank offered a wide range of banking services and products for SMB:

- loans for working capital finance – Development program;
- loans for investment purposes – Investment program;
- no-purpose loans under Microcredit program – available unsecured loans;
- Overdraft loan program to reduce payment gaps in the financial and economic activities;
- cash management services;
- payroll projects;
- acquiring;

■ COLA.

Development and Investment loan programs were in the highest demand. Under the Development program, a loan is extended for company's working capital finance (purchase of commodities, raw materials, expendables, etc.). The target accounts are companies and sole proprietorships.

The primary line of business is wholesale and retail trade (food products, consumer goods), manufacturing ventures. A loan is extended to the amount of from 1 mln. rubles to 15 mln. rubles for up to 24 months.

Under the Investment loan program, funds are granted for investments into immovable property, vehicles, equipment, construction. The loan program distinction is a long term of up to 5 years. The loan amount is from 1 mln. rubles to 30 mln. rubles.

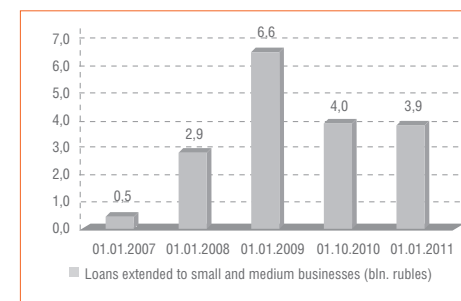
In 2010, Absolut Bank improved SMB lending terms. Thus, the bank lifted "suspension" for extension of loans to clients, which lease out immovable property, reduced a client's equity share in the project finance from 30% to 15% as part of the Investment loan product, revised conditions of the

Overdraft loan product, by having made it more affordable and appealing. In the meantime, the bank arranged favorable events for SMB clients on many occasions, which provided for reduced interest rates and longer lending terms.

In 2010, the bank reduced interest rates for the key SMB loan products on a quarterly basis. The total reduction has made up from 2 to 7 percentage points contingent upon the product since the turn of the year.

Following the results of the reporting period, the volume of loans extended under the SMB lending program amounted to 2.73 bln. rubles. As of the end of the year 2010, the loan portfolio hit 3,934,430,000 rubles. The loan portfolio grew up by 1.8%. In 2010, the midterm lending from 2 to 5 years was in the highest demand, the share of such loans in a portfolio amounted to 74%.

SMB lending dynamics in the last 5 years



The small business lending perspectives are shaped by the dynamics of its growth. In the next year, the bank plans to keep on improving SMB lending terms, including, inter alia, new loan programs, CMS and payroll projects.



Customer Relationship Management

Absolut Bank started its service quality project as far back as 2007. For a few years, the bank has developed and implemented different service standards and service evaluation methods, staff training and incentive programs and used different control systems.

At the turn of the year, the bank drastically revised and toughened up service quality standards. All the amendments to standards were based on the feedback from our clients, executives and employees of our offices. These amendments affected the incentive programs as well since it expanded the list of persons in charge of service quality.

An important part of the client loyalty management is the service quality evaluation and control. Service quality control system underwent some changes in 2010. Apart from the Mystery shopper, which is in continuous use, the bank employed telephone inquiries of clients about service quality at the bank's offices, car and mortgage loan extension quality. Clients' opinions were thoroughly

analyzed. Based on these findings, the bank took required steps to improve banking products, services and business processes.

Absolut Bank began to pay more attention to the staff training programs. The clients noticed greater interest, politeness, professionalism and competence of Absolut Bank employees compared to the previous year.

In 2010, the bank revised the structure of claims activities. The offices became more involved in handling claims from clients. They were given certain authority to resolve disputes with clients, which allowed the bank to expedite claims processing and quality of resolution of disputes with clients.

According to estimates of PricewaterhouseCoopers and Senteo, in 2010, Absolut Bank joined the Top-3 most client-oriented banks. The rating encompassed over 90 retail banks chosen by the size and market share. This client-oriented approach to client service will remain a priority area in the strategy of Absolut Bank in future.



