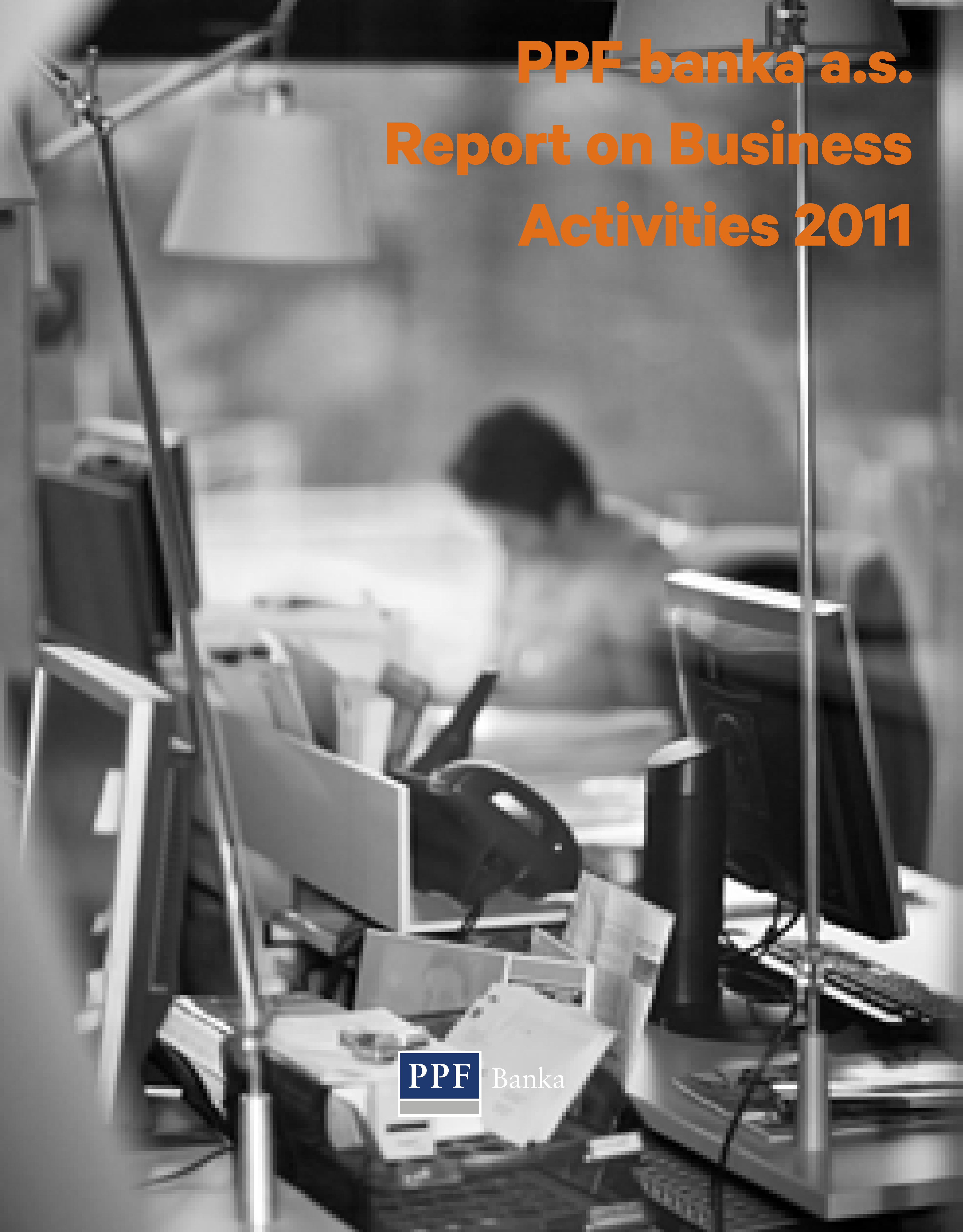
PPF banka a.s.
Report on Business Activities 2011



PPF Banka

PPF banka a.s.

PPF banka a.s. ("PPF banka" or the "Bank") is an integral part of the PPF financial group. The Bank focuses, in particular, on providing financial, investment, and consulting services to selected customers who, in the course of their business activities, require an individually tailored approach in addressing their needs, while maintaining maximum effectiveness of the Bank's services.

In terms of its strategy, PPF banka specializes in providing investment services, operating in the financial markets, and corporate banking. Since 2010, PPF banka has been successfully developing an export financing business with support from EGAP. In the investment banking field, the Bank provides services in most markets of Europe, the USA, Russia, and certain Asian countries. PPF banka's principal customer segments are financial institutions, medium and large industrial enterprises, and municipal entities. Since 2011, the Bank has been providing private banking services, including a new Concierge service, to individuals. PPF banka also acts as PPF's central treasury bank. For other PPF Group companies, the Bank both conducts international payment transactions and provides hedging and other investment services, such as arranging for financing in the capital markets.

Over the past few years, PPF banka has built up a reputation, both in the financial world and amongst its customers, for being a solid, trustworthy partner. This renown, combined with our strategic role in PPF Group, enables the Bank to achieve above-average financial performance.

Report on Business Activities 2011

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Letter from the Chairman

Dear shareholders, customers, business partners and colleagues,

The economic upturn we were hoping for turned out to be very fragile, and 2011 showed that the degree of economic recovery within the European Union varies considerably from country to country. Negative developments in the financial situation of Greece in particular, and uncertainty in the run-up to the presidential elections in Russia once again brought great volatility to the financial markets. Even though 2011 was no easy year for us, the management and employees of PPF banka, we did complete most of our tasks. And that is something for which I would like to thank everyone who played a role in achieving the results presented in this report.

2011 put to the test our ability to manage growth. I am pleased to report that, thanks to the pro-active approach of all our employees, the experience of our management, and the trust of our customers, the Bank managed to continue to grow its total assets, number of customers, and transaction volume. According to the audited results, we reached a year-end consolidated total assets figure of CZK 67 billion, up 24% year-on-year with a net income of over CZK 600 million. Return on average equity (ROAE) neared 17%, return on average assets (ROAA) was 1.00% and management succeeded in keeping the efficiency indicator, CIR (operating expenses / net return) under 55%.

Two newly opened business lines – export & structured finance and private banking for corporate customers – successfully ended their first year of business at the Bank and reaffirmed management's strategy in this area. We were also very pleased with the performance of the municipal and public banking team, which managed to grow capital and expand the customer base in the regional authorities, regional councils, and statutory cities segments. Like in previous years, once again in 2011 PPF banka continued to play a key role in PPF Group, providing support primarily for companies in Home Credit Group, Generali PPF Holding, and Energy and Industrial Holding as well.

The Bank's total assets figure, which grew nearly CZK 13 billion compared to 2010, i.e. to CZK 67 billion, firmly established us among the medium-sized banks segment. In 2011 we expanded in corporate lending as well as in export & structured finance, chalking up a 11% year-on-year increase in loan portfolio volume. The previous conservative strategy of making allowances enabled the Bank in 2011 to reverse CZK 12 million more corporate loan allowances than it made. Risk costs of corporate loans in 2011 were practically zero. The proportion of classified debts (according to Czech National Bank criteria) in total receivables from customers fell substantially year-on-year, to 13.55% in 2011 from 17.17% at 31 December 2010.

Considering the course of 2011, both economic and political, the results achieved by the Bank are very good and confirm that the strategy of diversifying the Bank's business is the right one. The Bank's further long-term growth is enabled by fact that the shareholders reinvested their returns in the business. During 2012, we expect to see the acquisition activities we undertook in 2011 bear fruit, and we will continue to develop more projects – in private banking for individuals, for example.

Of great value to the Bank is the fact that it continues to grow even in a time of economic crisis – with very good financial performance, a healthy balance sheet, and robust capitalization. Although the Bank has definitely not chosen an easy strategy we, the Bank's management, are confident that – thanks to the dedication and professionalism of the Bank's employees, support from the shareholders, and the trust of our customers – the strategy will be successful and our innovative approach, as well as our ability to address complex situations and find advantageous solutions, will bring the Bank positive results once again this year. I thank everyone who participated in the Bank's operations in 2011.

Prague, 4 April 2012

Petr Milev
Chairman of the Board of Directors

Petr Milev

Chairman of the Board of Directors and Chief Executive Officer

Josef Zeman

Vice Chairman of the Board of Directors and Managing Director, Risk Management

Jaroslava Studenovská

Member of the Board of Directors (since 16 April 2012) and Managing Director, Operations

Consolidated Financial Highlights

According to International Financial Reporting Standards

Assets

CZK thousands (TCZK)	2011	2010	2009	2008	2007
Financial Assets	17,199,237	10,640,365	8,028,784	9,219,837	4,136,188
Loans and advances to banks	26,936,406	22,342,506	20,854,949	20,177,544	15,206,648
Loans and advances to customers	22,370,500	20,175,278	14,993,928	8,838,464	7,562,825
Other assets	557,620	1,007,742	932,190	6,474,236	511,187
Total assets	**67,063,763**	**54,165,892**	**44,809,851**	**44,710,081**	**27,416,848**

Liabilities and Shareholders' Equity

TCZK	2011	2010	2009	2008	2007
Deposits from banks	1,159,835	1,898,257	67,335	383,585	563,286
Deposits from customers	45,596,835	35,997,964	29,343,753	34,947,996	20,897,707
Debt securities issued	2,841,846	3,203,552	4,258,718	3,463,315	2,074,167
Trading liabilities	8,804,731	3,970,780	4,380,344	2,381,348	1,227,303
Subordinated liabilities	0	0	0	0	0
Total shareholders' equity	4,693,699	4,172,664	3,513,506	2,673,827	2,170,673
Other liabilities	3,966,817	4,922,675	3,246,195	860,010	483,712
Total liabilities and shareholders' equity	**67,063,763**	**54,165,892**	**44,809,851**	**44,710,081**	**27,416,848**

Profit and Loss Statement

TCZK	2011	2010	2009	2008	2007
Net interest income	2,391,052	2,039,135	1,658,120	1,156,212	883,597
Dividend income	12,019	96	408	24,428	23,382
Net fee and commission income	814,471	580,700	157,730	(113,795)	9,319
Net trading income	(237,846)	141,016	531,342	138,798	191,385
Other operating income	10,106	24,028	46,593	26,770	27,004
Operating income	2,989,802	2,784,976	2,394,193	1,232,413	1,134,687
Operating Expenses	(2,228,907)	(1,978,429)	(1,357,866)	(662,070)	(443,153)
Net gain/(loss) from associate	0	0	0	0	0
Income from associates	0	0	0	0	0
Profit before income tax	760,895	806,546	1,036,327	570,343	691,534
Income tax expense	(152,526)	(144,009)	(224,946)	(28,019)	(163,688)
Net profit for the year	**608,370**	**662,537**	**811,381**	**542,324**	**527,846**

Basic Ratio Analysis

%	2011	2010	2009	2008	2007
ROE	16.69	20.31	25.73	22.39	27.77
ROA	1.01	1.26	1.72	1.50	2.03
Operating expenses/operating income	74.55	71.04	56.71	53.72	39.06
Non-interest operating income/operating income	20.03	26.78	30.74	6.18	22.13


Petr Jirásko
Managing Director, Financial Markets

František Vencl
Chief Financial Officer

Břetislav Tichánek

Managing Director, Export & Structured Finance

Corporate Profile

General Information

Name	PPF banka a.s.
Legal form	joint stock company
Seat	Evropská 2690/17, Prague 6, Post Code 160 41, Czech Republic
ID No.	47116129
Registry court	Municipal Court in Prague, part B, insert 1834
Date of incorporation	31 December 1992

Registered capital	TCZK 769,004
Shareholders' equity	TCZK 4,170,324
Total assets	TCZK 52,360,785
Shares	unlisted, registered ordinary, recorded in the Central Securities Depository Prague

Note: figures as at 31 December 2011

Principal Businesses

PPF banka's principal businesses encompass all types of banking transactions, provision of banking and financial services together with related services, both within the Czech Republic and in relation to other countries. The Bank's offering is targeted, in particular, at Czech clients in the municipal and corporate segments. The Bank specializes in financial and capital markets trading, in the scope stipulated by applicable law and on the basis of the licenses granted by the Czech National Bank.

PPF banka Is a Member of:

— Czech Banking Association,
— Czech Institute of Internal Auditors,
— Union of Banks and Insurance Companies,
— Prague Economic Chamber,
— Prague Stock Exchange,
— Chamber for Economic Relations with CIS.

Shareholder Structure

PPF Group N.V.	92.96%
City of Prague	6.73%
Others	0.31%

Jiří Kaňák

Managing Director, Public Sector (since 1 April 2012)

Governing Bodies as at 31 December 2011

Board of Directors

Petr Milev
Chairman of the Board of Directors of PPF banka,
Chief Executive Officer

Josef Zeman
Vice Chairman of the Board of Directors of PPF banka,
Managing Director, Risk Management

Pavel Langr*
Member of the Board of Directors of PPF banka,
Managing Director, ICT

* Pavel Langr ceased being an employee of the Bank as of 30 April 2012.

