# ANNUAL REPORT

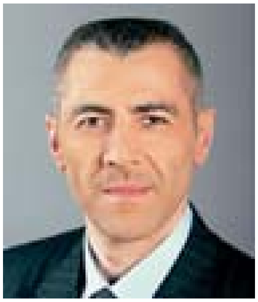
MDM Bank 2005

# Annual Report
# 2005

MDM Bank

# Contents

# CHAIRMAN'S STATEMENT



A. Vernikov

In step with the remarkable development of the Russian economy, MDM Bank is focused on strengthening its position at the vanguard of the domestic banking sector. We intend to capitalise on opportunities for growth and the country's extraordinary potential while continuing to promote new standards of governance, openness and transparency.

This annual report marks an important milestone for MDM Bank. It is the first report by the Bank as a standalone entity, while previous editions were produced on behalf of the MDM Financial Group. Making the Bank the Group's centre of capitalisation was a logical step in the institution's evolution, fully in line with the drive towards greater transparency in the Russian financial sector.

As a major participant in this market, we are fully aware of the role we play in strengthening Russia's banking sector. MDM Bank continues to set the pace for corporate governance among Russian banks, and we have achieved the strongest track record in this field. In December 2005, Standard & Poor's Governance Services upgraded our corporate governance rating from CGS-5 to CGS-6, which puts us into the top rank nationally, even though we are a private institution. Further underscoring our achievements, in March 2006 *Global Finance* magazine named us Russia's Best Bank in Corporate Governance.

These distinctions reflect the continued efforts of our Board of Directors to put good governance into practice. They also highlight the fact that we do our utmost to protect our shareholders' interests while taking into account the interests of customers, bondholders, counterparties and employees.

Upgrading the Bank's governance and management systems has taken place in parallel with continued business growth. MDM Bank is now firmly established as a leader in several attractive segments of the financial services market. It is also consistently one of the most profitable and efficient banks in Russia.

Our Board of Directors is positioned for effective, strategic decision-making. Its members contribute extensive experience in the Russian context, as well as internationally. The Board now comprises five independent members and MDM Bank's two beneficiaries. Together, we provide the experience and insight needed to give clear direction to the Bank's ongoing development.

The Board's role is evolving hand-in-hand with increased empowerment for management. Crucially, the Board was responsible for the management change that resulted in the arrival of a new and widely respected CEO in early 2006. Having a strong management team in place will allow the Board of Directors to concentrate on formulating strategy and providing effective oversight. At the same time, we are encouraging greater initiative at all levels and cultivating a strong sense of accountability.

Creating a corporate culture that provides incentives for each individual to create value for the Bank within his or her own business area is a long process. The success of such a culture requires commitment and focus at every level of management. Our Board is building a system that rewards individual, business unit and Bank-wide performance. The strong steps taken in the last year are already having a clear, positive impact on the way we work.

I would like to take this opportunity to thank all the staff of MDM Bank, the Management Board, the Board of Directors and, of course, our clients for an extremely satisfying year. I would also like to welcome our new CEO, Michel Perhirin. We look forward to achieving even more in the years to come.

**Andrei Vernikov**
Chairman of the Board of Directors

# CEO STATEMENT

**Dear Shareholders, Clients and Stakeholders,**

M. Perhirin

At the beginning of 2006, I joined MDM Bank as its Chief Executive Officer. I embraced this new role with a great sense of excitement, given that MDM stands at an important juncture on its path to becoming a world-class financial institution. Over the course of 2005, MDM Bank not only solidified its reputation as one of Russia's most stable private banks, but achieved many milestones in consolidating its position as one of the leaders in Russia's banking industry.

The Bank is rightly proud of its reputation for being at the forefront of corporate governance in Russia. In early 2005, one of the most significant and far-reaching steps MDM Bank took to strengthen its corporate governance programme was the establishment of a professional and truly independent Board of Directors. The Board plays a critical role in ensuring that we, as a company, adhere to best business practices, balance the interests of all participants in the corporate process and set a high standard for financial transparency and disclosure.

Working across business lines, we achieved great success in strengthening our system of internal controls as well as enhancing both operational and financial efficiencies. In cooperation with two Big Four consulting firms, we completed studies in the key areas of tax, credit, business processes and information technology and have implemented a broad range of measures designed to maximise our efficiency and our results.

Wide-ranging enhancements to our processes and procedures, as well as significant investments in technology, infrastructure and staff, allowed us to capitalise on favourable market conditions and make considerable gains across our core business lines. In our corporate and retail businesses, we not only significantly increased the number of corporate, small-business and retail clients, but grew deposits and extended our lending business by substantial margins. In investment banking and brokerage, we continued to lead the industry in Eurobond and CLN issues, expand our M&A business and achieve attractive growth in our equities franchise.

For the fifth consecutive year, MDM Bank maintained its status as one of the most profitable privately-owned banking groups in Russia[1]. Consolidated net profit under IFRS was reported at US$ 112 million, while assets grew to US$ 4.8 billion, a 14% increase over the H1 2005 level. Shareholders' equity increased to US$ 851 million, a 15% increase over the H1 2005 level.

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[1] Please refer to Management Discussion and Analysis (page 62) for more details.

As we move forward over 2006, a number of challenges remain to be met. While the outlook for Russia's banking industry is positive and we anticipate strong growth in business volumes and interesting opportunities, we will face increased competitive pressures as foreign institutions expand their participation in the Russian financial services market and bring managerial and technical expertise to competing institutions.

In order to continue enhancing our competitive position and remain on the industry's cutting edge, we will be called upon to make increasing investments in technology, human capital and our network. Although we have already made significant investments in these areas, we must continue to emphasise advancement. Careful cost management will also be necessary, and we must make every effort to lower our cost of funding.

Continued product line expansion is critical to our success, as is a sustained programme of cross-selling products and services across business lines. Each of our businesses is well-positioned in its own right, but together they are even stronger. Leveraging opportunities across business lines allows us to create additional value and capitalise on MDM's extensive set of products and services, enhancing our brand and further strengthening the trust of our customers.

Going forward in 2006, we will take every measure possible to not only sustain, but improve our position within Russia's banking sector. Offering our customers and clients value added products and services designed with their needs in mind and delivering these products and services with maximum efficiency and attention to detail is the way we will achieve this objective.

MDM's success is possible only through the sustained support of all our stakeholders – our employees, partners, customers and clients, as well as our community. I look forward to working with each and every one of you as MDM pursues even greater success over the coming year – yours and ours alike.

**Michel Perhirin**
Chief Executive Officer

# OVERVIEW OF RUSSIA'S ECONOMIC AND BANKING ENVIRONMENT IN 2005 AND OUTLOOK FOR 2006

In 2005, Russia continued to make huge strides economically. In 1999, nominal GDP stood at about US$ 200 billion and GDP per capita was US$ 1,345; in 2005, these indicators reached US$ 756 billion and US$ 5,300 respectively – truly a remarkable leap forward.

Against this backdrop, investors have returned to the market en masse as demand for Russian assets has strengthened. The RTS grew by only 8% in 2004, but rose by 83% in 2005. IPOs with a total value of more than US$ 6 billion were held last year. Russian Eurobonds also generated high returns in 2005, with the EMBI+ Russia index adding 13.8%. The EMBI + Russia spread to Treasuries narrowed by 95 basis points over the year to end at 115 basis points.

GDP grew by 6.4% in 2005, significantly ahead of expectations. Economic growth accelerated in the second half of the year, driven by high global oil and gas prices, robust consumer demand and, most importantly, a pickup in fixed investment growth.

The federal surplus reached a record high of 7.6% of GDP last year. The Stabilisation Fund, established in 2004 to protect the budget against volatility in oil prices, ended the year with US$ 43 billion in its coffers. During the year, the Fund grew by net US$ 24.2 billion, while US$ 19 billion was used to make early debt repayments to the Paris Club and Vneshekonombank. In 1999, Russia's external debt to GDP ratio was around 90%; by the end of 2005, it had fallen to less than 10%.

Last year's strong fiscal performance was not surprising given the extremely favourable external conditions. Urals blend oil averaged over US$ 50 per barrel and other world commodity prices also performed well, bolstering Russia's overall economic performance. Most encouragingly, the government's solid commitment to a tight fiscal policy helped it withstand pressure to tap the Stabilisation Fund to cover spending needs.

Foreign direct investment rose to a record high of almost US$ 20 billion in the first three quarters of 2005, compared to US$ 5.3 billion in the same period of 2004. Solid growth in domestic consumption continued to drive FDI as investment in retail, wholesale, trade and catering remained strong. Cyprus is consistently cited as one of the main investors in the Russian economy, an indication that flight capital is finding its way back to Russia. This is perhaps one of the most positive signs that the situation is improving, as Russians themselves see their country as a stable and dependable place to invest.