Private Banking

In 2010, the bank approved the new regulation on private banking, based on which the bank resegmented VIP clients throughout the year. It gave the bank additional opportunities to shape further private banking strategy. Thus, the bank had the opportunity to expand the client base by transferring the current clients from retail to private banking and attracting new clients.

During the segmentation, the bank analyzed the key target client group of the well-off, which was split up into certain subgroups, including financial preferences and stereotypes of potential clients. Findings of this analytical research showed that VIP clients were interested in premium service and investment opportunities, which the bank offered as part of private banking. The clients became more demanding towards the quality of the banking service and in the meantime more careful in respect of their financial savings.

Based on conclusions and market trends, the bank focused on the comprehensive offer of investment products. The bank approved the strategy for

deposit attraction and retention through formation of an investment portfolio for clients, consisting of BMMF for diversification and optimization of income. Following the 2010 results, the net asset value under BMMF management exceeded 500 mln. rubles, 90% of which is investments of VIP clients.

PB account managers are ready to make up a personal investment portfolio for every client by defining a portfolio, which includes deposits, investment funds and coins.

The above led to the growth of the PB client base and increase in financial performance indices across all the principal areas. Thus, the number of affluent clients attracted by Absolut Bank in 2010 grew up by 22%. The volume of deposits increased by 60% during this period of time. Investments into the bank's BMMF amounted to 445,000 rubles.

Although the first and foremost rule of the private banking at Absolut Bank is always intact: tailored approach based on understanding and meeting investment needs and high service quality. These will be our priority for 2011.



Operating Efficiency

Deputy Chairman of the Management Board of Absolut Bank Alexander Chuhlantsev:

“Operating efficiency is one of the key strategic objectives of Absolut Bank. In order to achieve the objectives of our bank, we have to improve efficiency in our internal operations. Today, the Russian banking market does not let banks sit back. The post-crisis situation is not an easy one, as the sector is about to witness consolidation, which most efficient banks will survive only.

Therefore, in the reporting period we did our best to analyze efficiency of our operations and implementation of projects on efficiency improvement. In 2010, we, among other things, achieved several tactical objectives and laid the foundation for further efforts in this field. Our major objective

outlined by the strategy is the launch of new products. We have defined their selection and already started implementation. Thus, we are developing bundled offers and migration to the OpenWay card platform. It was partially implemented. But for the time being, it allows us to work with ATMs and payment systems only. We should transfer all plastic card transactions to OpenWay. Another priority of ours is to cooperate with the Lending factory in implementation of a new module, which will enable us to optimize credit decision-making. We have very fascinating projects in the information layer sphere. These projects are vital for the bank, as they allow us to gain management information for decision-making.

The bank has been stepping up efforts in reduction of its operating risks since 2009. We almost finished closing recommendations on network security and IT security policy implementation in the bank.

IT Development

Absolut Bank uses IT technologies as a strategic tool to achieve competitive advantages, improve quality and promptness of client service.

The hi-tech solutions employed by the banks are designed for processing of large-scale banking operations and performance of transactions. The IT technologies are also used to enhance and create new banking products.

In 2010, unlike many other market players, Absolut Bank decided to go on with its IT projects and started implementing new technologies to support reorganization of the risk management model, switched over to the innovative concept of information layers, finished optimization of its investment and trade department, which has considerably enhanced its performance efficiency. Absolut Bank became the 3rd lending agency in Russia, which implemented the state-of-the-art MUREX system, enabling the bank to drastically improve performance efficiency.

As part of the uniform platform, MUREX covers investment management processes for the front, middle and back offices. The system provides a wide range of tools both for simple transactions,

such as cash operations, and for more complex transactions, such as derivatives for all classes of assets. The use of MUREX allows the bank to get focused on the major objectives and tasks, while reducing operating risks and expenses.

In 2010, IT development policies of Absolut Bank were aimed at effective use of best hi-tech solutions from market leaders. Our priority was automation of the lending operations and whatever has to do with retail client services: mortgages, auto loans and plastic cards. Besides, during the reporting period, the bank accomplished tasks to implement new business products, improve efficiency in operations of the bank's subdivisions, perform recommendations of the internal audit and standards upheld by the KBC Group.