Jaroslava Studenovská
Member of the Board of Directors of PPF banka since 16 April 2012,
Managing Director, Operations

Supervisory Board

Jiří Šmejc
Chairman of the Supervisory Board of PPF banka

Antonín Weinert
Vice Chairman of the Supervisory Board of PPF banka

Karel Hanzlík
Member of the Supervisory Board of PPF banka

Bohuslav Samec
Member of the Supervisory Board of PPF banka

Lenka Baramová
Member of the Supervisory Board of PPF banka

Martin Hýbl
Member of the Supervisory Board of PPF banka

Audit Committee

Jiří Šmejc

Valdemar Linek

Bohuslav Samec

Senior Management

Petr Milev
Chief Executive Officer since 1 June 2005

Petr Jirásko
Managing Director, Financial Markets since 30 April 2004

Jan Švoma
Managing Director, Corporate and Municipal Banking from 19 October 2009 to 31 March 2012

Pavel Langr
Managing Director, ICT from 1 October 2002 to 30 April 2012

Jaroslava Studenovská
Managing Director, Operations since 1 May 2007

Josef Zeman
Managing Director, Risk Management since 1 December 2006

František Vencl
Chief Financial Officer since 1 January 2009

Marek Ploc
Managing Director, Private Banking since 1 November 2008

Břetislav Tichánek
Managing Director, Export & Structured Finance since 1 September 2010

Marek Ploc

Managing Director, Private Banking

Report of the Board of Directors

Bank Financial Performance in 2011

Despite difficult conditions in the real economy and capital markets, PPF banka posted solid financial performance results in 2011. The Bank's business performance, measured primarily in terms of net interest income and net fee and commission income, including allowances, was up 22% year-on-year, while the 2011 the earnings result was affected by a one-off capital markets loss. Administrative expenses moved in line with the Bank's development of new businesses, increasing by 16% year-on-year. Overall, PPF banka continues to see growth in both total assets and income, while maintaining a reasonably low degree of risk. Profit before tax according to International Financial Reporting Standards (IFRS) surpassed CZK 760 million. PPF banka's net income in 2011 was down 8% from 2011, exceeding CZK 600 million; i.e., CZK 608.4 million compared to CZK 662.5 million in 2010.

PPF banka's total operating income in 2011 reached CZK 2,989.8 million, up 7% from 2010's figure of CZK 2,785 million. Growth was driven primarily by a CZK 351.9 million year-on-year increase in net interest income and a CZK 233.8 million increase in net fee and commission income, while revenues from financing transactions were down CZK 378.9 million year-on-year, ending in a net loss and having a negative impact on income.

Despite our investments in new businesses such as the Private Banking division (which provides specialized services to small and medium enterprises and private individuals) and the Export & Structured Finance division, administrative expenses grew by 16%, or CZK 105.6 million. All of the growth is attributable to the higher number of employees in these new projects, and associated staff expenses.

PPF banka's total assets grew substantially – by 24% to CZK 67.1 billion in 2011 from CZK 54.2 billion in the previous year. In order to diversify its revenue streams, PPF banka continued to expand its lending in 2011, growing lending volume by 11% to CZK 22.4 billion. The 12% rise in PPF banka's shareholders' equity had a positive effect on the Bank's acquisition activities, as customers appreciated our superior stability in comparison with certain other European banks.

In conjunction with new projects, PPF banka increased expenditures for tangible and intangible fixed assets, and depreciation and amortization increased by over 40% year-on-year. In 2010 and 2011, the conservative strategy in the creation and use of allowances and provisions for debts and guarantees served PPF banka well, and it had a positive impact on the Bank's earnings in both years. The 6% rise in PPF banka's tax liability, from CZK 144.0 million in 2010 to CZK 152.5 million in 2011 despite lower earnings, was caused by reversal of tax-exempt allowances in 2010 and their absence in 2011.

The NPLs ratio for the corporate loan book – i.e., the proportion of classified loans – decreased year-to-year by 3.62% from 17.17% in 2010 to 13.55% in 2011. The volume of classified corporate loans decreased CZK 411 million, to CZK 602 million at year end 2011.

PPF banka continued in its charity-related activities, similar to past years.

PPF banka paid no dividends in 2011; the 2010 earnings were used to strengthen the Bank's shareholders' equity. The return on average equity (ROAE) reached 16.69% at December 31, 2011; the return on average assets (ROAA) was 1.01%; and capital adequacy was 10.85%.

Capital and Capital Adequacy*

TCZK	2011	2010	2009	2008	2007
Capital adequacy	10.85%	11.55%	10.52%	10.74%	13.49%
Tier 1	4,086,350	3,442,653	2,636,082	2,074,944	1,556,627
Tier 2 and Tier 3	0	0	0	0	0
Sum of deductible items	0	0	0	0	0
Total capital	4,086,350	3,442,653	2,636,082	2,074,944	1,556,627
Capital requirements for investment portfolio	2,454,694	1,769,937	1,447,247	1,145,422	643,008
Capital requirements for trading portfolio	371,435	436,327	427,629	278,934	280,090
Capital requirements for operational risks	187,634	179,199	129,504	121,276	0
Risk weighted assets	31,173,247	22,677,646	21,534,979	14,317,773	8,037,603

* According to Czech Accounting Standards and Czech National Bank criteria.

Business Operations in 2011

PPF banka Operations in the Financial Markets

In 2011, PPF banka built on its accomplishments from years past. The portfolio of capital market operations expanded substantially, and the Bank focused even more on improving the quality of existing services, particularly toward customers. In this respect, a major shift was achieved in intermediation of trades in the money and capital markets. PPF banka is a primary dealer in Czech government bonds and treasury bills, a member of the Prague Stock Exchange, and an MTS Czech Republic market maker. It is an active player in the domestic Czech market, in the advanced markets of Europe and the United States of America, and in "emerging markets" as well.

The Financial Markets division posted total securities trading volume of CZK 343.9 billion in the year in question.

In 2011 PPF banka expanded its activity portfolio: in addition to being a primary dealer in Czech government bonds, it also became a primary dealer in Czech State treasury bills.

In the market for domestic government bonds, 2011 saw a further reinforcement of PPF banka's position as it was recognized by the Ministry of Finance of the Czech Republic as the fourth most active primary dealer in Czech government bonds. At the same time, the Bank participated – as a founding member – in a new electronic trading platform for Czech government bonds, entitled MTS Czech Republic. PPF banka ranked as the number two (out of 13) market maker for Czech government bonds on the MTS Czech Republic platform.

Furthermore, the Bank launched a system for listing bonds electronically through the Bloomberg trading system, where PPF banka is now an active provider of both sell-side and buy-side listings, both for Czech Koruna-denominated government bonds and for a number of sovereign Eurobond and corporate bond issues from Eastern Europe.

In terms of bond trading volume on the secondary market, 2011 was the fourth consecutive year in which PPF banka was one of the top three members of the Prague Stock Exchange.

Corporate and Municipal Banking

2011 saw dynamic growth in the Bank's balance sheet. The Municipal and Public Banking segment had a very successful year, swelling the balance sheet with its attractive deposit products, which attracted new customers and approximately CZK 12 billion in capital.

Even more important than the amount of client deposits acquired, however, is the Bank's fundamental geographical focus on the Czech Republic (Bohemia and Moravia), where it gained a number of excellent clients in the regional government segment. The fact that existing customers shared their positive experiences with potential new customers helped grow sales of the Bank's products.

In human resources, we strengthened the team engaging the public sector and this resulted in higher acquisition activity and, in particular, in greater ability to sit down with our customers and work together on joint projects with them. Late in the year, the Bank focused on identifying new market opportunities and partnership project proposals. We anticipate that these initiatives in the public sector will be of fundamental importance in 2012.

In view of the Bank's good position in terms of the liabilities and equity side of its balance sheet, and its strong capitalization (PPF banka never had any loan exposure in Greek government bonds or any other bonds from PIIGS countries), last year it was able to continue expanding its operations in the financing of Czech industry.

Despite the weak economic recovery, PPF banka continues to support the Czech economy by lending to the corporate sector. Compared to the year before last, 2011 saw corporate banking accelerate its growth even more, adding just under CZK 4.5 billion in active on- and off-balance sheet exposure. Business development occurred across all the attractive sectors, with particularly promising developments in financing of energy projects. We continue to succeed in keeping risk at an excellent level, as the minimal growth in allowances demonstrates.

Securities Trading Volume

CZK millions	2011	2010	2009
Domestic bonds	196,066	217,895	281,051
Foreign bonds	89,529	48,456	85,867
Bonds, total	**285,595**	**266,442**	**366,918**
Domestic equities	2,494	14,332	43,484
Foreign equities	55,804	55,049	38,726
Equities, total	**58,298**	**69,382**	**82,210**
Total	**343,893**	**335,824**	**449,128**

Tomáš Hadžega

Managing Director, Corporate Banking (since 1 April 2012)

Export & Structured Finance

Structured finance has become a pillar of PPF banka's business. Our experienced team drove a high rate of growth in both assets and income, and carried out a number of transactions both in the Czech Republic and abroad. The expansion of the Bank's activities in 2010 to include the highly specialized area of export finance was a step in the right direction, as it positioned the Bank to leverage the substantial recovery in foreign trade seen in 2011. Lower concerns over a possible recession brought high demand for services and financing in the area of foreign trade, and export especially. Despite this being its first year in action, PPF banka's export finance team built a good reputation for itself by clinching some big deals in the Czech market and winning the trust of a number of domestic manufacturers, as we help them to do business abroad.

Private Banking for Corporate and Individual Clients

The Private Banking division provides specialized services to both small and medium enterprises (SMEs) and private individuals. 2011 saw further development of our services for SMEs, to whom PPF banka provides a complete range of banking services, from deposits to transactional services and lending. In so doing, we place great emphasis on knowing our clients personally and taking an individualized approach to meeting their needs.

To better serve clients in this segment, PPF banka operates a customer services center in Prague 4, which opened in 2010, and in 2011 we opened another such center in Prague 10. In the future, we plan to expand the network of these centers so as to provide the best possible service to this promising customer segment.

In 2011, PPF banka continued to develop its offering of services and products for wealthy individuals. We successfully placed several non-public issues of investment certificates among these private investors and we will continue in this successful strategy this year as well. Private banking clients appreciate the fact that these transactions are absolutely discreet and, at the same time, they expect a unique and innovative offering of investment instruments.

The service, which the Bank launched in 2011, is an integral part of the Private Banking line-up. This highly sought-after service helps clients to address their non-financial needs and plays a substantial role in improving their quality of life.

Information Technologies and Security Policy

2011 was a very important year in terms of information and communication technologies, since it saw the implementation of a number of fundamental decisions. In May, we completed a new customer services center at the Vinice site in Prague 10. This center was built using technologies that give it direct, on-line access to the Bank's central systems, ensuring maximum integrity of services with minimum local infrastructure costs.

A significant step in improving the quality of our IT services was the completion of implementation of a new version of Kondor, our trading support system. In line with the Bank's position in the government bonds market, March 2011 saw the launch, through new trading systems, of trading in the MTS system. With this step, the Bank preserved its ability to participate in the government bonds market as a market maker. The Bank further expanded its portfolio of trading support systems by launching a new voice dealing platform. The voice system was implemented using cutting-edge Cisco technology with maximum integration with the Bank's existing communication system.

To further improve internal IT services, we implemented systems for management of terminal equipment and automated distribution of applications, as well as basic modules of a new monitoring system on the Nagios platform. With this, the Bank took a clear step toward standardization and streamlining of internal IS administration and operation processes. Optimization of IS resource and IT staff capacity utilization also continued in the area of databases and application services, led by the IBM/AS400 hardware which runs the main banking system, MIDAS. Here, 2011 saw the requisite licenses extended for another ten-year period.

The operations portion of our infrastructure took a major step towards embracing virtualization technologies, both in hardware and for individual applications and data storage equipment. This laid the foundations for changes that await the Bank in the years to come, and made it possible to respond faster and more effectively to changes in the operational and commercial demands placed on individual applications.

On an ongoing basis, the security and security policy areas were updated to reflect the various changes, thereby maintaining high standards set in these areas in years past. A planned risk analysis was carried out and it found no serious shortcomings in the Bank's installed and operated systems. Late in the year, implementation was completed on a system for more effective seeking and archiving of logging records, which will enable us to reduce capacity requirements for individual information systems and centralize operations involving these records.

Human Resources and Personnel Strategy

PPF banka's human resources management function always respects the overall corporate strategy of PPF Group, of which the Bank is a member.

The human resources management strategy at PPF banka continues to be fully in line with the plans and goals of the commercial strategy of PPF banka and of the Group as a whole.

At PPF banka, emphasis is placed above all on maintaining a pleasant and friendly work environment, mutual trust among employees, and the continual process of improving employee efficiency and performance, which relies primarily on a systematic training process. We achieve our goals through a variety of means, including frank and open communications, cultivation of the corporate culture, openness, and support for young talents.

We motivate our employees through the compensation system and the system of employee benefits, and we also focus on achieving overall employee satisfaction, which is a necessary prerequisite for good teamwork, without which we would not be able to lay firm foundations for loyalty and effectiveness. As the Bank continues to grow and add new business activities, the number of employees is also growing, and that is an indication of the Bank's prosperity and stature. We are seeing increasing interest in working for PPF banka among job candidates, and so we are placing great emphasis on the effectiveness of our job searches. Our goal is to recruit employees that will join forces with our team to ensure the satisfaction of our customers.

Our goal is to create a reliable, flexible, and dynamic company team, for whom working and achieving success together is both pride and joy. We believe that, through this strategy, we will secure a good environment for employees, and that of course is crucial for customer satisfaction as well.

The average number of employees in 2011 was 165. The number of employees at year end was 170.