A number of areas require further improvement to ensure future economic growth. The government needs to push through new laws and act more resolutely to implement its reform programme. Companies can do more to improve corporate governance. Although the financial system has been improved, for example through the introduction of a deposit insurance scheme, further problems need to be addressed. Russia has almost 1,400 banks, many of which are small, undercapitalised and involved in excessively risky activities. Businesses and investors face red tape and bureaucracy and evidence points to an increase in corruption in recent years.

Judicial, administrative and banking reform all require politicians to act decisively. Unfortunately, it is difficult to identify any driving force for these necessary changes. Furthermore, high oil prices may be lulling policymakers into a false sense of security, leading them to delay difficult and unpopular reforms. Given the inadequate pace of reform, Russia's recent economic progress looks even more impressive than at first glance.

We expect economic growth to continue strengthening this year with GDP growth estimated at 6.6% on the back of continued robust domestic demand. We also expect benefits from stronger growth in investments, the key for creating long-term, sustainable growth in Russia. GDP per capita is set to increase from US$ 5,300 in 2005 to more than US$ 6,000 in 2006. Furthermore, nominal GDP should reach US$ 870 billion, compared to US$ 760 billion last year.

As for inflation, the government is likely to miss its target of 8.5%. However, we believe that for the first time in Russia's post-Soviet history, it will come in below 10%. Although pressures on prices will remain, we see the Central Bank allowing the ruble to appreciate in order to curb inflation. While excessively strong currency appreciation could be damaging, we believe Russian companies are in a good position to cope with a stronger ruble environment, as we think that there is still significant room for cost cutting by corporate Russia generally.

On the back of continued strong commodity prices, we expect Russia to continue showing healthy current account and federal budget surpluses. By the end of 2006, the Stabilisation

Fund will grow to as much as US$ 90 billion. The government has also pledged to make an additional early debt repayment of up to US$ 12 billion to Paris Club creditors. Russia's ratio of federal external debt to GDP could very well fall to 6% by the end of 2006. This is likely to spark further positive rating actions by agencies like Moody's, Fitch and Standard & Poor's, with benefits for Russia's capital markets.

As for the stock market, 2006 began with a strong rally. We expect IPOs worth more than US$ 16 billion this year and with many offerings originating from sectors outside oil and gas, the stock market will become more diverse.

In recent years, Russia has made great progress in its efforts to become a member of the World Trade Organization. We anticipate that discussions will be finalised in 1H06, allowing Russia to become a WTO member by the end of 2006, or in early 2007 at the latest.

Although we are optimistic that the economy will perform well this year, we see a risk related to the elections of 2007 and 2008: if politicians give in to fears of upsetting the electorate, the reform process could stagnate further. However, the greatest threat to Russia's economy, in our view, would be further state involvement in the private sector.

## Banking Sector Developments

The banking sector grew strongly in 2005: total assets climbed 35% and amounted to US$ 335 billion by year-end. Although growth continues to be impressive, Russia's banking sector is still small by international standards. By comparison, U.S.-based Citigroup has total assets of US$ 1.26 trillion.

Total bank deposits increased 42% in 2005, amounting to about 20% of GDP. Equally outstanding, loans to non-financial private organisations and households amounted to US$ 185.4 billion as of 1 December 2005, close to 25% of GDP and up 43% from a year earlier. Loans to households remain low at a mere 6% of GDP but are growing rapidly.

The Russian population is slowly regaining trust in the nation's banking system. A very encouraging sign is that loans and deposits with a maturity of more than one year are now growing faster than short-term loans and deposits. This shows that the population and corporations are changing their way of thinking, and also suggests that banks themselves are beginning to take a more long-term view.

The Central Bank of Russia continued to make progress on reforming the banking sector in 2005, although the pace has been painfully slow. Following the mini-banking crisis in summer

2004, more small and under-capitalised banks have been closed, and the sector is going through a process of consolidation. While Sberbank will maintain its near-monopoly position in deposits for the foreseeable future, the credit market has become highly competitive, a process pushed forward by the increased presence of foreign banks. The increasingly competitive environment is putting pressure on local banks to improve their efficiency, and this necessity is largely driving the restructuring of Russia's financial system.

## The Banking Sector – 2006

We expect the banking sector to continue its expansion in 2006 with strong growth in both deposits and lending. With the ruble likely to strengthen this year, this should further fuel the demand for the domestic currency. With the expanded role of the ruble in the economy, banks will benefit from increased savings and lending.

However, 2006 is set to be a breakthrough year for Russia's banking sector for another reason. The sector, in a sense, represents the last frontier in Russia: few banks have gone public and foreign investment has been limited. However, a number of institutions are planning to go public this year and in 2007, signalling a quantum leap in terms of transparency in the sector. We expect the appetite for banking stocks to be strong, in part because the banking sector is showing one of the strongest growth surges in the Russian economy.

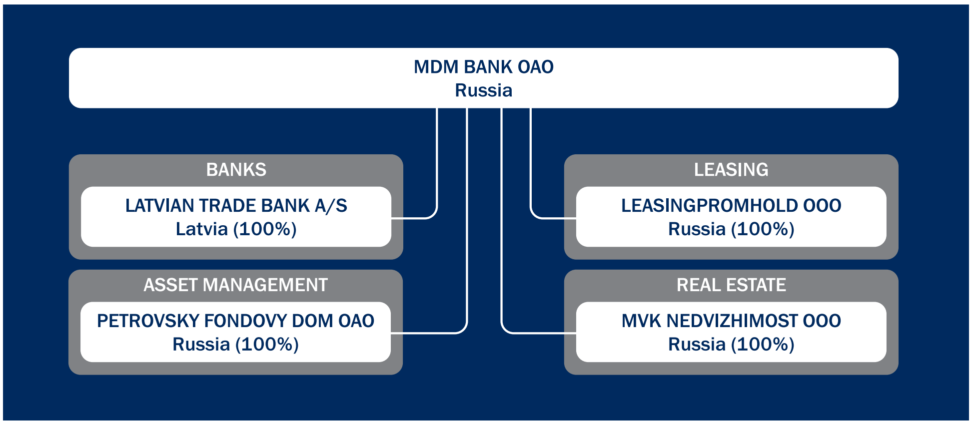
The government has made it clear that there will be no change to the law prohibiting foreign banks from opening branches in Russia. This has been a stumbling block in Russia's WTO negotiations, although it has not been a major obstacle for the increased presence of foreign banks on the market. The state has, however, announced that it will lift the limit on foreign banks' participation in the share capital of Russian banks from the current 25% to 50%.

Foreign interest in Russia's banking sector has been growing over the last couple of years as most global banks began to shop around for possible acquisitions. Increasing the threshold of foreign- controlled banking capital will increase the presence of foreign banks in Russia, bringing important spillovers in the form of management and technical knowledge.

# MDM BANK TODAY

MDM Bank is the lead operating entity of MDM Financial Group, which includes MDM Holding GmbH (Austria) and its subsidiaries. In addition to MDM Bank, subsidiaries include MDM Bank Saint Petersburg, MDM Bank Urals and the Latvian Trade Bank. Other principal subsidiaries include asset management, securities trading and leasing companies as well as a subsidiary that controls the Group's real estate holdings. MDM Bank accounted for 86% of the Group's assets and 84% of operating income at the end of 2005.

MDM Financial Group's principal holding company – MDM Holding GmbH – is owned 50%-50% by two companies, the beneficiaries of which are Andrey Melnichenko and Sergei Popov, respectively.




Among Russia's private and public financial institutions, MDM Bank is an established industry leader in providing an extensive array of banking and financial services to corporate and retail clients. Our core lines of business include corporate banking, investment banking, capital markets and retail banking. We number among our clients many of Russia's top 100 corporations, and have a network of more than 100 full service branches to meet the needs of our corporate, institutional and retail clients.

As an institution, our objective is to be a top three provider of products and services in each line of business in which we are active. We are achieving this goal across business lines based on our commitment to offering a complete spectrum of high quality products and services. Our business is focused on providing our customers with sophisticated solutions that will help them achieve their financial and business goals.

MDM Bank is one of the three largest privately-owned banks in Russia based on assets, with US$ 4.82 billion in assets at the end of 2005. We are also one of the most profitable, posting a US$ 109.4 million net profit at the end of the 2005. Our results make it clear that banking in Russia can be a sustainable and profitable business based on financial intermediation between unrelated parties.