The 2011 plans of Absolut Bank include implementation of the strategy elements: automation of business processes, launch of new products, improvement of the Bank-client system. Special attention will be paid to the security, reduction of risks, compliance with the regulators' requirements, which will eventually increase the competitive advantages of Absolut Bank in the market."

In the reporting period, Absolut Bank made the following amendments to the information and techno-

logical policy. The bank closed down the dedicated development center Luxoft (refusal to outsource its own development). The bank capitalized salaries and uniform social tax of employees from the Software Development Division of the IT Department. It also split up ITD resources into pools, which allowed the bank to make their distribution transparent. Maintenance ICT was implemented in all ITD pools. The bank put the catalogue of infrastructure services into operation.

The following processes were also implemented:

- ICT Request For Change Management-Unspecified Requirement Management
- ICT Request For Change Management-Specified Requirement Management
- ICT Release Management
- ICT Account and Service-Level Management
- ICT Problem Management
- ICT Risk Management
- ICT Sourcing and Procurement

- ICT Project Management
- ICT Documentation

It also completed a pilot project for implementation of an overdue debt handling module. The bank passed acquiring certification of the chip plastic cards. Absolut Bank carried out the ABS load testing, which showed that system performance meets the requirements of the business strategy. It also established a connection to the online real-time payment system and implemented the centralized data backup system. The regional offices of the bank installed firewalls.

During the reporting period, the bank accomplished tasks to implement new business products, improve efficiency in operations of the bank's subdivisions, perform recommendations of the internal audit and standards upheld by the KBC Group.

In 2011, the bank plans to develop and offer new products for business (packages of invoices, new functionality of the Internet bank system for individual clients, implementation of the credit finding approval system) and take further steps to reduce the risk level in IT and implement group standards of the KBC Group.



Efficient Risk Management

Risk Management Director of Absolut Bank Renaat Kelens:

“Balanced risk policy is one of the key priorities of Absolut Bank. In 2010, the bank revised its approaches to risk assessment entirely and built a risk-oriented business model. It is obvious that the risk management system is vital for the bank. When there are a handful of positive trends in the economy and a stronger competition for a client, while the client “quality” does not become any better, one of the most important questions is how to assess the risk properly and set the appropriate price for a product offered by the bank. Absolut Bank adopted a western business model. The risk management system, which we have started building since October 2008, consists of three levels.

Frankly speaking, our concept of risk management arrangements is that business should above all

be risk-oriented. Besides, we formed a global risk management subdivision, which is responsible for policies and limits and makes sure they are implemented properly. It also handles market risks, credit risks at the portfolio level and operating risks, i.e. sets standards and rules, which all other subdivisions should follow.

There is another subdivision (Credit product factory (CPF) between businesses and risks. Regardless of the business, CPF takes part in transaction decision-making, i.e. puts policies to practice

It is much simpler to structure business and incur minimum costs on it within such a system. Executive decision-making is simplified. If we know how to streamline the level of ambitions according to the degree of risks, which is possible thanks to the proper system tuning, we have the opportunity to develop our business in a most efficient way. I am sure that our bank will become more competitive upon implementation of all the new technologies.”

Credit Risk

In 2010, the risk policy of Absolut Bank underwent virtually no changes. The bank kept on reducing concentration of its loan portfolio in areas, which suffered from the financial crisis most of all. In the meantime, the bank expanded the loan portfolio both in the new segments (business owners, auto loans for used cars) and in some old segments, which felt no negative impact of the crisis. The bank still places emphasis on the mortgage finance, as it allows for an optimum combination of the credit risk, loan return and quality.

Absolut Bank pays much attention to the quality of the loan portfolio. The principal elements of the control system are tried and tested procedures, qualified staff, appropriate information system. The bank takes steps to avoid unreasonably high concentration of credit risks per a borrower.

The crisis taught us an important lesson: increase in business volumes may not be achieved by the reduction of loan quality. Today, the bank has an active and preferential stance towards risk acceptance.