Directions of Further Growth and Outlook for 2012

2012 will not be an easy year: in order to consolidate government debt at a sustainable and acceptable level, the tax burden will be increased and government spending will be cut. Add to this the possibility that foreign banks (and their Czech subsidiaries/branches) may be reluctant to finance the Czech economy due to a requirement that they increase their capitalization at the group level. The economy is expected to stagnate and, indeed, this latest GDP figures seem to confirm this, having slipped slightly in the third and fourth quarters, by 0.1% each time.

In 2012 the following commercial activities of the Bank will be key:

— ongoing active approach to financing the industrial sector
— preparation of joint projects involving the public sector
— developing activities in the financial and capital markets
— supporting the Czech Republic's exports through export & structured finance
— expanding the activities of the Private Banking division.

Public Benefit Projects

As a member of PPF Group, PPF banka is involved in certain Group projects – especially those relating to culture and the arts. We participate in the Summer Shakespeare Festival, a theater project that PPF Group has been a general partner of for a number of years, and we also provide funding for the Jára Cimrman Theater in Prague's Žižkov district.

In order to develop education, science, and sports, in 2011 the Bank provided financial support to the Bilingual Nursery School for the Hearing Impaired, the Association for Helping Children With Handicaps, the Czech Volleyball Union, the Joint Activities Center of the Academy of Sciences of the Czech Republic and the CEVRO Institute. Further, we provided a financial donation to THE KELLNER FAMILY FOUNDATION to support education, philanthropy, science, culture, heritage protection, and environmental improvement.

Prague, 3 April 2012

Petr Milev
Chairman of the Board of Directors

Josef Zeman
Vice Chairman of the Board of Directors

Financial Section

Independent Auditor's Report to the Shareholders of PPF banka a.s.

We have audited the accompanying consolidated financial statements of PPF banka a.s., which comprise the statement of financial position as of 31 December 2011, and the statement of comprehensive income, the statement of changes in equity and the cash flow statement for the year then ended, and the notes to these consolidated financial statements including a summary of significant accounting policies and other explanatory notes. Information about the company is set out in Note 1 to these consolidated financial statements.

Statutory Body's Responsibility for the Financial Statements

The statutory body of PPF banka a.s. is responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal controls as the statutory body determines are necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the assets and liabilities of PPF banka a.s. as of 31 December 2011, and of its expenses, revenues and net result and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Prague, 11 April 2012

KPMG Česká republika Audit, s.r.o.
Licence number 71

Jindřich Vašina
Partner
Licence number 2059

Consolidated Financial Statements for the Year Ended 31 December 2011

According to International Financial Reporting Standards

Consolidated Statement of Comprehensive Income

In thousands of CZK	Note	2011	2010
Interest and similar income	6	4,183,679	3,564,656
Interest expense and similar charges	6	(1,792,627)	(1,525,521)
Net interest income		**2,391,052**	**2,039,135**
Dividend income	7	12,019	96
Fee and commission income	8	880,432	635,248
Fee and commission expense	8	(65,961)	(54,548)
Net fee and commission income		**814,471**	**580,700**
Net trading income	9	(237,846)	141,016
Other operating income	11	10,106	24,028
Operating income		2,989,802	2,784,976
General administrative expenses	12	(767,904)	(662,264)
Impairment (loss)/reversal	25	(1,363,020)	(1,257,057)
Other operating expenses	13	(97,983)	(59,108)
Operating expenses		(2,228,907)	(1,978,429)
Profit before income tax		**760,895**	**806,546**
Income tax expense	22	(152,526)	(144,009)
Net profit for the year		**608,369**	**662,537**
Other comprehensive income			
Fair value reserve (AFS financial assets)		(85,205)	(1,381)
Net change in fair value, net of tax		(85,205)	(1,381)
Net amount transferred to profit and loss, net of tax		–	–
Other comprehensive income for the period		**(85,205)**	**(1,381)**
Total comprehensive income for the period		**523,164**	**661,156**

The notes on pages 42 to 80 are an integral part of these consolidated financial statements.

The consolidated financial statements were approved by the Board of Directors on 4 April 2012.

Signed on behalf of the Board of Directors by:

Petr Milev

Josef Zeman

Consolidated Statement of Financial Position

In thousands of CZK	Note	2011	2010
Assets			
Cash and balances with the central bank	14	147,109	558,631
Trading assets	15	10,828,541	6,537,114
Financial assets available for sale	16	6,370,696	4,103,251
Loans and advances to banks	17	26,936,406	22,342,506
Loans and advances to customers	18	22,370,500	20,175,278
Property, plant and equipment	20	59,225	43,860
Intangible assets	21	84,366	58,346
Current tax assets	30	27,953	–
Deferred tax assets	22	4,410	–
Other assets	24	234,557	346,906
Total assets		**67,063,763**	**54,165,892**
Liabilities			
Deposits from banks	26	1,159,835	1,898,257
Deposits from customers	27	45,596,835	35,997,964
Debt securities issued	28	2,841,846	3,203,552
Trading liabilities	29	8,804,731	3,970,780
Income tax provision	30	–	25,758
Deferred tax liabilities	22	–	10,119
Other liabilities	31	3,966,817	4,886,798
Total liabilities		**62,370,064**	**49,993,228**
Shareholders' equity			
Issued capital	33	769,004	769,004
Share premium	33	411,545	411,545
Statutory reserve fund	34	153,801	153,801
Retained earnings		3,444,606	2,838,366
Fair value reserve		(85,257)	(52)
Total shareholders' equity		**4,693,699**	**4,172,664**
Total liabilities and shareholders' equity		**67,063,763**	**54,165,892**

Consolidated Statement of Cash Flows

In thousands of CZK	2011	2010
Profit before income tax	760,895	806,546
Adjustments for non-cash items		
Impairment (loss)/reversal	1,363,020	1,257,049
Depreciation and amortisation	42,752	29,763
Net interest income	(2,391,052)	(2,039,135)
Increase/decrease in fair value of financial instruments	90,574	(35,922)
Profit/(loss) on the sale of property and equipment	(34)	(121)
Profit/(loss) on the sale of securities	(147,273)	(186,396)
Operating profit before changes in operating assets and liabilities	**(747,468)**	**(168,216)**
Changes in balances of operating assets and liabilities		
Balances with central bank	450,926	90,738
Trading assets	(4,291,427)	(1,521,163)
Loans and advances to banks	(4,593,900)	(1,487,557)
Loans and advances to customers	(2,195,222)	(5,181,350)
Other assets	112,349	(124,066)
Deposits from banks	(738,422)	1,830,922
Deposits from customers	9,598,871	5,599,045
Trading liabilities	4,833,951	(759,564)
Taxes	68,240	(103,780)
Other liabilities	(919,981)	1,780,261
	1,577,917	(44,731)
Interest received	3,949,283	3,304,787
Interest paid	(1,810,152)	(1,656,973)
Cash flows from operating activities	**3,717,048**	**1,603,083**
Acquisition of investment securities	(3,530,968)	(5,603,207)
Proceeds from sale of investment securities	938,759	4,949,856
Purchase of property, plant and equipment and intangible assets	(105,248)	(84,333)
Proceeds from sale of property, plant and equipment	34	3,097
Cash flow from investing activities	**(2,697,423)**	**(735,087)**
Revenues from issued securities	13,762,622	14,990,407
Repayment of issued securities	(14,487,226)	(15,823,821)
Cash flow from financing activities	**(724,604)**	**(833,414)**
Net increase/(decrease) in cash and cash equivalents	295,021	34,582
Cash and cash equivalents at 1 January	**420,459**	**385,877**
Net cash flows from operating activities	3,717,048	1,603,083
Net cash flow from investing activities	(2,697,423)	(735,087)
Net cash flow from financing activities	(724,604)	(833,414)
Cash and cash equivalents at 31 December (see Note 38 (f))	**715,480**	**420,459**

Consolidated Statement of Changes in Equity

In thousands of CZK	Issued capital	Share Premium	Statutory Reserve Fund	Reserves from revaluation of available-for-sale securities	Retained Earnings	Total Equity
Balance at 1 January 2010	**769,004**	**411,545**	**141,124**	**1,329**	**2,190,504**	**3,513,506**
Total comprehensive income for the period						
Profit for 2010	–	–	–	–	662,537	662,537
Other comprehensive income						
Changes in fair value on available-for-sale financial assets, net of tax	–	–	–	(1,381)	–	(1,381)
Transfers	–	–	12,677	–	(14,675)	(1,998)
Total comprehensive income for the period	**769,004**	**411,545**	**153,801**	**(52)**	**2,838,366**	**4,172,664**
Transactions with owners, contribution and distribution to owners						
Dividends paid	–	–	–	–	–	–
Balance at 31 December 2010	**769,004**	**411,545**	**153,801**	**(52)**	**2,838,366**	**4,172,664**
Balance at 1 January 2011	**769,004**	**411,545**	**153,801**	**(52)**	**2,838,366**	**4,172,664**
Total comprehensive income for the period						
Profit for 2011	–	–	–	–	608,369	608,369
Other comprehensive income						
Changes in fair value on available-for-sale financial assets, net of tax	–	–	–	(85,205)	–	(85,205)
Transfers	–	–	–	–	(2,129)	(2,129)
Total comprehensive income for the period	**769,004**	**411,545**	**153,801**	**(85,257)**	**3,444,606**	**4,693,699**
Transactions with owners, contribution and distribution to owners						
Dividends paid	–	–	–	–	–	–
Balance at 31 December 2011	**769,004**	**411,545**	**153,801**	**(85,257)**	**3,444,606**	**4,693,699**

Notes to the Consolidated Financial Statements

1. Introduction

PPF banka a.s. (“the Bank”) was established on 31 January 1995 as the successor to the former Royal Bank (operating on the market from 3 December 1992) by a resolution of the Prague City Council in order to create a strong financial partner for cities and municipalities.

The Bank is registered in the Commercial Register as a joint-stock company, with the following scope of business:

– execution of banking transactions and provision of banking services in the Czech Republic as well as overseas, to the extent permitted by relevant legislation and the license granted by the Czech National Bank. The Bank can acquire an interest in other companies both in the Czech Republic and abroad including non-financial service companies.

On 23 June 2004 the shareholders of the Bank decided to change the name of První městská banka,a.s. to PPF banka a.s. The change of name to PPF banka a.s. was recorded in the Commercial Register on 1 September 2004.

The ultimate controlling entity of the Bank is PPF Group N.V. registered in the Netherlands.

The registered office of the Bank

PPF banka a.s.
Evropská 2690/17
160 41 Praha 6
Czech Republic

2. Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) as adopted by the European Union.

3. Significant Accounting Policies

(a) Basis of preparation

The financial statements are presented in Czech Crowns, which is the functional currency, rounded to the nearest thousand. The financial statements are prepared on the historical cost basis except for derivative financial instruments, financial assets and liabilities at fair value through profit or loss, and available-for-sale assets.

The preparation of the financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of judgements concerning the carrying values of assets and liabilities that are not readily apparent from other sources. The actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to the accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both the current and future periods.

Judgements made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 5.

The accounting policies have been consistently applied by the Bank and are consistent with those used in the previous year.

During 2009 the Bank acquired two subsidiries PPF B1 B.V. and PPF B2 B.V. and therefore the Bank prepares the consolidated financial statements.

(b) Foreign currency

Transactions in foreign currencies are translated to the presentation currency of the Bank at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the presentation currency at the foreign exchange rate ruling at the dates that the values were determined.

(c) Financial instruments

(i) Classification

Financial instruments at fair value through profit or loss are those acquired or incurred principally for the purpose of selling or repurchasing in the near term or those that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking (financial instruments held for trading), or instruments that are designated upon initial recognition as at fair value through profit or loss. These include investments, certain purchased loans and derivative contracts that are not designated and effective hedging instruments, and liabilities from short sales of financial instruments. All trading derivatives in a net receivable position (positive fair value), as well as options purchased, are reported as trading assets. All trading derivatives in a net payable position (negative fair value), as well as options written, are reported as trading liabilities.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, other than:

– those designated upon initial recognition as at fair value through profit or loss or available for sale, or

– those for which the holder may not recover substantially all of its initial investment, for reasons other than credit deterioration, which should be classified as available for sale.

Loans and receivables include loans and advances to banks and customers.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

Available-for-sale financial assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity. Available-for-sale instruments include money market placements and certain debt, equity and other investments.

(ii) Recognition

The Bank recognises financial assets on the day they are transferred to the Bank (settlement date accounting).

(iii) Measurement

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition, all financial instruments at fair value through profit or loss and all available-for-sale assets are measured at fair value, except for any instruments that do not have a quoted market price on an active market and whose fair value cannot be reliably measured, which are stated at cost, including transaction costs, less impairment losses.

All financial liabilities that are not at fair value through profit or loss, loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated using the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

(iv) Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using discounted cash flow techniques or pricing models where all significant inputs are directly or indirectly observable from market data.

(v) Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of financial assets and liabilities at fair value through profit or loss are recognised directly in profit or loss as "Operating income".

Gains and losses arising from a change in the fair value of financial assets available-for-sale are recognised directly in other comprehensive income and become an equity item "Changes in fair value on available-for-sale financial assets".

(vi) Specific instruments

Cash and balances with the central bank

Cash and balances with the central bank comprise cash in hand, cash deposited with central banks and short-term highly liquid investments, including treasury bills and other bills eligible for refinancing with the central bank.