While a solid financial foundation is the bedrock of our business, equally critical to our success is the way we deal with our financial stakeholders – customers, shareholders, employees and our community. A strong corporate governance programme lies at the heart of everything we do, and we have taken measures intended to ensure that we implement world-class corporate governance practices.

Our efforts have not gone unnoticed. Every international rating agency has rewarded our emphasis on corporate governance and financial transparency with high credit ratings. We have the joint-highest credit ratings from Moody's (Ba2) and Fitch (BB-) and the second highest rating from Standard & Poor's (B+) for a privately owned Russian financial institution. Moreover, we have been recognised by numerous industry groups and the financial press for our corporate governance practices.

# BOARD OF DIRECTORS

## Andrey Vernikov
**Chairman of the Board of Directors**

## Alexander Bolshakov
**Member of the Board of Directors**

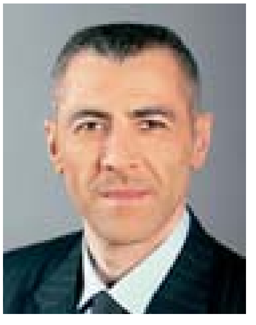
## George Cardona
**Member of the Board of Directors**

## Vladimir Stolin
**Member of the Board of Directors**

## Andrey Melnichenko
**Member of the Board of Directors**

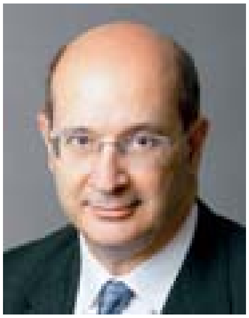
## Sergei Popov
**Member of the Board of Directors**

## Richard Sheath
**Member of the Board of Directors**



**Andrei Vernikov**
is the Chairman of the Board of Directors. He has 13 years of experience in international financial institutions, commercial banking, central banking and general management. Formerly, he was a member of the Executive Board of the International Monetary Fund and Deputy CEO of ABN AMRO Bank's subsidiary in Russia.

**Alexander Bolshakov**
has 31 years of experience in banking and general management, and has advised several western financial institutions on establishing banks in Russia. He was a partner in the audit practice of PricewaterhouseCoopers. Alexander is a recognised authority in Russian banking circles on accounting, audit and internal control and is the author of numerous publications on Russia's banking industry.



**George Cardona**
has 30 years of financial experience in banking and general management, and served as a Special Adviser to the UK Treasury. Formerly, he was General Manager and Head of Strategy for HSBC Group. He has served as a non-executive director for numerous banks and financial services companies and has particular experience in banking in emerging markets.

**Andrey Melnichenko**
is the beneficiary of a company owning a 50% stake in MDM Holding GmbH. He received a degree in Finance and Credit from the Plekhanov Russian Economic Academy. As one of the original founders of MDM Bank, he served as its CEO until October 1, 2001, and as Chairman of the Board until May 19, 2005.

**Richard Sheath**
has more than 20 years of experience in banking, general management, audit and risk management. He was a partner in the risk management consulting practice of PricewaterhouseCoopers and has extensive experience in advising Russian banks. He also heads a UK consultancy specialising in advising large companies on corporate governance and control structures.

**Vladimir Stolin**
has over 17 years of experience in the field of human resources and management consulting, as well as over 20 years of teaching experience as a professor of psychology at Moscow State University. As a specialist in motivational techniques, he is well recognised in the Russian market for his extensive work on employee motivation. He also has experience in chairing and serving as a member of the Board of Directors for several Russian companies.

**Sergei Popov**
is the beneficiary of a company owning a 50% stake in MDM Holding GmbH. He joined MDM Bank's Board of Directors on June 10, 2002, after acquiring a 50% stake in MDM Financial Group from his longstanding business partner, Andrey Melnichenko. He graduated from Ural Politechnical University with a degree in Industrial Heat and Power Engineering.

For MDM Bank, corporate governance isn't just about compliance with international standards. It's about how we run our business. We have put in place governance structures that are designed to provide effective strategic leadership and control. We want our governance to strengthen our performance.

Our Board is charged with ensuring that we have clear strategic goals, that we are progressing steadily toward meeting these goals and that management are focused as a team on achieving targets. With the Board's guidance, we will establish a sound balance between risk and reward, and operate with the benefit of a strong control culture.

During 2005, we implemented a governance approach that is not only in line with good practice: it is being built into how we work on a day-to-day basis.

Good governance cannot be introduced overnight by simply putting structures and processes in place. It has to become an integral part of what we do. There is more to be done and we fully understand that we must strive to make our governance practices fully effective. Nonetheless, much has been achieved. This report discusses not only these achievements, but the plans to accomplish our goals in the future.

## Getting the Right Board in Place

In May 2005, we appointed a new Board of Directors. Our aim was to have a majority of independent, non-executive directors who contributed the right mix of skills. This goal was fully achieved.

These non-executive directors bring to the table a combination of risk management, accounting, financial reporting and control strategic planning and human resource management skills along with extensive knowledge of international operating standards and expertise in banking and capital markets.

**George Cardona**, **Alexander Bolshakov** and **Richard Sheath** continue to serve on the Board. **Andrew Seton**, who helped establish the Nomination & Remuneration Committee at MDM Bank, has unfortunately resigned due to family reasons. His place has been taken by **Vladimir Stolin.**

Our non-executive Chairman, **Andrei Vernikov**, has extensive international experience in the banking sector.

The independent non-executives are joined on the Board by **Andrey Melnichenko** and **Sergei Popov.**

Until December, two executive directors also sat on the Board, Andrey Saveliev (the former CEO) and Andrey Ilyin (Finance Director). At that stage, we had established an effective Management Board that met regularly to make operational and strategic decisions. As the Board was functioning well, it was determined that it would be preferable for the Board to focus on strategic direction and oversight as a body made up fully of independent directors and the shareholders. As a result, the executive directors left the Board in December. The new CEO continues to attend all Board meetings as a non-voting participant.

Further biographical details of the Board directors are provided on page 18-19 and on our Web site at http://www.mdmbank.com.

We feel that the Board is the right size for the present, and has an effective mix of experience that will support the Bank's strategic development and oversee its control structures.

## Helping the Board Do its Job

When the Board was formed, management provided a series of presentations that acted as an introduction for the non-executive directors. The directors continue to ensure they have the necessary knowledge by meeting with a cross-section of senior management during the periods when Board and Committee meetings are held. The Chairman is based in the Bank, and consequently has regular contact with management. The directors' knowledge has been supplemented by a number of visits to branches in Moscow and various locations throughout Siberia as well as to MDM Bank Saint Petersburg and our daughter bank in Latvia. These visits will continue during 2006.

The presentation of information to the Board is an area in which considerable work will be done during 2006. The Board has received considerable information through both oral and written presentations, and is satisfied that management have been fully open in sharing information and responding to questions and requests for clarification. However, management have faced the dual challenges of learning how to present information effectively to the Board and Board Committees, and also how to structure management information in a way that supports the Board in monitoring performance against strategy. Their task has recently become easier with the implementation of systems to produce IFRS information for MDM Bank on a standalone basis. The appointment of a new CEO with extensive experience in working with Boards at an international level will also make a significant difference.

Management proposals to the Board are generally considered in advance by the Management Board so that, by the time they reach the Board, they have already been evaluated and scrutinised by the executive management team.

The Board is supported in its work by the Company Secretary and her team. They are responsible for co-ordinating the Board's activity, and that of its Committees, as well as facilitating the interaction between the Board and the management team. The Company Secretary also provides advice on legal procedures and disclosures relating to the Board and the General Shareholder Meetings. This function has been strengthened by the appointment in October of a General Legal Counsel.

## What the Board Does

The Board of Directors is responsible for protecting the interests of the shareholders by providing strategic direction and oversight. Its role is to monitor management's execution of the Bank's strategy, provide longer-term strategic direction, make sure that the Bank is well-controlled and operating in line with regulatory and legal requirements, and to assess management performance. Additional information on the Board's responsibilities is provided at www.mdmbank.com.

In line with our belief that our Board and Committees must meet regularly and actively take an independent stance, our committees meet monthly and have fully independent memberships. They are all independent in formal terms, having no financial relationship with MDM Bank (except for their remuneration as directors) or any close personal relationships with management or shareholders. But crucially, beyond this formal definition, they all exercise in strong terms an independent mindset: they are all fully aware of the importance of their independence and their role as independent directors. Whilst working with management by using their experience to help them evaluate and develop strategic proposals and control systems, they exercise their independence through continual challenge of management at Board and Committee meetings. At times, this has meant that Board advice or decisions have resulted in a changed management position.