High quality collateral for extended loans is ensured by means of the following:

- comprehensive analysis of all risk factors pertaining to extension of loans to the borrowers;
- commitment to a certain group of borrowers;
- the bank is first of all committed to the clients

with a stable income from their day-to-day operations sufficient to service their liabilities.

The control over the share of overdue payments starts upon consideration of the borrower's loan application, when the bank defines if the borrower risk level is acceptable for it, their mid- and long-term business solvency and quality of the credit history. In order to identify the client's troubles at an early stage, the bank adopted and tuned up the borrower's business solvency and financial standing monitoring system. For mass segments (retail banking, SMB), the bank implemented a specialized automated system for overdue debt handling. Should the clients' troubles be regular, the bank has special procedures, which allow it to reduce the financial load on the client (restructuring) or repay the amount outstanding by selling the pledged property. Otherwise, the bank recovers debts in a judicial proceeding pursuant to the laws of the Russian Federation.

The restructuring program is committed to help honest borrowers, suffering from temporary hardships, by repairing their business solvency through reduction of a monthly installment or deferral for payment of the principal amount of a debt. By virtue of this program and prompt reaction to the client's statements on their deteriorated financial standing, the bank maintained the loan portfolio quality in 2010, having created "a basis" for further reduction of distressed assets and general growth of the loan portfolio.

The level of retail overdue debts of Absolut Bank is

3.9%, which is much lower than the average market index of 6.9% and considered to be one of the best indices in Russia.

Corporate overdue debts amount to 28.7%. A relatively high level of this index is due to the fact that the bank took steps to reduce the loan portfolio volume. In absolute figures, the overdue debt portfolio of Absolut Bank was reduced on a going basis in 2010.

Absolut Bank applies different tools and instruments to credit risk management:

Limitation suggests restrictions for the credit risk extent (product, risk level per borrower, etc.) and their further control. The limit size reflects the readiness of the bank to accept certain risk, without exceeding the needs of a business subdivision.

Diversification is a risk control method based on selection of assets, proceeds from which are poorly correlated among one another. For example, the bank forms its loan portfolio by means of loans to different categories of borrowers: individuals, corporate clients, small and medium businesses.

Monitoring as a risk management tool suggests calculation of the risk extent, study of its dynamics through time and analysis of reasons for changes on a continuous basis. The bank monitors borrowers (financial standing, payment discipline, pledged property insurance), products (default levels, returns, reserve and fund adequacy) and general macroeconomic situation on a timely basis.

Collateral or pledge – in its credit policy, the bank adheres to mandatory security for loans, thanks to which the collection of bad loans and loan portfolio quality is at an acceptable level.

Provisioning – the bank forms funds equal to expected portfolio losses in future on a continuous basis.

The bank may predict its losses in advance largely thanks to provisioning, which allows it to properly assess the loan portfolio quality and provide for future losses at the expense of the current revenues.

Scenario analysis or modeling is used in prediction of possible development trends of the current situation. During the scenario analysis the bank develops ways to address adverse changes in external conditions. Worst-case scenarios are analyzed by stress tests, which are performed on a continuous basis in order to identify weaknesses of the bank and action plans for emergencies.

Credit risk management principles are based on the requirements of the Bank of Russia, guiding principles of the KBC Group and respective universally recognized international standards.

The bank plans to develop its own risk management methods as part of the best business practices and Basel II requirements, such as: implementation of the system for monitoring of early risk warning signals, improvement of stress test methods, implementation of pricing system subject to the client's risk level, etc.



Market Risk

Market risk includes currency risk (a risk of losses, arising from changes in the exchange rates) and interest risk (a risk of losses, arising from changes in the interest rates).

The key elements of the bank's market risk management system are as follows:

- division of the bank's assets and liabilities into trading and bank books,
- analysis of the bank's balance sheet sensitivity to market fluctuations,
- interest risk management by setting targets for the asset and liability structure in terms of volumes, maturity, returns/costs,
- a special procedure to set limits for the trading and bank books, restricting acceptance by the bank of market risks (limits for foreign exchange exposures, stop-loss limits for conversion transactions, limits for sensitivity to the interest rate and limits for marketable securities transactions),
- daily limit monitoring system.