Loans and advances to banks and customers

Loans and advances to banks and customers and purchased loans that the Bank has the intent and ability to hold to maturity are classified as loans and receivables.

Loans and advances are reported net of allowances for impairment to reflect the estimated recoverable amounts – see accounting policy (g).

Debt securities issued (Other liabilities supported by paper evidence)

Other liabilities for which paper evidence exists are classified as non-trading liabilities.

(vii) Embedded Derivatives

An embedded derivative is a component of a combined instrument that also includes a non-derivative host contract – with the effect that some of the cash flows or other characteristics of a combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative may be separated from the host contract and accounted for as a separate derivative if, and only if:

– the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract,

– a separate financial instrument with the same terms as the embedded derivative would meet the definition of a derivative, and

– the host instrument is not measured at fair value with changes in fair value recognized in profit or loss or the host instrument is measured at fair value, but changes in fair value are recognised in the statement of financial position.

(d) Derecognition

A financial asset is derecognised when the Bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is terminated.

Available-for-sale assets and trading assets that are sold are derecognised and the corresponding receivables from the buyer are recognised on the date they are transferred (settlement date accounting). The Bank uses the specific identification method to determine the gain or loss on derecognition.

Held-to-maturity instruments and loans and receivables are derecognised on the day of maturity or on the day they are transferred by the Bank.

(e) Repurchase transactions

The Bank enters into purchases (sales) of financial assets under agreements to resell (repurchase) substantially identical financial assets at a certain date in the future at a fixed price. Financial assets purchased subject to commitments to resell them at future dates are not recognised. The amounts paid are recognised in loans to either banks or customers. The receivables are shown as collateralised by the underlying security. Financial assets sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy for assets held for trading as appropriate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers. Financial assets purchased subject to commitments to resell them at future dates are not recognized. The amounts paid are recognised in loans to either banks or customers. The receivables are shown as collateralised by the underlying security.

The difference between the sale and repurchase considerations is recognised on an accrual basis over the period of the transaction and is included in interest income.

(f) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when the Bank has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

(g) Impairment

Financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated and impairment of assets is recognised.

If in a subsequent period the amount of the impairment loss decreases and the decrease can be linked objectively to an event occurring after the write down, then the write-down or provision is reversed through the statement of comprehensive income.

Loans and advances and held-to-maturity investments

Loans and advances are presented net of specific and portfolio provisions for uncollectibility.

Specific provisions are established against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of the outstanding balances to reduce these loans and advances to their recoverable amounts. The provisions are calculated as the difference between the carrying amount of a loan and the present value of the estimated future cash flows from the loan, including amounts recoverable from guarantees and collateral discounted at the financial asset's original effective interest rate.

If the Company determines that no objective evidence of impairment exists for an individually assessed financial assets, whether significant or not, it includes the assets in a group of financial assets with similar risk characteristics and collectively assesses them for impairment. Financial assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Provisions recognized on a portfolio basis are maintained to reduce the carrying amount of portfolios of similar loans and advances to their estimated recoverable amounts at the balance sheet date. The expected cash flows for portfolios of similar assets are estimated based on previous experience and late payments of interest or penalties.

In some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, the Bank uses its experience and judgment to estimate the amount of any impairment loss.

Increases in the provision account are recognised in the statement of comprehensive income. When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly.

(h) Interest income and expense

Interest income and expenses are recognised in the statement of comprehensive income as they accrue, using the effective yield of the asset or the applicable floating rate. Interest income and expenses includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

(i) Fee and commission income

Fee and commission income arises from financial services provided by the Bank including cash management services, brokerage services, investment advice and financial planning, investment banking services, project and structured finance transactions.

Fee and commission income is recognised when the corresponding service is provided.

(j) Penalty fees

Penalty fees are recognised in the statement of comprehensive income when a penalty is charged to a customer, taking into account its collectability.

(k) Gains/Losses from financial operations

Gains/Losses from financial operations include gains and losses arising from disposals of financial assets and liabilities at fair value through profit or loss and available-for-sale assets and gains and losses arising from changes in the fair value of financial assets and liabilities at fair value through profit or loss.

(l) Dividend income

Dividend income is recognised in the statement of comprehensive income on the date that the dividend is declared.

Income from equity investments and other non-fixed income investments is recognised as dividend income when it accrues.

(m) Property, plant and equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and impairment. Depreciation is calculated using the straight line method to write down the cost of such assets to their residual values over their estimated useful lives as follows:

Buildings	10–30 years
Other	1–5 years

Leasehold improvements are depreciated over the leasing period or over their lifetime whichever period is the shorter.

Low value tangible assets with a purchase price of less than TCZK 40 and an estimated useful life shorter than 1 year are recognized as expenses in the period in which they are purchased.

(n) Intangible assets

Software and other intangible assets

Software and other intangible assets that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful lives of the intangible assets.

(o) Provisions

Provision means a probable outflow of an uncertain amount and in an uncertain period of time.

Provisions are recognised when:

– there is a legal or constructive obligation as a result of past events,

– it is probable, and the probability exceeds 50%, that an outflow of resources will be required to settle the obligation,

– a reliable estimate of the amount of the obligation can be made.

(p) Income taxes

The income tax base is calculated from the current year profit. Expenses considered as non-taxable expenses are added and income considered as non-taxable income is deducted. The income tax base is modified by tax allowances and tax benefits.

Deferred income tax arises from temporary differences between the accounting values of assets and liabilities and their carrying amounts in the financial statements. The deferred tax is calculated using the tax rates applicable in the periods in which the timing difference is expected to reverse. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which they can be utilised.

(q) Financial guarantees

Financial guarantees are contracts that require the Bank to make a specified payment to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of the debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under guarantee has become probable). Financial guarantees are included in other liabilities.

4. Standards, Interpretations and Amendments to Published Standards that Are not yet Effective and Are Relevant for the Bank‘s Financial Statements

The Bank has evaluated the impact of standards, interpretations and amendments to valid standards mentioned below, which are not yet in force, but which are already approved and will have an impact on the Bank’s financial statements in the future.

Amendments to IFRS 7 Disclosures – Transfers of Financial Assets (effective for annual periods beginning on or after 1 July 2011) requires disclosure of information that enables users of financial statements to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities, and to evaluate the nature of, and risks associated with, the entity’s continuing involvement in derecognised financial assets.

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2013) contains new disclosure requirements for financial assets and liabilities that are offset in the statement of financial position or subject to master netting arrangements or similar agreements.

The Bank’s management considers the impact of other already effective standards, which were not used in the preparation of the current financial statements, to be immaterial.

5. Critical Accounting Estimates and Judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical accounting estimates and assumptions

The Bank makes estimates and assumptions concerning future economic developments. The resulting accounting estimates will, by definition, seldom be equal to the actual results. The estimates and assumptions that carry the most significant risk of a material adjustment being required to the carrying amounts of assets and liabilities in the next financial year are discussed below.

(i) Impairment of loans and receivables

The Bank assesses at each balance sheet date whether there is objective evidence that any loan or receivable, or any group of loans and receivables, is impaired. A loan or receivable is impaired if there is objective evidence of impairment as a result of one or more events that occurred after their initial recognition and that loss event (or events) has an impact on the estimated future cash flows from the loan or receivable, or from the group of loans and receivables, that can be reliably estimated.

Objective evidence that a loan or receivable, or a group of loans and receivables, is impaired includes observable data that comes to the attention of the Bank about the following loss events:

– significant financial difficulty of the debtor;

– a breach of contract, such as default in the payment of interest or principal payments;

– the disappearance of an active market for that financial asset due to financial difficulties of the debtor.

The Bank first assesses whether objective evidence of impairment exists individually for any loan or receivable that is individually significant, and individually or collectively for any loan or receivable that is not individually significant. For the purposes of a collective evaluation of impairment, loans and receivables are grouped on the basis of similar credit risk characteristics.

Future cash flows from loans and receivables are estimated on the basis of contractual cash flows and historical loss experience for loans and receivables with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used to estimate future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

(ii) Estimated market value of credit default swap

The Bank has an open credit default swap where neither the counterparty nor the underlying asset is quoted on the market. The credit default swap is used to protect the existing asset (loan) in the statement of financial position. The Bank has estimated the market value of this swap using the accrual principle.

(iii) Change in accounting policy

There were no changes in accounting policies during the year 2011 and 2010.

(iv) Effect of the changes in accounting standards in these financial statement

In 2011 and 2010 the Bank did not identify any changes of financial reporting standards that would affect the Bank's financial statements.

6. Net Interest Income

TCZK	2011	2010
Interest and similar income		
Interest and similar income arise from		
Cash and balances with the central bank	5,322	5,435
Loans and advances to banks	323,311	221,704
Loans and advances to customers	3,284,410	2,895,567
Debt securities	570,636	441,950
	4,183,679	**3,564,656**
Interest expense and similar charges		
Interest expense and similar charges arise from		
Deposits from banks	(8,033)	(39,240)
Deposits from customers	(540,699)	(377,751)
Debt securities issued and short sales	(250,304)	(198,600)
Change in deferred purchase price	(993,591)	(909,930)
	(1,792,627)	**(1,525,521)**
Net interest income	**2,391,052**	**2,039,135**

The change in deferred purchase price follows the interest income from the purchased portfolio of receivables and consists of excess spread after waterfall of all costs (e.g. funding costs, service costs, etc.). It is paid to Home Credit a.s., originator and servicer of the acquired retail receivables portfolio.

The Bank dispensed no interest on late payment during years 2011 and 2010.

7. Dividend Income

In 2011 the Bank received dividend payments amounting to TCZK 12,019 (2010: TCZK 96), all from ownership of trading securities.

8. Net Fee and Commission Income

TCZK	2011	2010
Fee and commission income		
Transaction fee with banks	3,494	22
Transaction fee with clients	660,200	525,769
Fees from guarantees provided	13,708	19,655
Fees from payment protection insurance	86,578	65,011
Fees from administration of shares/bonds issue	80,202	3,300
Other	36,250	21,491
	880,432	**635,248**
Fee and commission expenses		
Transaction fee with banks	(20,408)	(15,888)
Transaction fee with clients	(45,553)	(38,660)
	(65,961)	**(54,548)**
Net fee and commission income	**814,471**	**580,700**

9. Net Trading Income

TCZK	2011	2010
Net profit/(loss) from FX transactions	773	(625)
Net profit/(loss) from securities/FX trading	37,956	117,669
Net profit/(loss) from derivatives	(276,575)	23,972
	(237,846)	**141,016**

10. Net Income from other Instruments Carried at Fair Value

The Bank did not gained any net income from other instruments carried at fair value for the years 2011 and 2010.

11. Other Operating Income

TCZK	2011	2010
Reimbursement of expenses	–	2
Reinvoicing and other similar income	4,851	9,529
Advisory services	5,120	11,400
Proceeds from sales of fixed assets	34	3,097
Other	101	–
	10,106	**24,028**

12. General Administrative Expenses

TCZK	2011	2010
Personal expenses		
Wages and salaries	(123,661)	(101,885)
Social expenses	(50,425)	(37,802)
Responsibility insurance, Pension insurance	(1,549)	(1,312)
Remuneration paid to		
Board of Directors	(20,938)	(17,857)
Supervisory Board	(4,997)	(4,025)
Executives	(27,268)	(27,330)
	(228,838)	(190,211)
Other general operating expenses	(539,066)	(472,053)
	(767,904)	**(662,264)**

The average number of employees, members of the Board of Directors, Supervisory Board and executives of the Bank in the years 2011 and 2010 was as follows:

	2011	2010
Board of Directors	3	3
Supervisory Board	6	6
Executives	6	6
Employees	155	140

13. Other Operating Expenses

TCZK	2011	2010
Depreciation of fixed assets	(42,752)	(29,763)
Payment to Deposit Insurance Fund	(31,235)	(21,741)
Payment to Guarantee Fund	(2,822)	(1,805)
Other	(21,174)	(5,799)
	(97,983)	**(59,108)**

14. Cash and Balances with the Central Bank

TCZK	2011	2010
Cash on hand	74,704	35,300
Balances with the central bank	72,401	523,327
Nostro accounts with the central bank	4	4
	147,109	**558,631**

At 31 December 2011 cash and balances with the central bank included balances with the central bank amounting to TCZK 72,401 (2010: TCZK 523,327) representing the obligatory minimum reserves. These funds are not available for the Bank's daily business.

15. Trading Assets

All financial assets at fair value through profit or loss are classified as held for trading.

TCZK	2011	2010
Bonds and notes issued by		
Government	6,725,037	2,995,349
Other issuers	2,739,360	1,951,797
Shares and other equity instruments issued by		
Other issuers	–	568,671
Positive fair value of derivatives		
Other counterparties	1,364,144	1,021,297
Of which		
Listed instruments	9,464,397	4,982,219
Unlisted instruments	1,364,144	1,554,895
	10,828,541	**6,537,114**

Interest income from trading assets is recognised in interest and similar income. The fair value of unlisted bonds and notes at fair value through profit or loss was estimated using discounted cash-flow techniques.

Shares and other equity instruments issued by Other issuers are traded on the stock exchange in Great Britain (2011: TCZK 0; 2010: TCZK 16,576), Slovakia (2011: TCZK 0; 2010: TCZK 200) and the Czech Republic (2011: TCZK 0; 2010: TCZK 50,895).