It is our firm belief that the Board must meet regularly to be effective, and consequently the Board meets monthly with the exception of August. During 2005, the Board met seven times. Prior to its formal appointment in May, the Board also met three times in advisory capacity.

Although it has been operating for only a short time, the Board has had a visible impact on how the Bank is run and on its strategic direction. Examples of its focus and actions during 2005 include:

- A review of the Bank's structure, including its subsidiaries, branch network and position within the MDM Financial Group;

- The development of detailed budgets for the current financial year and, at a higher level, for a three-year period;

- The establishment of a functioning Management Board structure and process;

- Consideration and development of a new reward structure for senior management;

- The strengthening of an integrated internal audit and compliance function;

- The review of key risks and risk management structures, with a particular emphasis on credit risk management and Board approval of major credit exposures;

- Oversight of the processes for approving transactions with interested parties to ensure legal compliance;

- Discussion of strategic initiatives, particularly our retail banking approach.

The Board was also very pleased to be able to announce the appointment of Michel Perhirin as Chief Executive Officer in February 2006.

The Board Committees are central to our governance approach. They meet regularly and undertake detailed reviews of issues before they are presented to the full Board. Their work during the year is described in the individual committee reports below.

During 2006, the Board will continue to develop its approach. Having addressed some of the core issues around the organisation's structure and controls, it will increasingly focus on ensuring that the Bank has a fully coherent strategy across its different markets and monitoring performance against clear goals, be these related to financial and strategic targets or aimed at strengthening operations and staff performance. Establishing an effective senior management reward system will also be a particular priority.

We will also focus on how the Board and the Bank communicate with stakeholders, particularly the regulatory authorities, and we will be developing a more structured approach to meeting our social responsibilities to the community.

The Board will also act on the results of its own performance review. We recognise that there is always scope for improvement as governance procedures develop to reflect changes in our business. In March 2006, we assessed how well we were working as a Board at a specially-convened meeting. We applied a rigorous approach drawing upon the best practices applied to Board evaluation in the UK. Improvements we will be seeking as a result of our discussions include enhancing the way information is presented to ensure the Board receives a clear picture of performance and risks on a timely basis; restructuring agendas to allow greater strategic focus; and more tightly monitoring progress in the implementation of Board decisions and recommendations. Each Board committee also conducted reviews of their performance. We believe that such evaluations of the governance structures are important in strengthening corporate governance and will conduct them annually; possibly using different approaches in future years once the Board and Committees have been operating longer.

The Board is also taking into account recommendations made by Standard & Poor's during their annual assessment to determine our Corporate Governance score.

## How our Board Committees Work

In line with our belief that our Board and Committees must meet regularly and actively take an independent stance, our committees meet monthly and have a fully independent membership. Having the right people is crucial: the relevance of each Committee's membership is visible from the descriptions of director experience provided above.

The Committee's work is central to the effectiveness of our governance structures. The Board appoints Committee members and delegates responsibilities to the Committees. The Committees undertake detailed review to ensure effective oversight, and provide advice to management on their proposals. However, the Committees remain very aware of the need to act in a non-executive capacity and maintain an independent perspective. Their achievements to date are described in the reports below.

The Committee Chairmen report regularly to the Board. At each meeting, they provide a brief summary of their Committee's activity. When appropriate, they also highlight specific issues to the full Board and make recommendations on decisions the Board needs to take.

Full details of the Committees' responsibilities are set out in their Terms of Reference, and can be found at www.mdmbank.com.

## The Audit Committee

The Audit Committee exercises oversight of financial reporting and internal control. This includes the work of the external and internal auditors.

It is particularly important than the Audit Committee combines independence with appropriate expertise in order to oversee the work of both management and auditors. Our Audit Committee consists of two independent, non-executive directors and one independent expert. All have more than ten years' experience in the financial sector. The Committee is chaired by **Alexander Bolshakov**.

**Richard Sheath** is a member along with **Marina Frolova**, (the independent expert) who has worked for nine years as a Senior Advisor to the World Bank Financial Institution Development Programme. She brings particular expertise in financial reporting as well as specialised knowledge in Russian accounting. On joining the Committee, Richard Sheath received specific training on issues related to Russian bank accounting standards from KPMG.

Since May 2005, the Committee has held monthly meetings, as well as an additional meeting to approve annual financial statements. Additionally, it met as an advisory group three times prior to its formal appointment. We believe that this frequency has been appropriate given the push to strengthen internal controls, the need to maintain full compliance with Central Bank regulations and the Bank's approach to promoting transparency through the publication of quarterly IFRS accounts.

Each meeting was attended by the full Committee and, by invitation, the Finance Director and Head of Internal Audit. Others who have attended by invitation for specific parts of meetings have included the Chairman of the Board, the CEO and the Chief Accountant. To make sure that the Committee is visible more widely and meets those responsible on a day to day basis for internal control, it also regularly asks other members of management to speak on specific issues.

The Committee works from a 12-month forward agenda that is regularly updated. Each month it is adapted to cover any developments necessary for review. During 2005, the Committees responsibilities included overseeing:

- The creation of a specialist unit with responsibility for IFRS financial statements, supported by a programme of specialist IFRS training. This included the development of a programme of continuing education for MDM professionals involved in preparing IFRS financial statements;

- A reduction in the timeframe for preparing and publishing IFRS financial statements;

- The initiation of a data warehouse project;

- Efforts to reduce the gap between RSA and IFRS accounts and to make financial reporting more transparent, with improved disclosures in a number of key areas. (These changes, which have been welcomed by rating agencies and bank analysts, included in particular disclosures on related party transactions, risk management and segmental reporting);

- Action to strengthen control systems in the Bank's branches;

- The development of a plan for further developing internal controls and strengthening our control culture (including a particular focus on Anti-Money Laundering measures);

- The conduct of an independent review of credit risk and tax compliance processes by Ernst & Young.

The Commmittee has also guided the development of a new style Internal Audit Department (IAD) in several key ways: defining the IAD's mandate to ensure an effective combination of risk-based auditing with reviews of regulatory compliance; overseeing the development and commencement of a training programme for the Department's staff reviewing the remuneration of the Head of Internal Audit (who reports directly to the Committee); and instigating a stakeholder review of management expectations for internal auditors. Under the Committee's guidance, the relationship between internal audit and management has improved with a more effective balance of independent checks and constructive advice to strengthen internal control. As the IAD in its present form was established only in July 2005, a review of its effectiveness will not be undertaken until later in 2006. However, as part of their credit and tax review, Ernst & Young provided a number of recommendations for improving the internal audit function, most of which will be acted on during the year.

The Audit Committee, in reviewing the annual and interim financial statements, pays particular attention to critical accounting policies, major judgments, unusual transactions, and the clarity of disclosures as well as compliance with accounting standards.

It sees its responsibility for oversight of external auditors as particularly important. During the year it has:

- Reviewed the appointment of both international standard and Russian standard auditors;

- Ensured that the independence and objectivity of the auditors is not impaired through regular questioning of the auditors and monitoring the nature of their relationship with management. After development by the Committee, the Board also adopted a policy on the provision of non-audit services by the external auditor: this requires that the auditor must not review its own work, make management decisions, have a mutuality of financial interest with the Bank, or be put in the role of advocate for the Bank;

- Reviewed the scope of the audit and the detailed audit plans and oversaw their implementation;

- Provided comments to the auditors on areas that required particular attention during the 2005 audit;

- Discussed the implications of the newly effective ISAs and IFRSs.

The Committee also initiated a review of external audit performance through a questionnaire-based exercise administered by the IAD to ensure an adequate level of independence. The results were discussed with the auditors: their constructive response and renewed efforts from the Bank's management have helped improve the effectiveness of the 2005 audit, particularly in respect to communications between the auditors and Bank staff.

In 2006, the Committee will be conduct such a review in conjunction with a tender to appoint the same auditor for both the IFRS and RAS-based financial statements.

In March 2006, the Audit Committee reviewed its effectiveness through a structured self-assessment discussion. As a result, over the coming year the Committee will primarily aim to improve the timing for submitting information as well as reduce the level of detail. The Committee expects to focus on making further improvements in the preparation of the financial statements, minimising the gap between RAS and IFRS accounts, further strengthening compliance and control processes and continuing to develop the Internal Audit Department.

## The Risk Committee

The Risk Committee oversees management of the Bank's risks.

As with the Board and other Committees, the independence of its members and the relevance of their experience are of primary importance. It has two members, both independent, non-executive directors. The Committee is chaired by **Richard Sheath**, who sits on the Committee with **Alexander Bolshakov**.