Liquidity Risk

Liquidity risk may be a potential threat to bank's capabilities to generate a cash flow and keep costs reasonable.

On a continuous basis, Absolut Bank performs stress tests of liquidity in order to make a quantitative determination and analyze risk level with respect to probable origin of liquidity risk in future and to confirm that the current level of risk meets the level acceptable for the bank. If not so, liquidity stress tests make up a basis for remedial steps or actions to reduce the risk in the bank, strengthen the liquidity buffer and adjust the bank profile in terms of liquidity so that it meets the acceptable level from the viewpoint of risks. It should ensure that the bank may fulfill its payment obligations in the crisis situations, during the "survival", without resorting to measures, which may harm the franchise. In fact, the bank's management receives additional time to decide what extra measures should be taken to secure the bank's liquidity in the longer term pursuant to its emergency funding/finance plan. Consequently, the bank stress test findings also play a key role in development of emergency plans and determination of a bank's strategy and tactics during the bank's liquidity crisis.

Stress tests shape further actions of the bank in emergency finance. This step is a part of the liquidity crisis management. It sets procedures for replenishment of cash shortage in emergencies and distributes the respective tasks and obligations. Guaranteed fast decision-making, fast access of decision-makers to operating and detailed information on liquidity and opportunities to quickly perform a diversified set of efficient emergency finance measures help the bank gain time and consider a range of possible steps to

protect the bank's liquid position.

The emergency funding/finance plan is developed on the basis of passed liquidity stress tests. It reflects the bank's crisis strategy, sets procedures to eliminate liquidity gaps during the crisis, determines the respective decision-makers and distributes their objectives in crisis. This plan ensures prompt decision-making and timely access of decision-makers to detailed information on liquidity. Besides, different viable measures to

handle unexpected liquidity issues may be taken swiftly, while the bank will have more time to consider ways to strengthen liquidity.

Liquidity stress tests and emergency funding/finance plan are an integral part of the Sound Liquidity Management Practices passed by the Basel Committee on Banking Supervision in 2000 and described in more detail in the 2009 revision of the said paper, which is called Principles for Sound Liquidity Risk Management and Supervi-

sion. Importance of the liquidity stress tests is also outlined in the Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring (2010).

Liquidity stress tests and development of emergency funding/finance plans are recognized by the best industry practices along with other measures incorporated into the Principles of Liquidity Risk Management (2007) of the Institute of International Finance.

Operating Risk

Operating risk is a risk of losses, arising from poorly developed or inaccurate internal processes, actions of employees and systems or external events. Operating risk also includes fraud risk, legal, regulatory and tax risks, as well as risks, arising from incompliance with the set procedures. Absolut Bank and its subsidiaries achieved considerable success in implementation of the operating risk management system, which is maintained by the competent guidance in the operating risk management. The principal rule for operating risk management is that the ultimate responsibility for operating risk management shall be imposed on the line management, which is supported by the local risk managers (LORMs). Operating risk committee ensures control and management (ORC). ORC takes specific steps to reduce the risks either directly or through line management.

ORC monitors practical implementation of internal documents on operating risk management in the bank and takes specific steps to reduce such a risk either directly or through line executives.

LORMs are trained professionals, who perform business functions and bear no responsibility for business results.

Operating Risk Division (ORD) of the Risk Management Department ensures independent control and assists business subdivisions in implementation of new procedures/policies by providing training and consultations to LORMs. ORD is also responsible for supervision over practical implementation by line executives of the respective documents on operating risk management in the bank. Besides, ORD bears responsibility for supervision over operating risk management quality, analysis of the key risk figures and preparation of accounts for ORC.

The management system consists of several standard operating risk management blocks, which are gradually implemented. These standard blocks are described in the Operating Risk Management Policy, which also includes methods employed to determine the capital for the operating risk and methods applied to form IFRS and RAS provisions.