16. Financial Assets Available for Sale

TCZK	2011	2010
Bonds and notes issued by		
Government	4,464,103	3,114,322
Other issuers	1,342,133	801,258
Shares and other equity instruments issued by		
Other issuers	564,461	187,661
Of which		
Listed instruments	5,822,312	2,718,436
Unlisted instruments	548,384	1,384,815
	6,370,696	**4,103,251**

Interest income from financial assets available for sale is recognised in interest and similar income. The fair value of unlisted bonds and notes available for sale was estimated using discounted cash-flow techniques. The fair value of shares available for sale was established at cost due to non-existence of active market and at net asset value per mutual fund share.

17. Loans and Advances to Banks

TCZK	2011	2010
Loans to central bank under reverse repo transaction	2,000,256	7,701,486
Loans to banks	9,299,510	4,655,451
Money market transactions	14,995,868	9,600,414
Other (nostro / current account balances)	640,772	385,155
Total loans and advances to banks	26,936,406	22,342,506
Impairment loss on loans and advances to banks	–	–
Net loans and advances to banks	**26,936,406**	**22,342,506**

During 2011 and 2010 the Bank did not create or release any impairment to loans and advances to banks.

18. Loans and Advances to Customers

TCZK	2011	2010
Corporate customers		
Financial institutions	1,687,539	557,171
Non-financial institutions	5,576,940	2,648,839
Non-profit organisations	–	9,700
Self-employed	77,870	–
Public sector	22,429	92,990
Resident individuals	12,195,326	12,057,555
Non-residents	4,521,813	6,397,680
Total loans and advances to customers	24,081,917	21,763,935
Impairment loss on loans and advances to customers	(1,711,417)	(1,588,657)
Net loans and advances to customers	**22,370,500**	**20,175,278**

Specific allowances for impairment (loans and advances to customers only from the Bank):

TCZK	2011	2010
As at 1 January	259,184	266,646
Impairment losses recognised in the statement of comprehensive income	63,362	124,085
Reversal of impairment of loans to customers	(66,097)	(130,657)
Use of impairment on loans and receivables	(8,820)	–
Exchange difference	277	(890)
	(11,278)	(7,462)
As at 31 December	**247,906**	**259,184**

Collective allowances for impairment (loans and advances to customers only from subsidiaries):

TCZK	2011	2010
As at 1 January	1,329,473	781,471
Impairment losses recognised in the statement of comprehensive income	1,374,575	1,263,629
Amount related to loans written off	(1,240,537)	(715,627)
	134,038	548,002
As at 31 December	**1,463,511**	**1,329,473**

19. Business Combinations

the Bank acquired 100% share of PPF B1 B.V. for TCZK 595 on 29 April 2009 and 100% share of PPF B2 B.V. for TCZK 509 on 21 July 2009. The assets of the above entities consisted solely of cash equivalents and respective registered capital. No goodwill or amount of any excess (previously referred as negative goodwill) arose from the acquisition as carrying amount equalled the fair value of the assets. The purchase price was settled in cash.

The profit of PPF B1 B.V. and PPF B2 B.V. since the acquisition date of TCZK 1,025 (2010: TCZK 501) and TCZK 3,411 (2010: TCZK 1,772) respectively is included in the calculation of consolidated profit.

20. Property, Plant and Equipment

TCZK	Low value fixed assets	Building	Cars	Furniture and Fittings	Equipment	Works of art	Fixed assets not yet in use	Total
Cost								
At 1 January 2010	1,952	6,267	–	13,096	92,109	4	19,928	133,356
Additions	302	5,380	–	3,852	12,092	–	634	22,260
Transfers	14	–	–	–	19,914	–	(19,928)	–
Disposals	(283)	–	–	(699)	(4,508)	–	–	(5,490)
At 31 December 2010	**1,985**	**11,647**	**–**	**16,249**	**119,607**	**4**	**634**	**150,126**
At 1 January 2011	1,985	11,647	–	16,249	119,607	4	634	150,126
Additions	344	4,198	–	2,350	21,501	–	5,392	33,825
Transfers	–	–	–	–	634	–	(634)	–
Disposals	(339)	–	–	(654)	(11,950)	–	–	(12,983)
At 31 December 2011	**1,990**	**15,845**	**–**	**17,945**	**129,792**	**4**	**5,392**	**170,968**
Depreciation								
At 1 January 2010	1,952	38	–	11,565	84,396	–	–	97,951
Additions	316	158	–	1,142	11,500	–	–	13,116
Disposals	(283)	–	–	(699)	(3,819)	–	–	(4,801)
At 31 December 2010	**1,985**	**196**	**–**	**12,008**	**92,077**	**–**	**–**	**106,266**
At 1 January 2011	1,985	196	–	12,008	92,077	–	–	106,266
Additions	344	279	–	2,242	15,555	–	–	18,420
Disposals	(339)	–	–	(654)	(11,950)	–	–	(12,943)
At 31 December 2011	**1,990**	**475**	**–**	**13,596**	**95,682**	**–**	**–**	**111,743**
Net book value								
At 31 December 2010	**–**	**11,451**	**–**	**4,241**	**27,530**	**4**	**634**	**43,860**
At 31 December 2011	**–**	**15,370**	**–**	**4,349**	**34,110**	**4**	**5,392**	**59,225**

21. Intangible Assets

TCZK	Software	Total
Cost		
At 1 January 2010	175,574	175,574
Additions	62,073	62,073
Disposals	(31,753)	(31,753)
At 31 December 2010	**205,894**	**205,894**
At 1 January 2011	205,894	205,894
Additions	71,423	71,423
Disposals	(21,075)	(21,075)
At 31 December 2011	**256,242**	**256,242**
Depreciation		
At 1 January 2010	130,901	130,901
Additions	16,647	16,647
Disposals	–	–
At 31 December 2010	**147,548**	**147,548**
At 1 January 2011	147,548	147,548
Additions	24,332	24,332
Disposals	(4)	(4)
At 31 December 2011	**171,876**	**171,876**
Net book value		
At 31 December 2010	**58,346**	**58,346**
At 31 December 2011	**84,366**	**84,366**

22. Deferred Tax and Current Tax

Deferred taxes are calculated from all temporary differences between the tax and accounting value of assets and liabilities. To determine the recognised deferred tax asset the Bank uses the income tax rate applicable in the periods in which the losses carried forward are expected to be utilised, i.e. 19% for the following years (in 2011 and 2010 the tax rate in the Czech Republic was 19%).

The recognized deferred tax assets and liabilities consist of the following items:

TCZK	2011	2010
Deferred tax assets		
Deferred tax asset from financial assets available for sale	19,987	–
Deferred tax asset from wages and unpaid social and health insurance	4,133	–
Deferred tax assets	**24,120**	**–**
Deferred tax liabilities		
Deferred tax liability from penalty interest not yet collected	(19,710)	(10,119)
Deferred tax liabilities	**(19,710)**	**(10,119)**
Total deferred tax assets (liabilities)	**4,410**	**(10,119)**

The amount of deferred tax relating to changes in the tax rate applicable for the deferred tax calculation is TCZK 0 (2010: TCZK 0). There was no unrecognized item related to deferred tax.

At 31 December 2011 the Bank recorded receivables from customers of penalty interest not yet collected of TCZK 103,737 (2010: TCZK 53,260), where the relevant income is not tax deductible. Therefore, the bank created a deferred tax liability of TCZK 19,710 (2010: TCZK 10,119), all of which was recognised.

Deferred tax from finacial assets available for sale disclosed as at 31 Decemeber 2011 was offset with “Fair value reserve” in the Bank’s equity.

Income tax reconciliation:

TCZK	2011 Tax basis	2011 Tax	2010 Tax basis	2010 Tax
Tax rate		**19.0%**		**19.0%**
Profit from operations (before taxation)	760,895		806,546	
Computed taxation using applicable tax rate		144,570		153,244
Tax non-deductible expenses	127,943	24,309	114,738	21,800
Non-taxable income	(67,317)	(12,790)	(174,589)	(33,172)
Other items	(18,753)	(3,563)	11,247	2,137
Total income tax (expense)/income		**(152,526)**		**(144,009)**

"Other items" also included in 2011 deferred tax expense of TCZK 5,458 (2010: expense of TCZK 10,043).

23. Operating Leasing

Non-cancellable operating lease rentals are payable as follows:

TCZK	2011	2010
Less than one year	30,723	23,274
Between one and five years	43,333	10,584
More than five years	3,305	2,595
Total	**77,361**	**36,453**

The Bank leases branch and office premises under operating leases. The leases typically run for a period of up to 10 years, with an option to renew the lease after that date. The operating leasing expense was TCZK 30,075 in 2011 (2010: TCZK 28,364).

24. Other Assets

TCZK	2011	2010
Clearing with securities market	69,402	20,727
Prepayments and deferred expenses	23,011	18,351
Cash collateral to payment cards	99,441	69,736
Receivable related to accrued excess spread	–	199,716
Other	42,703	38,376
Impairment loss on Other assets	–	–
	234,557	**346,906**

Receivable related to accrued excess spread consists of the present value of the off-setting item the Bank believes can utilize in the future against excess spread liability.

25. Impairment Losses

TCZK	Receivables to clients (note 18)	Total
As at 1 January 2010	1,048,117	1,048,117
Impairment of loans to customers	1,387,714	1,387,714
Reversal of impairment of loans to customers	(846,284)	(846,284)
Use of impairment on loans and receivables	–	–
FX difference	(890)	(890)
As at 31 December 2010	**1,588,657**	**1,588,657**
As at 1 January 2011	1,588,657	1,588,657
Impairment of loans to customers	1,437,937	1,437,937
Reversal of impairment of loans to customers	(1,306,634)	(1,306,634)
Use of impairment on loans and receivables	(8,820)	(8,820)
FX difference	277	277
As at 31 December 2011	**1,711,417**	**1,711,417**

26. Deposits from Banks

TCZK	2011	2010
Other deposits from banks	1,020,367	1,886,043
Other (loro account balances)	139,468	12,214
	1,159,835	**1,898,257**

27. Deposits from Customers

TCZK	2011	2010
Payable on demand		
Corporate customers		
Financial services	95,002	87,807
Non-financial institutions	2,827,526	1,686,704
Insurance institutions	178,809	126,241
Non-profit organisations	53,260	86,038
Self-employed	299,876	142,593
Public sector	8,239,361	5,200,187
Resident individuals	241,344	183,227
Non-residents	3,062,542	1,900,846
Total payable on demand	14,997,720	9,413,643
Term deposits		
Corporate customers		
Financial services	8,326,815	9,268,693
Non-financial institutions	4,643,659	2,646,626
Insurance institutions	3,928,172	4,557,215
Non-profit organisations	227,826	153,674
Self-employed	289,605	239,700
Public sector	3,940,474	1,906,990
Resident individuals	232,063	58,220
Non-residents	9,010,501	7,753,202
Total term deposits	30,599,115	26,584,321
	45,596,835	**35,997,964**

Interest is recognised in interest expense and similar charges.

28. Debt Securities Issued

TCZK	2011	2010
Financial institutions	71,003	–
Non-financial institutions	1,266,878	1,001,183
Public sector	335,430	2,173,703
Non-resident individuals	796,209	–
Resident individuals	372,326	28,664
	2,841,846	**3,203,552**

29. Trading Liabilities

All financial liabilities at fair value through profit or loss are classified as held for trading.

TCZK	2011	2010
Negative fair value of derivatives		
Interest rate contracts	886,511	199,383
Currency contracts	705,405	698,436
Other contracts	99	115
Liabilities from short sales of securities	7,212,716	3,072,846
	8,804,731	**3,970,780**

30. Income Tax Assets and Provision

As of 31 December 2011 a tax provision of TCZK 146,369 (2010: TCZK 132,140) is offset against income tax advances totalling TCZK 174,322 (2010: TCZK 106,382).

31. Other Liabilities

TCZK	2011	2010
Payables to suppliers	41,511	40,431
Accrued expenses and deferred income	406,773	373,502
Cash deposited as pledge	1,943,526	2,515,364
Social and health insurance	5,288	4,340
Other liabilities to employees	13,999	27,401
Liabilities from securities transactions	40,143	37,912
Deposits insurance fund	8,954	6,207
Payable related to acquired receivables portfolios	325,298	675,725
Deferred part of purchase price of receivables	596,271	554,986
Subordinated debt	462,004	561,159
Other liabilities	123,050	89,771
	3,966,817	**4,886,798**

Deferred part of purchase price of receivables is calculated as a present value of expected interest collections. The calculation is based on expected gross yield of receivables portfolio acquired, defaults and deduction of expenses as defined by the receivables transfer agreement.

The agreement on subordinated debt allows postponing repayment of the debt if there are no sufficient cash flows in PPF B2 B.V. which might lead to the reduction of the carrying value of the subordinated debt.

32. Repurchase and Resale Agreements

The Bank purchases financial instruments under agreements to resell them at future dates (“reverse repurchase agreements”). The seller commits to repurchase the same or similar instruments at an agreed future date. Reverse repurchases are entered into as a facility to provide funds to customers.

Assets purchased subject to agreements to resell them were as follows:

TCZK	Carrying amounts of receivables	F air value of assets held as collateral
Loans and advances at 31 December 2011		
to banks	9,328,909	9,255,906
to clients	1,126,316	1,730,656
Loans and advances at 31 December 2010		
to banks	10,965,069	10,799,368
to clients	2,810,911	3,987,856

The Bank raises funds by selling financial instruments under agreements to repay the funds by repurchasing the instruments at future dates at the same price plus interest at a predetermined rate. Repurchase agreements are commonly used as a tool for short-term financing.