Meetings are attended by the Chief Risk Officer and Head of Internal Audit. Other members of the management team, in particular the Heads of Credit Risk and Treasury, are regularly invited to discuss specific issues.

During 2005, the Committee met monthly. Activities included:

- Steering the development of risk reports to enhance the monitoring of changes in risk positions;

- Accelerating the appointment of a Chief Risk Officer (who has a dotted-line reporting relationship to the Committee);

- Conducting a detailed review of liquidity and interest rate management including the funds transfer pricing mechanism;

- Initiating revisions to credit approval procedures (including the requirement for Committee review and Board approval of large credit limits);

- Working with internal audit in evaluating the systems for managing trading risks;

- Overseeing the development of risk maps, in particular covering operational and reputation risks;

- Reviewing risk management policies covering credit, liquidity and interest rate risk management.

Its work has resulted in a tightening of procedures in a number of areas, and helped lay the foundation for a stronger control culture built around a full assessment of the risk-reward balance.

During 2006, the Committee has continued to drive the development of risk maps and will be paying particular attention to operational risks.

In March 2006, the Committee reviewed its own effectiveness. Having established a firmer basis for Board reporting, it will look to adopt a more cyclical approach to reviewing the full risk spectrum and aim to integrate its deliberations more fully with the strategic planning process.

## The Strategy Committee

The Strategy Committee's work is focused on overseeing the development of strategic plans and budgets, and the critical review and analysis of strategic proposals and organisational restructuring.

Its work to date has involved initiating a major cultural change in the Bank, shifting from an approach based on short-term cost budgeting to structured, long-term planning in each area of the business. It has sought to become a body that subjects the Bank's strategy to constructive debate.

An independent view in this debate is secured by the independence of its members. It is now made up fully of independent, non-executive directors (having included until December the CEO). It is chaired by George Cardona with Andrei Vernikov as the other member. Andrew Seton was a member until December; his position on the Committee remains vacant.

Since the establishment of a Strategic Planning Department in August, Committee meetings have been attended by the Head of Strategy. The Finance Director, business unit heads and General Legal Counsel are also invited by the Chairman to discuss specific issues. As part of the Committee's role is to develop a planning culture, this interaction with management is particularly important.

The Committee has met monthly during 2005. Formal meetings have been complemented by additional meetings to discuss specific issues, as well as visits to branches and the Bank's subsidiaries in Latvia and Saint Petersburg. Given the need to shift the approach to planning, this frequency of meetings has been necessary to ensure that momentum is maintained and that decisions can be reached after the required level of debate within an acceptable timeframe.

During the year, the Committee's work has included:

- Guiding the development of medium-term plans (covering 2006 – 2008) based on total shareholder return as the principal objective;

- Steering the development of bottom-up strategies for corporate, retail and private banking;

- Overseeing the 2006 budgeting process;

- Reviewing strategies for the Bank's subsidiaries in Latvia, Saint Petersburg and the Urals;

- Assessing proposals for restructuring the main business units, the Financial Group and the daughter banks;

- Evaluating the creation of an Asset Management Unit.

It has been a challenging year for management in terms of strategy development. Debate on fundamental issues has led to some organisational and management changes. The Strategy Committee and Board have made their presence felt, having a positive impact on strategic planning but requiring management to raise its strategic thinking to a new level of clarity and precision.

This shift will be felt further during 2006. The Committee will continue to give a high priority to developing medium-term strategies for the core business units. It will oversee the development of an external relations strategy incorporating a more structured approach to relations with government, investors, the media and the wider community, including policies covering sponsorship and charitable donations. More work will be done on guiding the development of performance reporting, including the definition of both financial and non-financial Key Performance Indicators.

## The Nomination and Remuneration Committee

The Committee has had a central role to play over the past year with the establishment of new governance bodies, changes in the senior management team and a push to adopt a reward structure.

Its role is a combination of making recommendations to the Board on appointments to the Board of Directors and the Management Board; succession planning for the Board and senior management positions; director compensation; and the level and structure of management remuneration. It also provides the Board with a performance assessment for the CEO and oversees the development of general human resource management policies.

The Committee is made up of two independent non-executive directors. Until November, it was chaired by **Andrew Seton**. Since then it has been chaired by **Vladimir Stolin**. The other member is **George Cardona**.

Meetings are attended by the Chairman of the Board, the CEO and the Head of Human Resources. Non-members are not present for discussion of their own performance or remuneration. The Committee meets monthly. During the year, particularly until the appointment of a new Head of Human Resources in October, the Committee also held additional discussions on the former CEO’s proposals for a new remuneration structure.

The Committee has spent much of its time on this issue, which is regarded as crucial. Its emphasis has been on encouraging the development of a system that is aligned with our strategic goals, based on both financial and non-financial targets. Although considerable progress has been made in developing a new structure, its implementation has been delayed in the light of the appointment of a new CEO and until implementation of the new IFRS financial systems allows the evaluation of performance across business units on the same basis as the financial statements. Implementation is the primary goal for 2006.

Activities have also included:

- The development of a new modus operandi for the Management Board combined with a review of contractual arrangements for its members;

- The securing of a new CEO;

- The evaluation of candidates for new directorships;

- The approval of a system for allocating overhead costs as an essential part of the future remuneration system.

In March 2006, the Committee conducted a brief self-evaluation of its effectiveness; a fuller review will be conducted next year once the Committee Chairman. The Committee expects to play a more distinctive oversight role in the issue of remuneration policy: this change in emphasis is enabled in part by the new CEO's role in developing reward systems and by the support provided by the new Head of Human Resources.

# MANAGEMENT BOARD

## Michel Perhirin
**Chairman of the Management Board**

## Vladimir Rykunov
**Member of the Management Board**

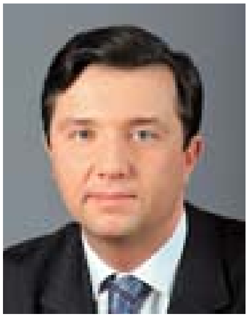
## Timur Avdeenko
**Member of the Management Board**

## Alexei Panferov
**Member of the Management Board**

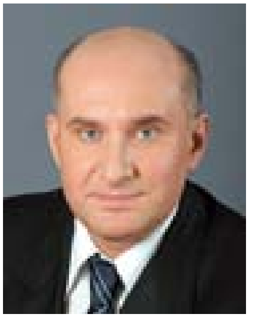
## Andrey Ilyin
**Member of the Management Board**

## Vladimir Izutin
**Member of the Management Board**

**Michel Perhirin**
was appointed Chairman of MDM Bank's Management Board on April 20, 2006. Michel was with Societe Generale from 1970 until 1996, working in a number of countries: France (1970—1976), the United Kingdom (1976—1983), Australia (1983—1987), Japan (1987—1991) and Spain (1991—1993). He also opened and ran Banque Societe Generale Vostok in Moscow from 1993 through 1996. From 1996 through 2005 he opened and ran, as CEO, ZAO Raiffeisenbank Austria in Moscow. Michel graduated from the University of Nantes with a degree in economics.



**Vladimir Rykunov**
has been a Vice Chairman of the Management Board since 1997 and is the Group's Head of Operations. Vladimir joined MDM Bank in 1996 as Head of the Customer Relations Department.



**Timur Avdeenko**
has been Vice Chairman of MDM Bank's Management Board since joining the Bank in November 2001. He is the Group's Head of Corporate Banking.
From 1996 to 2001, Timur was Senior Vice President and Head of the Major Client Department at Alfa Bank.

**Alexei Panferov**
has served as Vice Chairman of the Management Board and the Group's Head of Investment Banking and Financial Markets since March 2002.
From 1995 to 2002, Alexei held management positions with Zenit Bank, including Head of Investment Banking.

**Andrey Ilyin**
Prior to his appointment as Group CFO in May 2005, Andrey Ilyin was Head of International Business Development.
Andrey joined MDM Bank in October 2004. His experience includes several years at the London-based investment banking boutique Sindicatum Ltd and five years at the London office of Nomura International, where he was responsible for EMEA and West European banking equity research, as well as four years with PriceWaterhouse in Moscow. He is qualified as a Certified Accountant.

**Vladimir Izutin**
joined MDM Bank in April 2005 as Group Head of Retail and SME Banking.
Prior to this appointment, he was Chief Executive Officer at the Industrial Insurance Company (member of the UralSib Group). Vladimir worked for 8 years in senior management roles at Alfa Bank, Moscow, in the retail banking area, managing the plastic cards business and the retail network.