These blocks include:

- Losses database: all operating losses exceeding 1,000 have been registered in the central database ("LER") since 2009 pursuant to the Regulation on Collection of Data on Losses from Occurred Operating Risks approved by ORC. The data on losses is tabled to ORC twice a year. This database also records legal claims against the bank.
- Standards of best operating risk management practices: we singled out about 40 such standards, which are meant to ensure operating risk management in the bank up to the mark and on a continuous basis. For example, some of these standards describe the operating risk management in the following spheres: rights of access to information systems, double control, accounting control, claim administration, etc. The bank did its best to translate standards into dedicated procedures and processes. The respective processes in the bank are subject to examination for compliance with this or that standard within a 3-year period. ORC monitors proper implementation of standards in the bank. However, ORC may authorize certain deviations from the standard given a strict procedure for approval of such deviations is observed. ORD and Internal Control Service of the bank supervise compliance with the said standards. The audit findings are kept in a special database ("Are").
- Key risk indicators (KRI): ORC of the bank approved the Policy of Key Risk Indicators and started the project on KRI implementation in the bank. KRI implementation purpose is to monitor the level of specific operating risks. The data is collected according to a certain set of KRIs. LORMs and ORD play a leading role in KRI determination.
- Business continuity management: this project is developed in the bank in order to ensure business continuity and elaborate the plan for catastrophic events as long as one week. The purpose of this plan is to prevent considerable losses for the bank once the catastrophic scenario takes place.



Other Nonfinancial Risks

Regulatory risk comes from losses of returns, capital decrease and threat to bank's reputation, resulting from a failure to comply with a growing number of regulatory requirements and expectations. The bank developed the Procedures for Regulatory Risk Management, which should ensure compliance with the new requirements of the regulator. These procedures will be implemented in the bank in 2011. The Risk Committee expects a report on this matter in Q1 2011.

Reputational risk is a risk that arises from negative perception of the bank by some of its counterparties, partners, shareholders, creditors, market analysts and other third persons or regulatory authorities, which may have an adverse impact on the bank's capabilities to maintain or build new business relations and keep an access to finance sources (for example, in the interbank lending market or by way of securitization). Reputational risk is secondary/derivative, as it is always related to/realized in consort with another type of risk.

Proactive position or bank's post-reaction to

certain events and information falls within the competence of business subdivisions in consort with the Communications Department. The reputational risk management system in the bank and its subsidiaries will be developed in future.

Business risk is a potential risk of negative deviations from expected economic gain for the bank, arising from changes in the macroeconomic situation, banking sector and/or banking service markets and insufficiency of business resources, affecting the bank's business potential.

Business risk factors, which should be taken into account, include macroeconomic conditions, amendments to the legislation, actions of competitors, changes in the bank's product and service distribution/offer model, changes in the clients' needs, staff and IT system management. The bank's business subdivisions in consort with the Strategic and Organizational Departments account for the potential business risks in the respective development scenarios.

Besides, business risk, operating and reputational risks are annually considered during the risk study/procedures for risk scenario analysis.



Conclusion

Another year of our history has passed.

This year was a hard one. A plenty of different events took place both in the national economy and banking sector. We did a lot to enhance efficiency, improve business solutions and strengthen our market positions. We move on with the implementation of our new strategy but keep our key competitive edge, which is a quality service for the clients. We have been absorbing and adapting the KBC Group experience to the Russian reality for the last three years. We changed but adhered to our major principles, such as: client-oriented approach, attention to employees and partners, efficiency and strive for development.

We are sure that our experience and openness to

new ideas will contribute to our further growth. Today, our team has over 3,500 people. We are all very different. Someone joined the bank the other day; someone was loyal to the bank since the time of its foundation. But everyone knows what the bank is aspiring to and what each of us should do to achieve these objectives. We meet on a timely basis at official events where we discuss the strategy and our actions to implement it and at informal events where we just with each other.

We have time both for efficient work and holidays, issue of our own publication and social projects. We take an active part in the life of all regions of our presence, by making a contribution to their development. For us, Absolut Bank is place where we make our career plans come true and develop a basis for personal growth. We learn from each other and together we head towards new heights.

**Yours faithfully,
Team of Absolut Bank**