Assets sold under repurchase agreements were as follows:

TCZK	Carrying amounts of liabilities	Fair value of assets given as collateral
Deposits at 31 December 2011		
from banks	–	–
from clients	893,127	882,622
Deposits at 31 December 2010		
from banks	1,544,589	1,538,272
from clients	7,026,322	6,931,283

33. Issued Capital

	Number of shares	Nominal value CZK	Registered capital TCZK
As at 31 December 2011			
	192,131	2,602.5	500,021
	384,262	700.0	268,983
	576,393		**769,004**
As at 31 December 2010			
	192,131	2,602.5	500,021
	384,262	700.0	268,983
	576,393		**769,004**

The shareholder structure as at 31 December 2011 was as follows:

Name	Residence	Number of shares	Share (TCZK)	Share (%)
PPF Group N.V.	the Netherlands	554,711	714,866	92.96%
Hlavní město Praha	Czech Republic	19,882	51,754	6.73%
Other (less than 1%)		1,800	2,384	0.31%
		576,393	**769,004**	**100.00%**

No members of the management, the Board of Directors or the Supervisory Board held any shares of the Bank as at 31 December 2011 or as at 31 December 2010.

The Bank has not introduced any scheme for the purchase of its own shares or provided any remuneration in the form of options to purchase its shares.

All shares of the Bank were fully paid resulting in share premium amounting to TCZK 411,545 (2010: TCZK 411,545).

34. Statutory Reserve Fund

The statutory reserve fund was established for covering potential future losses of the Bank. The Bank annually contributes to the statutory reserve fund from its net profit for the year in the amount of at least 5% up to 20% of issued capital. The statutory reserve fund is not readily distributable to the shareholders of the Bank.

The Bank completed the statutory reserve fund from distribution of profit for 2009 and therefore no additional contributions neither from 2010 nor 2011 profit are required.

35. Proposed Allocation of Net Profit for the Year

The Bank and its subsidiaries propose to allocate their profit as follows:

TCZK	Net profit for the year
Net profit for the year 2011	608,369
Proposed allocation of profit for 2011	
Transfer to social funds	(2,000)
Transfer to retained earnings	(606,369)
	–

36. Off Balance Sheet Items

(a) Commitments and contingent liabilities

Guarantees and credit commitments are subject to the same procedures within the standard lending process, in terms of credit risk monitoring and regulation of the Bank's credit activity.

TCZK	2011	2010
Guarantees issued	2,396,712	1,104,712
Undrawn credit commitments	20,915,066	14,785,389
Letters of credit	19,614	469,516
	23,331,392	**16,359,617**

The total outstanding contractual commitments to extend credits indicated above do not necessarily represent future cash requirements, as many of these commitments will expire or terminate without being funded especially regarding consumer financing products held by Bank's subsidiaries.

(b) Off-balance sheet financial instruments

TCZK	Notional value 2011	2010	Fair value 2011	2010
Derivatives held for trading				
Interest Rate Swaps	54,781,217	52,059,778	(143,069)	(12,947)
Interest Forwards		–	–	–
Purchase		–		–
Sale		–		–
Foreign Exchange derivatives			(253,143)	70,357
Purchase	35,664,055	66,273,911		
Sale	35,917,197	66,203,553		
Equity derivatives			–	–
Purchase	–	–		
Sale	–	–		
Options	–	–	–	–
Other derivatives			168,341	65,953
Purchase	1,673,065	2,561,827		
Sale	1,675,904	2,559,007		
			(227,871)	**123,363**

Other derivatives consisted of futures and credit default swap.

(c) Residual maturity of derivatives

This table presents the notional amounts of all types of derivatives according to their residual maturity.

TCZK	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 year	Unspecified	Total
As at 31 December 2011						
Derivatives held for trading						
Interest Rate Swaps	349,489	–	52,831,728	1,600,000	–	54,781,217
FX derivatives (purchase)	22,164,749	12,351,428	1,147,878	–	–	35,664,055
FX derivatives (sale)	22,394,160	12,377,288	1,145,749	–	–	35,917,197
Other derivatives (purchase)	202,993	76,241	879,292	514,539	–	1,673,065
Other derivatives (sale)	322,784	1,152,403	200,717	–	–	1,675,904
As at 31 December 2010						
Derivatives held for trading						
Interest Rate Swaps	23,439	123,757	51,412,582	500,000	–	52,059,778
FX derivatives (purchase)	58,525,335	6,961,175	787,401	–	–	66,273,911
FX derivatives (sale)	58,450,622	6,970,976	781,955	–	–	66,203,553
Other derivatives (purchase)	911,116	1,565,074	85,637	–	–	2,561,827
Other derivatives (sale)	909,935	1,563,435	85,637	–	–	2,559,007

The Bank obtained a derivative license from the Czech National Bank in 2006.

37. Fair Value Disclosures

The following table shows a comparison of the carrying amounts and fair values of the Bank's financial assets and liabilities that are not carried at fair value.

TCZK	2011 Carrying amount	2011 Fair value	2010 Carrying amount	2010 Fair value
Financial assets				
Cash and balances with the central bank	147,109	147,109	558,631	558,631
Loans and advances to banks	26,936,406	26,936,406	22,342,506	22,342,506
Loans and advances to customers	22,370,500	22,423,707	20,175,278	20,447,243
Financial liabilities				
Deposits from banks	1,159,835	1,159,835	1,898,257	1,898,257
Deposits from customers	45,596,835	45,536,154	35,997,964	35,986,050
Debt securities issued	2,841,846	2,841,846	3,203,552	3,203,552

The major methods and assumptions used in estimating the fair values of financial instruments shown in the table are summarised below.

Quoted market prices, when available, were used as the measure of fair value of financial assets and liabilities. Where quoted market prices were not available, the fair values were based on present value estimates or other valuation techniques. The fair value of short term financial instruments that will mature or be renewed within twelve months and have no significant change in credit risk was deemed to be equal to the carrying amount in the Bank's balance sheet.

Cash and balances with the central bank

For cash and cash equivalent assets, the carrying value is deemed to be equal to the fair value.

Loans and advances to banks

Loans and advances with banks will mature in less than twelve months and their fair value has therefore been deemed to be equal to their carrying value.

Loans and advances to customers

Loans and advances are net of specific and other provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of the estimated future cash flows expected to be received. The expected cash flows are discounted at current market rates to determine the fair value. For loans and advances that will mature or be renewed within twelve months, the fair value was deemed to be equal to the carrying value.

Deposits from customers

The estimated fair value of current and deposit accounts without stated maturity were deemed to be equal to the carrying value.

All fixed rate term deposits and loans from banks are renewed regularly; thus the fair value is deemed to be equal to the carrying value.

Debt securities issued

For issued debt securities maturing within twelve months the fair value is deemed to be equal to the carrying value.

The following table analysed financial assets and liabilities recognised at fair value based on the quality of entry data used for valuation. The fair value levels are defined in Note 3 (c) (iv):

TCZK	Level 1	Level 2	Level 3	Total
As at 31 December 2011				
Financial assets				
Financial assets at fair value through profit or loss				
Securities held for trading	8,487,518	976,879	–	9,464,397
Derivatives held for trading	166,165	1,197,979	–	1,364,144
Available-for-sale securities	5,306,311	48,461	1,015,924	6,370,696
Financial liabilities				
Financial assets at fair value through profit or loss				
Securities held for trading	7,212,716	–	–	7,212,716
Derivatives held for trading	–	1,592,015	–	1,592,015

The following table states the transfers of financial assets recognised at fair value to and from Level 3:

	Financial assets at fair value through profit or loss		
TCZK	Securities for trading	Available-for-sale securities	Total
Balance as at 1 January 2011	**501,200**	**498,235**	**999,435**
Profit and loss from revaluation			
In profit or loss	9,500	27,285	36,785
In other comprehensive income	–	(5,300)	(5,300)
Purchases	–	1,735,004	1,735,004
Sales/ maturity	–	(1,750,000)	(1,750,000)
Transfers into Level 3	–	–	–
Transfers out of Level 3	–	–	–
Transfers between portfolios	(510,700)	510,700	–
Balance as at 31 December 2011	**–**	**1,015,924**	**1,015,924**

Profit of TCZK 27,285 is included in Interest and similar income and profit of TCZK 9,500 in Net trading income.

38. Risk Management Disclosure

This section provides details of the Bank's exposure to risk and describes the methods used by the management to control risk. The most important types of financial risk to which the Bank is exposed are:

(a) credit risk

(b) liquidity risk

(c) market risks

(d) operational risks.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

Trading

The Bank holds trading positions in certain financial instruments. The majority of the Bank's business activities are based on the requirements of its customers. These positions are also held for the purpose of speculation on the future development of financial markets. The Bank's business strategy is thus affected by the speculative expectation and market creation and its goal is to maximise net income from trading.

The Bank manages the risks associated with its trading activities at the level of individual risks and individual types of financial instruments. The basic instruments used for risk management are volume limits for individual transactions, stop loss limits and Value at Risk (VaR) limits.

(a) Credit risk

Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to its Credit Committee. A separate Credit department, reporting to the Credit Committee, is responsible for oversight of the Bank's credit risk, including:

– Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.

– Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to business unit credit officers.

– Reviewing and assesing credit risk. Credit Committee assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.

– Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).

– Developing and maintaining the Bank's gradings in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grades are subject to regular reviews of the Bank's risk department.

– Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided on the credit quality of local portfolios and appropriate corrective action is taken.

The Bank started calculating the capital requirement for credit risk of investment portfolio under the standardised approach as at 1 January 2008, i.e. as at the Basel II implementation date.

The capital requirement for credit risk of investment portfolio amounted to TCZK 2,454,694 (2010: TCZK 1,769,937).

Exposure to credit risk

The credit risk reflects the counterparty's ability to meet its commitments.

Credit risk management is regulated by the Bank's internal policies. For each customer, the Bank sets a limit of total credit exposure, which is decided during the process of approving of the credit product.

For the classification of receivables the Bank uses an internal system of receivable categorisation.

The rating quantifies the total risk connected with the customer and takes into account the nature of the requested transaction. Apart from an assessment of the number of days overdue the Bank assesses the quality of management, the position of the debtor in the market, the current market conditions, the macroeconomic situation, the structure and quality of collateral, the nature of the financial sources used to repay the debt, and an analysis of the financial statements (i.e. the structure of the financial position, operating cash-flow, productivity and others).

Impairment of individual loans

The Bank recognises the impairment of an individual loan if the loan's carrying amount decreases and the Bank does not write off such amount; that is, part of the loan receivable corresponding to the loss from the loan's carrying amount. The Bank assesses impairment of the carrying amount for each watched loan receivable and for all loan receivables with debtors in default. The Bank writes off a receivable when it does not expect any income from the receivable or from received collateral related to such receivable.

The Bank calculates the individual impairment in the amount of loss resulting from the decrease in the loan's carrying amount, i.e. impairment loss is equal to the difference between the carrying amount (reduced by the materially acceptable value of collateral) and the discounted value of estimated future cash flows from the unsecured part of the loan.

Collectively impaired portfolio of loans

The majority of the Bank's exposure to credit risk from collectively assessed portfolios arises in connection with the provision of consumer financing to private individual customers, which is the principal business of the Bank's subsidiaries. The Bank classifies the loans to individual customers into several classes where the significant ones are consumer loans, revolving loans, cash loans and car loans. As the consumer loan portfolio consists of large amount of loans with relatively low outstanding amounts, the loan portfolio does not comprise any significant individual items. The loans are allocated into time buckets as per due days and respective impairment allowance is calculated for each time bucket balance.

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of not impaired and individually impaired assets by risk grade.

Loans and advances to banks

		2011		2010
TCZK	Gross	Net	Gross	Net
Not impaired				
Standard	26,936,406	26,936,406	22,342,506	22,342,506
Impaired				
Watched	–	–	–	–
Sub-standard	–	–	–	–
Doubtful	–	–	–	–
Loss loans	–	–	–	–
Total	**26,936,406**	**26,936,406**	**22,342,506**	**22,342,506**

There was no accrued interest to individually impaired loans and advances to banks as at 31 December 2011 and 2010.

Loans and advances to customers (individually impaired)

		2011		2010
TCZK	Gross	Net	Gross	Net
Not impaired				
Standard	11,329,888	11,329,888	8,709,106	8,709,106
Impaired				
Watched	100,681	100,213	453,498	426,872
Sub-standard	–	–	–	–
Doubtful	38,479	10,631	74,267	29,092
Loss loans	463,257	243,667	485,655	298,272
Total	**11,932,305**	**11,684,399**	**9,722,527**	**9,463,342**

The accrued interests to individually impaired loans and advances to customers represented as at 31 December 2011 TCZK 218 (2010: TCZK 24,235).

Loans and advances to customers (collectively impaired)

TCZK	2011	2010
Collectively impaired		
Gross amount	11,553,341	11,486,422
Due	8,973,772	8,849,264
Past due 1–90 days	1,315,490	1,445,310
Past due 91–360 days	1,264,079	1,181,849
Past due more than 360 days	–	–
Allowances for impairment	(1,463,511)	(1,329,472)
Net amount	10,089,830	10,156,949
Deferred purchase price of receivables	596,271	554,987
Carrying amount	10,686,101	10,711,936
Total	**10,686,101**	**10,711,936**

Loans and advances to customers – Past due, but not impaired

As at 31 December 2011 and 2010 the Bank did not report any loans and advances to customers as "Past due, but not impaired".