# MDM AND SOCIETY

For MDM Bank, corporate social responsibility means, first and foremost, addressing the expectations of our customers, shareholders, employees and other stakeholders in managing our business responsibly, in order to ensure its long-term success.

While developing a more structured approach to meeting our social responsibility to the community is one of our goals for the years to come, we have already started to take steps toward addressing this agenda, focusing on such areas as transparency and accountability, achieving sustainable business growth and supporting local communities. Overall, we believe that our key social responsibility is to be successful in our core role as a financial services provider.

**Transparency of our business.** In order to make our business transparent for our stakeholders, we employ various channels of communication, including publication of annual and interim reports, rating reviews, market analytics and commentary, placing essential information on the Bank's activities in central and regional media, as well as on the Bank's Web site. We continually enhance the quality of our reports, and have significantly improved the timeliness of their publication.

MDM Bank has been recognised as one of the market leaders in respect to the transparency of our reporting and disclosure (see the section below for more detail). In addition to financial reporting, our Web sites (www.mdmbank.ru; www.mdmbank.com) contains detailed information tailored for various stakeholder groups, ranging from institutional investors to retail customers.

**Achieving sustainable business growth** largely depends on the success of our efforts to build durable client relationships, including retention of our long-term customers and establishing relationships with new ones. Toward this end, we became one of the first Russian banks to begin using a Client Relationship Management (CRM) system to monitor client-bank interactions and gather information necessary to better anticipate client needs and enhance the client experience. We improve our competitive edge by introducing innovative banking products, raising quality and increasing the supply of our traditional investment and corporate banking services, and improving our customers' access to both domestic and international markets.

To ensure a broader outreach to market participants, MDM Bank sponsors various seminars, conferences and symposia both in Russia and abroad. Over the past year, we sponsored EuroMoney's Bond Investors' Conference in London as well as the IFRU's First Annual Russian IPO Conference.

We leverage our regional network to enhance product offerings, in particular through development of lending to small and medium size enterprises (SME) and retail lending. At the end of 2005, we started to implement a new SME programme. With the support of International Financial Institutions as well as of the local governors in several Russian regions, the Bank is approaching the regional markets with a number of banking products specially designed for small business and entrepreneurs. Our improved regional presence has already brought about certain tangible results. In particular, our regional network has significantly contributed to the growth in corporate lending as well as in our automobile loan portfolio. We view such developments as our contribution to sustainable growth of the regional economies in which we are present, as well as to their increased social stability.

**More detailed descriptions of our strategic business units and the results of their activities over 2005 are presented in relevant sections below.**

Our efforts **in making MDM Bank a good place to work** are primarily focused on education and professional development for our personnel, both in the Headquarters and throughout the regional branch network. Engaged and qualified employees are more productive and provide a higher quality of service to clients, leading to better results and the creation of greater sustainable value for all our stakeholders. To help us achieve these goals, we invest continually in our employees. To that end, we have launched a programme of 'distance learning' via special software called Corporate University, allowing Bank employees all over Russia to benefit from on-the-job training, remain current on recent changes in the regulatory framework and internal procedures, or even to pass qualification tests under supervision of a specialist from the Bank's headquarters.

Additionally, in 2005, we arranged a number of specialised training programmes designed for those employees who are directly involved in promoting control and compliance culture within the organisation. In particular, this includes training the internal audit staff, as well as those head office and regional branch officers who are responsible for anti-money laundering activities. A number of key employees have successfully completed IFRS certification programmes, encouraging their peers to follow this successful example.

Another way in which we contribute to maximising our human capital is by using our links with external organisations to attract ambitious individuals from diverse backgrounds.

To retain our good staff, we are developing human resource management policies under the guidance and oversight of the Board's Nomination and Remuneration Committee.

**Supporting local communities.** We believe that it is important that we give back to the communities where we operate. We support a wide range of philanthropic and cultural causes, aim to facilitate cultural ties between Russia and other countries, and introduce Russian audiences to international masterpieces of art. In 2005, MDM Bank sponsored a tour of the opera Aida, produced by the great Italian director Franco Zefferelli, as well as the XXVII Moscow International Cinema Festival.

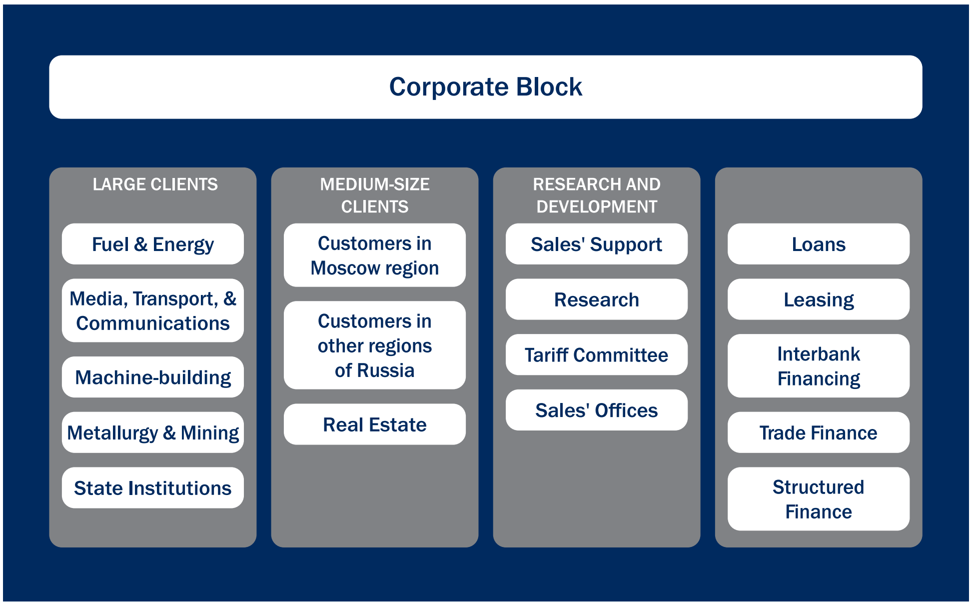
We also give support to disadvantaged members of Society. Over the past year, we have made a number of contributions to organisations that aid children, the elderly and the handicapped, as well as medical and scientific institutions. Some of the organisations we have supported over the past year include the Tagansky War, Labour and Army Veterans, the Fund for Mutual Understanding and Reconciliation, the Goncharnaya Sloboda War Veterans Union (financial aid for a 60th Anniversary Victory celebration), the Russian Troopers' Union (donation for a 60th Anniversary Victory Day Celebration) and the St. Petersburg 'Give a Chance' Fund.

In 2006, we will focus on developing a more structured approach to our social responsibility activities and will report on this increased activity next year.

# MDM'S STRATEGIC BUSINESS UNITS

## CORPORATE BANKING

Corporate Banking, which was the top contributor to our revenues and profits in 2005, continued to focus on expanding its presence in Russia's fastest growing corporate segment – the middle market. These emerging blue chips, most with annual sales between US$ 50 million and US$ 1 billion, are some of the fast-growing companies in Russia.




The market in Russia for corporate financial services is becoming increasingly competitive, with pressure on margins resulting from increased activity by state, quasi-state and foreign institutions; the improving access of top Russian corporates to international money and capital markets; and the significant amount of liquidity in the banking system due to an overall favourable economic situation. As with all MDM units in 2005, our Corporate Banking team worked to ensure that we not only successfully compete in these conditions, but continue to increase our market share and strengthen our position at the forefront of the banking sector.

**CHART: Deposits, trade finance and structured finance transactions in 2003–2005**

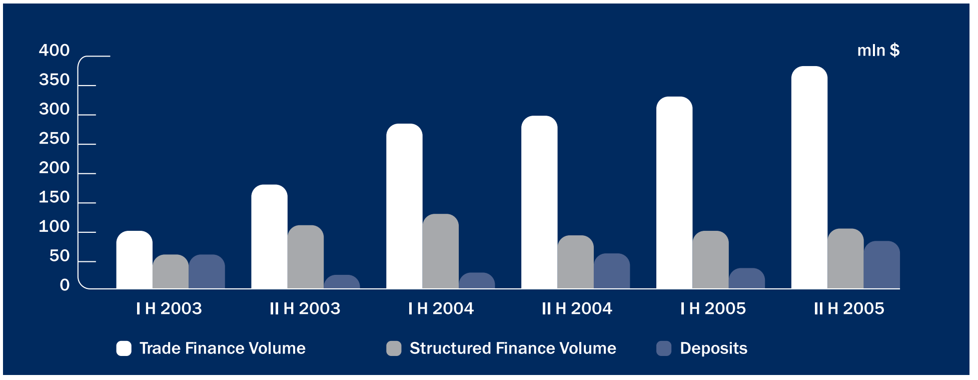
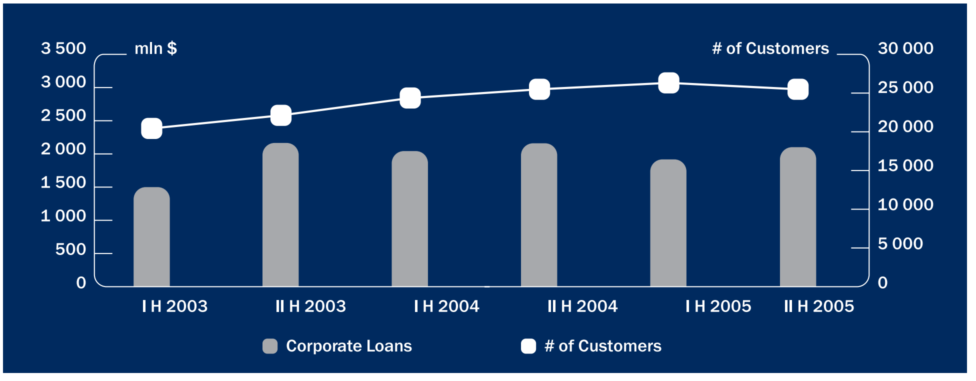



**CHART: Growth in number of customers and volume of corporate loans in 2003-2005**




In 2005, the Corporate Banking unit focused on laying the right foundation for achieving our medium-term objectives – above-market growth with sustained profitability.

## Fast and flexible solutions for customers

We continue to monitor our product range in order to respond to changing customer needs.

Overdrafts were added to our range of services in 2003, and by the end of 2005 over 500 corporate customers were actively using this facility.

Treasurers of large corporates with a multi-regional presence increasingly demand cash management and cash pooling services. MDM has the capability to accept deposits through regional affiliate offices and allow holding companies to more closely control subsidiaries by providing constant access to subsidiary accounts and monitoring/authorising the subsidiary's payment activity.

Commercial mortgages were launched in 2003. This product represents an efficient way for many lower-tier, medium-size corporates to raise relatively inexpensive funding. By the end of 2005, MDM's commercial mortgage portfolio amounted to over US$ 45 million.

Specialised programmes created specifically for the auto industry have contributed to growth in lending. The Bank extends loans to car dealers and accepts inventory or, in some cases, the actual business, as collateral. Other examples of industry-specific initiatives include funding advances on precious metals transactions (more than US$ 30 million in 2005), providing financing for cooperative programmes in the media industry, and financing more than US$ 75 million in real estate and construction projects.

Our product development team will continue to add to our product range (for example, factoring), augmenting it with new offerings that are in demand from a strategically important segment for us –fast-growing, medium-sized companies. In 2006, we will begin offering our corporate clients a new sweep function that will allow companies to establish maximum balances for regional subsidiaries holding accounts in MDM branches. Amounts over the limit specified by the parent company will automatically be swept into the parent company's consolidated account.

## Cost of funding

MDM Bank has one of the lowest funding costs among privately owned Russian banks, yet it is certainly higher than that of state-owned and foreign banks operating in Russia. The Bank continuously looks for ways to reduce its cost of funding without taking excessive liquidity and interest rate risks.

Toward the end of 2005, MDM launched an interest-bearing current account for corporate customers, responding to the growing demand from corporates for more effective treasury management. This demand should increase over time, and enhance diversification of this pool of stable and relatively inexpensive source of funds.

## Staff

MDM has been able to attract and retain entrepreneurial relationship and sales managers and high-quality credit analysts. In 2005, the Corporate banking unit added 62 new specialists to its team. Going forward, we will refocus our efforts on increasing the quality and quantity of credit and sales managers in the regions.

## Cross-selling

We want the ability to cross-sell effectively to be our key strategic advantages in an increasingly competitive market. We became one of the first Russian banks to begin using a Client Relationship Management (CRM) system to monitor client-bank interactions and gather the information necessary to better anticipate client needs and enhance the client experience.

We believe that the effective coordination of Corporate and Investment Banking units can be improved further, and in early 2006 we introduced a Client Committee to our organisational structure as the body responsible for this coordination.

We continue improving our ability to leverage our existing relative advantages. We use MDM Bank's high visibility and strong reputation in the international markets in provide our corporate customers with trade finance and structured finance solutions that represent a cheaper financing option for importers and exporters. In 2005, MDM issued nearly US$ 500 million in letters of credit, a 5% increase over the previous year. Moreover, we doubled the volume of trade-related loan facilities. International institutions provided MDM with funds exceeding US$ 360million, and approximately 50% of relevant instruments were subsequently traded in the secondary market. We also continued to place structured pre-export facilities to provide financing for Russian precious metal producers. Going forward, we will simplify these structures and increase the tenor to 2 years.

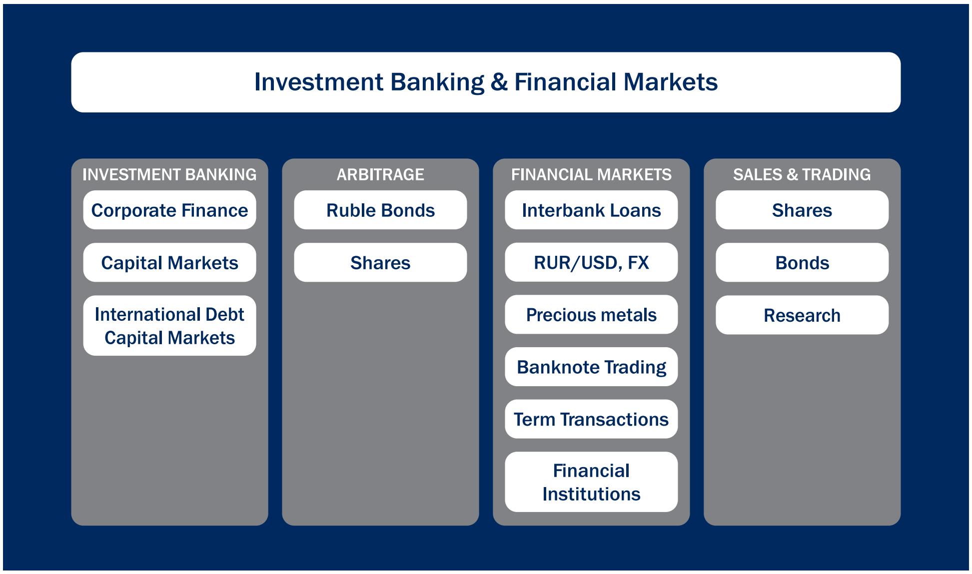
## Regions

The future growth of MDM Bank's corporate franchise will, to a significant extent, come from the regions. In 2005, the corporate loan portfolio in our branch network grew from US$ 336 million to US$ 605 million, comprising 21.7% of our total corporate exposure as of the year-end. In 2006, we will emphasise adding motivated and qualified experts in the regions in order to reach our ambitious growth targets.

# INVESTMENT BANKING AND FINANCIAL MARKETS

Our Investment Banking and Financial Markets Unit continued to perform successfully in 2005.

The key to our success in this area, where many universal international and Russian banks have traditionally failed to perform, is our customer focus and quality of human capital. We focus on medium-size corporate clients, or emerging blue chips – a segment where we have an advantage over large international banks. We have also been able to attract and motivate entrepreneurial and profit-driven staff, which gives us an edge over most of the local investment banking competitors.




## Investment Banking

In 2005, our Debt Capital Markets (DCM) Unit further strengthened its position in the sector, while important milestones were reached by Equity Capital Markets and Corporate Finance.

MDM Bank's DCM unit acted as lead manager on Nizhnekamskneftekhim's US$ 200 million debut Eurobond offering in a transaction unprecedented on the Russian market. This transaction marked the first time a Russian bank arranged a Eurobond offering independently, and clearly established our reputation as a bank able to compete for clients in the Russian market with the leading international institutions. *Global Finance* magazine also named MDM Best Domestic Eurobond Arranger.

In 2005, MDM underwrote 10 ruble-denominated offerings valued at more than RUB 23 billion, including a RUB 3 billion offering for TMK, the largest holding company in Russia's pipe producing industry, a RUB 1.5 billion issue for Nizhnekamskneftekhim, and a RUB 3.5 billion offering by the Irkut Corporation. We continue to be an industry leader in arranging credit linked notes (CLNs), and acted as lead manager on CLN transactions for Amtel, Ritzio Entertainment Group, Seventh Continent, Salavatnefteorgsintez and Nutrinvest.