As at 31 December 2011 and 2010 the Bank did not report any other assets as "Past due, but not impaired".

Evaluation of collateral

The Bank generally requires collateral before providing loans to certain debtors. To reduce the gross credit exposure and for the purpose of calculating adjustments, the Bank considers the following to be acceptable types of collateral:

– Cash

– Securities

– First-class receivables

– Bank guarantees

– Guarantees provided by a reputable third party

– Real estate

– Machinery and equipment.

The Bank's assessment of the net realisable value of the collateral is based on an expert appraisal or an internal evaluation prepared by the Bank's specialist department. The net realisable value of the collateral is determined using this value and a correction coefficient, which reflects the Bank's ability to realise the collateral when necessary.

The Bank usually does not require collateral for the consumer loans.

The following table shows Loans and advances to customers split according to type of collateral:

TCZK	2011	2010
Bank guarantees	42,708	25,060
Property	8,170,800	7,159,649
Security held by the Bank	–	794
Unsecured	14,156,992	12,989,775
Total	**22,370,500**	**20,175,278**

The following table shows Loans and advances to customers classified as watched, substandard, doubtful and loss loans (individually impaired) according to type of collateral:

TCZK	2011	2010
Property	290,774	495,526
Unsecured	63,737	258,710
Total	**354,511**	**754,236**

The Bank did not record any collateral for loans and advances to customers past due, but not impaired as at 31 December 2011; and 2010 whereas any such loans were not reported by the entity (page 67).

Concentration of credit risks

The concentration of credit risks arises as a result of the existence of loans with similar economic characteristics affecting the debtor's ability to meet his obligations. The Bank treats a receivable from a debtor or an economically connected group of debtors that exceeds 25% of the Bank's capital as a significant exposure. At the balance sheet date the Bank did not have any significant concentration of credit risks with respect to any individual debtor and the limits were not exceeded in relation to individual debtors and to related parties.

i) Concentration of credit risks according to economic sector/industry

An analysis of the concentration of credit risks according to the individual sector/industries is included in Note 17 and 18.

ii) Concentration of credit risks according to geographical sectors

Loans and advances to customers

TCZK	2011	2010
Czech Republic	17,848,710	13,804,225
Slovak Republic	11,760	12,495
Russia	1,117,560	289,549
Cyprus	1,446,195	5,428,974
Vietnam	735,481	564,918
Netherlands	310,829	75,106
Other	899,965	11
Total	**22,370,500**	**20,175,278**

Loans and advances to banks

TCZK	2011	2010
Czech Republic	17,306,652	16,587,582
Slovak Republic	–	937,559
Russia	3,642,482	1,235,275
Ukraine	250	236
Austria	2,915,764	1,737,567
United Kingdom	1,352,354	592,472
Netherlands	420,962	219,669
Kazakhstan	196,672	321,376
Belarus	645,759	576,376
United States of America	288,143	65,827
Hungary	82,861	43,346
Germany	24,697	17,181
Poland	1,386	6,825
France	56,780	–
Other	1,644	1,215
Total	**26,936,406**	**22,342,506**

Debt securities

TCZK	2011	2010
Czech Republic	12,736,803	7,207,151
Russia	103,961	1,109,234
Luxembourg	1,279,592	277,631
Slovakia	399,929	–
United Kingdom	34,757	–
Austria	2,618	–
Kazakhstan	21,293	20,511
Ireland	691,680	248,210
Total	**15,270,633**	**8,862,737**

(b) Liquidity risk

The liquidity risk represents the risk of the Bank incurring losses due to momentary insolvency. The Bank can also suffer a loss as a result of low liquidity in the market for the financial instruments included in the Bank's portfolios. The insolvency risk threatens the Bank's funding and investment needs. Market liquidity risk represents the risk of not being able to liquidate financial instruments quickly enough, or in sufficient volume and for reasonable prices. If the conditions are not favourable, this risk can substantially worsen the Bank's position.

The Bank has access to diverse sources of funds, which comprise deposits and other savings, loans accepted and equity. This diversification makes the Bank flexible and limits its dependency on one financing source. The Bank regularly evaluates the liquidity risk, in particular by monitoring changes in the structure of financing and comparing these changes with the Bank's liquidity risk management strategy, which is approved by the Board of Directors. The Bank also holds, as part of its liquidity risk management strategy, a portion of its assets in highly liquid funds, such as state treasury bills and similar bonds.

The following table shows undiscounted cash flows on the Bank's financial assets and liabilities on the basis their earliest possible contractual maturity.

Residual maturity of the Bank's assets and liabilities

TCZK	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Unspecified	Total
At 31 December 2011						
Cash and balances with the central bank	74,708	–	–	–	72,401	147,109
Trading assets	478,628	576,935	4,539,065	5,233,913	–	10,828,541
Financial assets available for sale	257,406	1,228,450	1,255,368	3,065,011	564,461	6,370,696
Loans and advances to banks	25,698,078	1,192,121	42	46,165	–	26,936,406
Loans and advances to customers	10,713,425	1,168,571	6,059,738	4,428,766	–	22,370,500
Property, plant and equipment	–	–	–	–	59,225	59,225
Intangible assets	–	–	–	–	84,366	84,366
Other assets	231,297	–	–	–	35,623	266,920
Total	**37,453,542**	**4,166,077**	**11,854,213**	**12,773,855**	**816,076**	**67,063,763**
Deposits from banks	719,783	440,052	–	–	–	1,159,835
Deposits from customers	34,772,937	10,797,067	26,831	–	–	45,596,835
Debt securities issued	2,313,831	334,762	193,253	–	–	2,841,846
Trading liabilities	7,712,691	173,366	801,387	117,287	–	8,804,731
Tax and other liabilities	2,872,447	631,635	210,539	131,887	120,309	3,966,817
Shareholders' equity	–	–	–	–	4,693,699	4,693,699
Total	**48,391,689**	**12,376,882**	**1,232,010**	**249,174**	**4,814,008**	**67,063,763**
Gap	**(10,938,147)**	**(8,210,805)**	**10,622,203**	**12,524,681**	**(3,997,932)**	**–**
Cumulative gap	**(10,938,147)**	**(19,148,952)**	**(8,526,749)**	**3,997,932**	**–**	**–**
At 31 December 2010						
Cash and balances with the central bank	35,304	–	–	–	523,327	558,631
Trading assets	772,590	470,034	2,376,198	2,349,621	568,671	6,537,114
Financial assets available for sale	1,002,786	863,919	2,048,886	–	187,660	4,103,251
Loans and advances to banks	21,578,620	763,886	–	–	–	22,342,506
Loans and advances to customers	10,208,777	1,546,859	5,855,117	2,564,525	–	20,175,278
Property, plant and equipment	–	–	–	–	43,860	43,860
Intangible assets	–	–	–	–	58,346	58,346
Other assets	235,443	–	–	–	111,463	346,906
Total	**33,833,520**	**3,644,698**	**10,280,201**	**4,914,146**	**1,493,327**	**54,165,892**
Deposits from banks	1,698,246	200,011	–	–	–	1,898,257
Deposits from customers	30,829,379	5,164,616	3,969	–	–	35,997,964
Debt securities issued	1,859,209	1,344,343	–	–	–	3,203,552
Trading liabilities	3,677,743	94,078	178,999	19,960	–	3,970,780
Tax and other liabilities	2,383,184	2,071,782	196,434	112,108	159,167	4,922,675
Shareholders' equity	–	–	–	–	4,172,664	4,172,664
Total	**40,447,761**	**8,874,830**	**379,402**	**132,068**	**4,331,831**	**54,165,892**
Gap	**(6,614,241)**	**(5,230,132)**	**9,900,799**	**4,782,078**	**(2,838,504)**	**–**
Cumulative gap	**(6,614,241)**	**(11,844,373)**	**(1,943,574)**	**2,838,504**	**–**	**–**

The above table shows the residual maturity of the accounting value of the items, not the total expected cash flows.

(c) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Bank buys and sells derivatives, and also incurs financial liabilities in order to manage market risks. All such transactions are carried out within the guidelines set by the Risk Management Department.

Value at risk

Market risks arising from the Bank's trading activities are managed using the Value at Risk method. Value at Risk represents the potential loss arising from an unfavourable movement on the market within a certain time period and at a certain confidence level. The Bank determines the Value at Risk using the parametric method based on the historical development of interest rates, exchange rates and prices of equity instruments. Value at Risk is measured based on a one-day holding period and a confidence level of 99%.

TCZK	31 December 2011	Average for 2011	31 December 2010	Average for 2010
VaR of interest instruments	10,328	8,690	7,977	7,278
VaR of currency instruments	238	529	354	477
VaR of equity instruments	–	15,550	4,504	4,859

Stress testing

The Bank carries out daily stress testing of interest rate, currency risks and changes in prices of equity instruments by applying internally defined improbable scenarios and simulating their impact on the net present value of the Bank's portfolio.

i) Currency risk

Currency risk is the risk of a change in the value of a financial instrument due to a change in the exchange rates.

Assets and liabilities denominated in foreign currencies including off-balance sheet instruments represent the Bank's exposure to exchange rate risk. Realised and non-realised exchange rate gains and losses are stated directly in the profit and loss statement.

The Bank has set currency risk limits based on its net currency exposure in individual currencies according to their significance. The Bank also sets a limit with respect to the total net currency exposure.

ii) Interest rate risk

The interest rate risk is the risk of a change in the value of a financial instrument due to a change in market interest rates.

The Bank is exposed to interest rate risks resulting from the different maturity or renewal period of interest rates and the different amounts of interest bearing assets and liabilities in these periods. Interest rate management activities are intended to optimise the net interest income of the Bank in accordance with the strategy approved by its Board of Directors.

Part of the Bank's income is generated by the difference between interest rate sensitive assets and liabilities, which is summarised in the table below.

Interest sensitivity of the Bank's assets and liabilities

TCZK	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Unspecified	Total
At 31 December 2011						
Cash and balances with the central bank	147,109	–	–	–	–	147,109
Trading assets	1,198,268	577,766	8,212,990	817,972	21,545	10,828,541
Financial assets available for sale	257,406	1,228,450	1,255,368	3,065,011	564,461	6,370,696
Loans and advances to banks	25,897,478	1,038,886	42	–	–	26,936,406
Loans and advances to customers	14,722,769	935,836	3,783,844	2,928,051	–	22,370,500
Property, plant and equipment	–	–	–	–	59,225	59,225
Intangible assets	–	–	–	–	84,366	84,366
Other assets	15,000	–	–	–	251,920	266,920
Total	**42,238,030**	**3,780,938**	**13,252,244**	**6,811,034**	**981,517**	**67,063,763**
Deposits from banks	719,783	440,052	–	–	–	1,159,835
Deposits from customers	34,772,937	10,797,067	26,831	–	–	45,596,835
Debt securities issued	2,313,831	528,015	–	–	–	2,841,846
Trading liabilities	8,513,255	258,009	33,467	–	–	8,804,731
Tax and other liabilities	2,088,129	468,939	–	–	1,409,749	3,966,817
Shareholders' equity	–	–	–	–	4,693,699	4,693,699
Total	**48,407,935**	**12,492,082**	**60,298**	**–**	**6,103,448**	**67,063,763**
Gap	**(6,169,905)**	**(8,711,144)**	**13,191,946**	**6,811,034**	**(5,121,931)**	**–**
Cumulative gap	**(6,169,905)**	**(14,881,049)**	**(1,689,103)**	**5,121,931**	**–**	**–**
At 31 December 2010						
Cash and balances with the central bank	558,631	–	–	–	–	558,631
Trading assets	1,036,210	415,428	2,167,184	2,349,621	568,671	6,537,114
Financial assets available for sale	1,301,157	1,330,872	1,283,561	–	187,661	4,103,251
Loans and advances to banks	21,766,362	576,144	–	–	–	22,342,506
Loans and advances to customers	14,407,044	1,006,730	4,094,347	667,157	–	20,175,278
Property, plant and equipment	–	–	–	–	43,860	43,860
Intangible assets	–	–	–	–	58,346	58,346
Other assets	15,000	–	–	–	331,906	346,906
Total	**39,084,404**	**3,329,174**	**7,545,092**	**3,016,778**	**1,190,444**	**54,165,892**
Deposits from banks	1,698,246	200,011	–	–	–	1,898,257
Deposits from customers	30,829,379	5,164,616	3,969	–	–	35,997,964
Debt securities issued	1,859,209	1,344,343	–	–	–	3,203,552
Trading liabilities	3,863,233	107,107	440	–	–	3,970,780
Tax and other liabilities	1,280,059	1,873,576	–	–	1,769,040	4,922,675
Shareholders' equity	–	–	–	–	4,172,664	4,172,664
Total	**39,530,126**	**8,689,653**	**4,409**	**–**	**5,941,704**	**54,165,892**
Gap	**(445,722)**	**(5,360,479)**	**7,540,683**	**3,016,778**	**(4,751,260)**	**–**
Cumulative gap	**(445,722)**	**(5,806,201)**	**1,734,482**	**4,751,260**	**–**	**–**

The carrying amounts of assets and liabilities are recorded either in the period in which they are due or in the period in which the interest rate changes, i.e. whichever occurs earlier.

Certain assets or liabilities are allocated to individual periods on the basis of an expert appraisal due to their expected preliminary repayment or non-defined maturity dates.

Effective yield information

The effective yields on significant categories of financial assets and liabilities of the Bank as at 31 December 2011 and 2010 were as follows:

In %	2011	2010
Financial assets		
Cash and balances with the central bank	0.37	0.26
Trading assests	4.25*	5.35*
Financial assets available for sale	4.34*	2.66*
Loans and advances to banks	1.48	0.98
Loans and advances to customers	14.37	15.49
Financial liabilities		
Deposits from banks	1.14	0.85
Deposits from customers	1.01	0.74
Debt securities issued	2.18	1.07
Trading liabilities	1.69	1.93

Note: (*) Yield interest rate is calculated from debt securities only.

Apart from gap analysis as indicated above, the Bank monitors its exposure to interest rate risk by Basis Point Value (BPV) and stress testing. Both of these methods measure the potential impact on the Bank's overall position of shift of intererst rate yield curves

Basis point value

Basis point value measures how much monetary positions of the Bank will gain or loose for a 100 basis point (bp) movement in the yield curve in terms of fair value changes. Therefore, it quantifies the Bank's interest rate risk for small changes in interest rates.

As at 31 December 2011 BPVs for individual currencies were as follows:

TCZK		Banking Book		Trading book
Currency	BPV	Limit	BPV	Limit
CZK	(23,524)	70,000	13,461	45,000
EUR	(25,926)	30,000	(16,004)	45,000
USD	(25,088)	30,000	(3,075)	45,000
RUB	(3,386)	10,000	(389)	30,000
SKK	–	10,000	–	10,000
KZT	(1,557)	10,000	–	10,000
UAH	–	10,000	–	10,000
GBP	(37)	10,000	–	30,000
VND	–	10,000	–	10,000
Total BPV (absolute)	79,518		32,929	80,000

As at 31 December 2010 BPVs for individual currencies were as follows:

TCZK		Banking Book		Trading book
Currency	BPV	Limit	BPV	Limit
CZK	(44,531)	–	2,340	45,000
EUR	(8,289)	10,000	(18,373)	30,000
USD	(12,483)	10,000	16,109	45,000
RUB	(5,929)	10,000	(1,553)	30,000
SKK	–	10,000	–	10,000
KZT	(87)	10,000	–	10,000
UAH	–	10,000	–	10,000
GBP	–	10,000	–	30,000
VND	(127)	10,000	–	10,000
Total BPV (absolute)	71,448		38,375	80,000

Stress testing

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel fall or rise in significant currencies with respect to the Bank in related yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates in terms of fair value changes (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

		2011		2010
TCZK	100 bp parallel increase	100 bp parallel decrease	100 bp parallel increase	100 bp parallel decrease
At 31 December	79,518	79,518	71,448	71,448
Average for the period	66,337	66,337	30,043	30,043
Maximum for the period	79,518	79,518	71,448	71,448
Minimum for the period	54,683	54,683	1,026	1,026

iii) Equity risk

The equity risk is the risk of a change in the value of a financial instrument due to a change in market prices of equities or equity related instruments.

The Bank is exposed to equity risk resulting from open positions in equities or equity related instruments in accordance with the strategy approved by its Board of Directors. The Bank measures equity risk via the Value at Risk method as described above in the section Value at Risk.

iv) Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

The Bank is not exposed to settlement risk as all transactions are settled in delivery versus payment manner.

(d) Operational risk

Operational risks

The IT security and operational risk management departments are responsible for mitigation and management of operational risk, i.e. risk of loss resulting from human factors, inadequate or failed internal processes and systems, or from external events including legal risk, and therefore risk of increased expenses, decreased revenues of the Bank or penalties and sanctions, and impairment losses of tangible and intangible assets.

Based on the Organisational manual, the IT security and operational risk management department is sufficiently independent in its operations. The IT security and operational risk management department prepares methodology and procedures for operational risks; it identifies, measures, monitors, evaluates and proposes corrective action in relation to operational risks. In addition, it supervises information risk management, i.e. it monitors, measures, and evaluates information security and prepares methodology and procedures for management of information risks.

If a controllable operational risk is identified by the Bank's management, it proposes and implements operational, control or organisational measures to mitigate such risk. The Bank uses diversification of its activities (e.g trading activities) through its system of operational limits for elimination or mitigation of identified operational risks. The Bank controls the access of employees to tangible and intangible assets, and controls the risk from provision of bank services, from implementation of new products, and from outsourcing, etc. If operational, control or organisational measures are proposed by the Bank's management, the impact on the Bank's expenses and revenues is considered.

If an inherent operational risk is identified, the risk manager from the IT security and operational risk management department proposes procedures for its mitigation, transfer or acceptance. Termination of activities comprising any inherent operational risk is considered. The operational risk manager considers accessibility of insurance, insurance costs and the impact of potential measures on the Bank's expenses and revenues. The Bank accepts inherent operational risk of a one-off loss up to CZK 500 and inherent operational risk of recurring losses up to CZK 3,000 per month.

Legal and other risks

The Compliance department is responsible for monitoring and mitigation of legal risks, potential regulatory sanctions, financial losses or reputation losses from the Bank's non-compliance with the legal framework, regulatory requirements, executive regulations, internal guidelines and business practices. The compliance department's main responsibilities are to ensure that the Bank's internal guidelines and processes comply with requirements set by external standards; to create an environment that ensures this compliance; to set up an environment for fair provision of services to the Bank's customers and fair and equal treatment of the Bank's customers and its employees; to prevent conflicts of interest; to monitor the Bank's behaviour on financial markets (regulation of non-transparent trading); to ensure consistency of internal guidelines; to carry out and monitor AML procedures (anti money laundering) and to resolve complaints.

The Compliance department is an independent body, which is responsible to the Bank's Board of Directors. If part of the Compliance department's activities is assigned to another department within the Bank, the Compliance department coordinates this activity.

Each Bank employee is responsible for compliance with external standards within their duties and responsibilities, as well as with binding internal guidelines. If an employee has any doubts about their own or another person's compliance with external regulations, they are obliged to immediately ask their superior to express an opinion on the situation. If the employee or their superior has any doubts, even after positive assurance, they are obliged to ask an employee from the Compliance department to express an opinion.

The Bank's management is responsible for establishing an environment that enables compliance with external regulations and for supporting the education of subordinates in the area of external standards. Further, the Bank's management is responsible for issuing internal guidelines on each particular area of the Bank's activity; it is responsible for ensuring that internal guidelines comply with external standards, and monitors adherence to those standards. If non-compliance is identified, it immediately reports this to the Compliance department with suggested corrective action.

The Compliance department ensures that internal regulations comply with external standards mainly through suggestions/amendments in the process of issuing/updating internal regulations, where approval of the Compliance department is required. If non-compliance of internal and external standards is identified, the Compliance department notifies the responsible department. The Compliance department is entitled to carry out spot checks on Bank employees to check that their activities are in compliance with external standards and internal guidelines.

Since 2008, the Bank has applied standard the Basel II standard approach to operational risk. The Bank started calculating the capital requirement for operational risk under the basic indicators approach (BIA) as at 1 January 2008, i.e. as at the Basel II implementation date.

(e) Capital management

Regulatory capital

The Bank's lead regulator, the Czech National Bank, sets and monitors the capital requirements of the Bank. The Bank and individual banking operations are directly supervised by their local regulators. As the capital regulatory requirements are set only for the Bank, the structure of Tier 1 capital and Tier 2 capital is set only for the Bank.

In implementing current capital requirements the Czech National Bank requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets.

The Bank's regulatory capital is analysed into two tiers:

– Tier 1 capital, which includes ordinary share capital, share premium, statutory reserve funds and retained earnings after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

– Tier 2 capital, which includes qualifying subordinated liabilities.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also considered and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank and its individually regulated operations have complied with all externally imposed capital requirements throughout the period.

There have been no material changes in the Bank's management of capital during the period.

The Bank's regulatory capital position at 31 December was as follows calculated in compliance with Czech National Bank requirements were as follows:

TCZK	2011	2010
Tier 1 capital	**4,086,350**	**3,442,653**
Issued capital	769,004	769,004
Share premium	411,545	411,545
Statutory reserve fund	153,801	153,801
Retained earnings	2,836,366	2,175,827
Negative change in fair value of financial assets available for sale	–	(9,178)
Less intangible assets	(84,366)	(58,346)
Tier 2 capital		
Qualifying subordinated liabilities	–	–
Total regulatory capital	4,086,350	3,442,653
Risk weigted assets	31,173,247	22,677,646
Capital requirements		
Capital requirement for credit risk of investment portfolio	2,454,694	1,769,937
Capital requirement for credit risk of trading portfolio	210,129	216, 834
– for specific interest rate risk	170,693	149,812
– for specific equity risk	–	22,747
– for derivatives	39,166	44,275
Capital requirements for market risks	161,306	219,493
– for general interest rate risks of trading portfolio	159,015	171,885
– for general equity risks of trading portfolio	–	45,494
– for foreign exchange risks	2,291	2,136
Capital requirements for settlement risks	–	–
Capital requirements for operational risks	187,634	179,199
Total capital requirements	**3,013,764**	**2,385,485**
Capital adequacy ratio	**10.85%**	**11.55%**

The capital adequacy ratio is calculated according to regulatory requirements as the ratio of regulatory capital to total capital requirements multiplied by 8%. The capital adequacy ratio is required to be at least 8%.

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation and is subject to review by the Bank's Credit Committee or ALCO as appropriate.

(f) Components of cash flow statement

Cash and cash equivalents include cash in hand and account balances with the Czech National Bank, treasury bills with residual maturity up to three months and nostro account balances with financial institutions. Statutory minimum reserves are not included as cash equivalents in the cash flow statement due to their limited availability.

TCZK	2011	2010
Cash on hand	74,704	35,300
Balances with the central bank	4	4
Nostro account balances	640,722	385,155
Total	**715,480**	**420,459**

39. Related Party Transactions

The Bank has a related party relationship with its parent company, PPF Group N.V., and with its subsidiaries and associates.

The Bank also has related party relationships with its Directors and Executives, and enterprises in which it has in common key members of management.

All transactions with related parties were concluded under arm's length conditions.

(a) Transaction with the parent company

Below stated balances are included in statement of financial position and represented transactions with the parent company:

TCZK	2011	2010
Trading assets	736,421	203,120
Deposits from customers	(4,602,308)	(1,499,531)
Trading liabilities	(14,906)	–
Other liabilities	(1,302,133)	(1,407,727)
Total	**(5,182,926)**	**(2,704,138)**

Below stated figures are included in statement of comprehensive income and represented transactions with the parent company:

TCZK	2011	2010
Interest expense and similar charges	(91,046)	(76,793)
Fee and commission income	5,938	781
Net trading income	593,106	1,153,166
Total	**507,998**	**1,077,154**

(b) Transaction with other related parties

Below stated balances are included in statement of financial position and represented transactions with other related parties:

TCZK	2011	2010
Cash and balances with the central bank	17,751	15,039
Trading assets	799,144	537,956
Financial assets available for sale	411,152	303,024
Loans and advances to banks	800,412	388,634
Loans and advances to customers	115,132	170,681
Other assets	6,216	209,957
Deposits from customers	(5,242,839)	(763,697)
Deposits from banks	(505,263)	(73,048)
Trading liabilities	(8,438)	(69,766)
Other liabilities	(2,026,418)	(2,122,277)
Total	**(5,633,151)**	**(1,403,497)**

Below stated figures are included in statement of comprehensive income and represented transactions with other related parties:

TCZK	2011	2010
Interest expense and similar income	161,968	78,117
Interest expense and similar charges	(999,041)	(935,639)
Fee and commission income	17,321	26,138
Fee and commission expense	(1,208)	(7,686)
Net trading income	52,555	(27,890)
Other operating income	8,605	14,752
General administrative expenses	(239,762)	(219,343)
Total	**(999,562)**	**(1,071,551)**

(c) Supervisory Boards members, Directors and Executives

Below stated balances are included in statement of financial position and represented transactions with Supervisory Board members, Directors and Executives:

	Board of Directors		Supervisory Board		Executives	
	2011	2010	2011	2010	2011	2010
Trading assets	–	–	–	–	437	80
Deposits from Customers	(13,762)	(19,823)	(806)	(621)	(2,468)	(2,386)

The above payables consist mainly of term deposits and balances of current accounts with the Bank.

The above receivables consist of positive value of derivatives.

The Bank did not report related expenses and income for its Supervisory Board members, Directors and Executive as at 31 December 2011 and 2010 whereas these figures are considered to be not material.

(d) Off balance sheet items

As a related party transaction, as at 31 December 2011 the Bank provided a credit commitment to related parties of TCZK 66,974 (2010: TCZK 25,074).

40. Subsequent Events

Bank has founded its subsidiary PPFb Grant s.r.o. Subsidiary was recorded was recorded in the Commercial Register on 9 March 2012.

Pavel Langr, CIA has resigned on his membership in the Board of Directors at 4 April 2012.

There have been no another events subsequent to the balance sheet date that require adjustment of or disclosure in the financial statements or notes thereto.

Prague, 11 April 2012

Petr Milev
Chairman of the Board of Directors of
PPF banka a.s.

Josef Zeman
Vice Chairman of the Board of Directors of
PPF banka a.s.

Individual responsible for financial statements:

František Vencl
Chief Financial Officer

Individual responsible for accounting:

Růžena Šuserová
Chief Accountant

Notes

Contacts

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