Based on our successful track record, *Global Finance* magazine named MDM Bank the *Best Domestic Mergers and Acquisitions Arranger in Russia* in early 2006.

Our ECM team sealed an important IPO mandate in 2005 (Razguliay), and the transaction was executed seamlessly in the first quarter of 2006.

## Sales and Trading

Whilst MDM is one of the market's recognised leaders in fixed income sales and trading, we felt that in 2005 we needed to expand on our efforts in building the equity sales and trading team. Additionally, a major investment was made in research and we expect to become one of the top-rated research teams over the next few years.

For clients who wish to self direct investments, we introduced a new Internet-based trading product called NetInvestor. Customers can monitor trading in real-time and independently execute deals on MICEX (corporate and government securities), RTS-SGK (including Gazprom shares) and RTS-FORTS (RTS futures, options).

## Financial Markets

In our corporate model, Financial Markets comprises money markets, foreign exchange, bullion, derivatives and financial institutions units, which are staffed by recognised professionals, many of whom have helped to shape the Russian financial markets over the past 12 years. Its main functions are to generate client commission business in foreign exchange, derivatives and banknotes, to take advantage of arbitrage opportunities on the money and foreign exchange markets and to provide execution services for MDM Bank's Treasury.

During 2005, we maintained a very strong presence in the precious metals market, securing a 6.5% share of gold trading and a 20% share in silver trading. Also participating in precious metals financing, we sealed an unsecured and unrestricted US$ 10 million gold loan from Credit Suisse. In addition, Commerzbank AG has provided a one-year, US$ 20 million credit for the pre-export financing of precious metals production.

Our leadership in the foreign exchange and money markets was further reinforced over the course of 2005. We significantly upgraded our FOREX trading capabilities and expanded our online presence. Clients can trade all of the world's principal currencies 24 hours a day, 7 days a week. We were voted *Best Foreign Exchange Bank by Global Finance*. The Moscow International Foreign Exchange Association named MDM Bank among the top three institutions in three categories– *Best Foreign Exchange Dealer of 2005*, *Best Money Market Dealer of 2005* and *Best Money Market Desk of 2005*.

Going forward, MDM Bank will build on its current leadership position in commodity derivatives to continue driving the development of the derivatives market in Russia. As the market matures, access to hedging tools is becoming increasingly important to the more sophisticated corporate and bank treasurers. We will seek to play an active role in shaping the market by acting as a bridge between Russian clients and major international banks, without exposing our capital to arbitrage positions in the derivatives market.

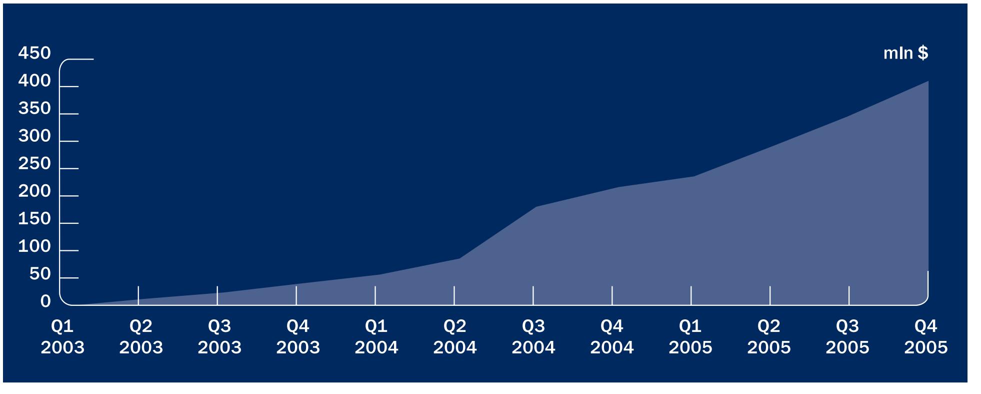
# RETAIL BANKING

Retail banking is MDM Bank's fastest growing division. Whilst this segment requires significant investment in systems, process, delivery channels and personnel, and the market environment is difficult given the dominant role of state and quasi-state banks, MDM Bank attaches significant importance to this business. Retail banking will shape the Bank's future in the longer term.

## Car Loans

In 2005, MDM Bank maintained its position as Russia's leading underwriter of car loans, with more than 11% of the market and a car loan portfolio of US$ 404.8 million as of year-end, an increase of 89% over the year. To secure and strengthen its position, the Bank established relationships with additional car dealerships. We now work with 1000 car dealers across the country. A very positive feature of current growth is that it is driven mostly by the regions outside Moscow, a trend that we expect to continue going forward.

**Car Loan Portfolio**



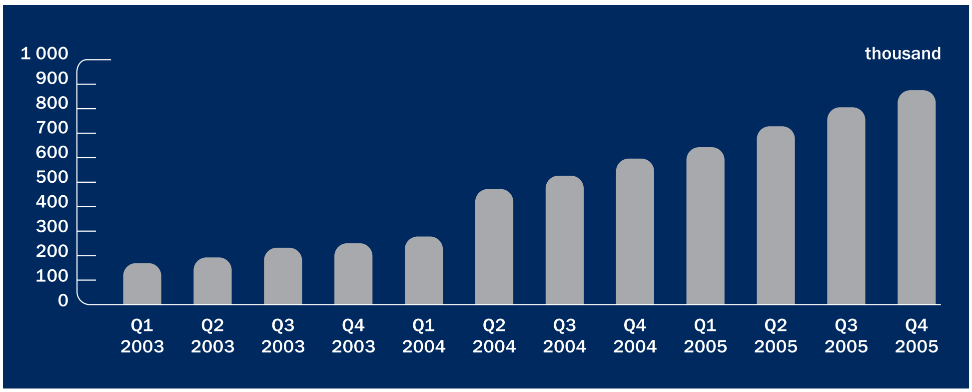

## Plastic Cards

Expanding our credit card business is also a strategic priority. In 2005, our credit card portfolio grew by 236% while credit card issuance grew by 282%. The increase in our credit card business can be attributed to the implementation of a number of new programmes and products as well as the modernisation of existing credit programmes in Moscow and the regions.

Overall, plastic card issuance increased by 45% in 2005, to more than 870,000 cards outstanding. This cemented our position as one of Russia's leading card issuers. Transaction volume increased by 60% over 2004, with US$ 1.1 billion in outstanding balances. Within the acquiring network development in 2005, MDM recruited more than 700 merchants. Acquiring turnover amounted to US$ 1 billion, increasing by almost US$ 400 million over the year.

By the end of 2005, MDM worked with 62 banks under agent and sponsorship agreements for issuing and acquiring card programmes. During the year we added 23 banks – 18 banks as associated members of VISA International and 8 banks as MasterCard affiliated members. MDM's processing centre currently services more than 500,000 cards for bank partners. Retail transaction turnover on the cards of bank partners totalled US$ 41 million, increasing 204% over the year. In 2005, acquiring turnover at the merchants network of bank partners totalled US$ 539 mm, increasing by 45%.

**CHART: Plastic cards issued in 2003-2005**



## Small and Medium Enterprises

During 2005, MDM Bank embarked on a three-year-long project aimed at establishing a leadership position in the national SME market. Emphasis will be on developing standardised credit products representing the best price-quality combination for the customer. Over 2005, we built a team of experienced professionals in this area, and have set ourselves ambitious growth targets. We are actively exploring ways to work with the international development organisations to help fund our growth in the SME field.

## Mortgages

The residential mortgage market represents a significant growth opportunity for Russian banks, as almost 90% of residential housing transactions continue to be cash-based. MDM's mortgage lending business continued to grow rapidly throughout 2005 from a low base, and totalled US$ 30 million at the end of 2005. The regional market yielded the most growth, increasing tenfold in 2005.

## Infrastructure

We expanded our network of ATMs and self-service terminals over 2005, increasing the number of machines by 45%. By year-end, the Bank had more than 100 ATMs and 50 self-service terminals. Customers can use the network to obtain cash, change dollars and euros to rubles, and pay mobile phone or satellite TV operators as well as use a cash-in option to pay off their MDM credit card balances. We have also increased customer convenience by making it possible for cardholders to access account information and complete certain card transactions through telephone and Internet-banking applications.

# PRIVATE BANKING

In 2005, we emphasised building a foundation for a competitive and structured approach to private banking to serve the needs of our high net worth clients (those with investable assets of over US$ 500 thousand). Our greatest achievement over the year was to develop a customised, four-step advisory process that focuses on understanding every aspect of a client's personal circumstances, business interests, aspirations and relationship to wealth and investments. No other Russian institution offers a comparable approach to wealth management for private clients.

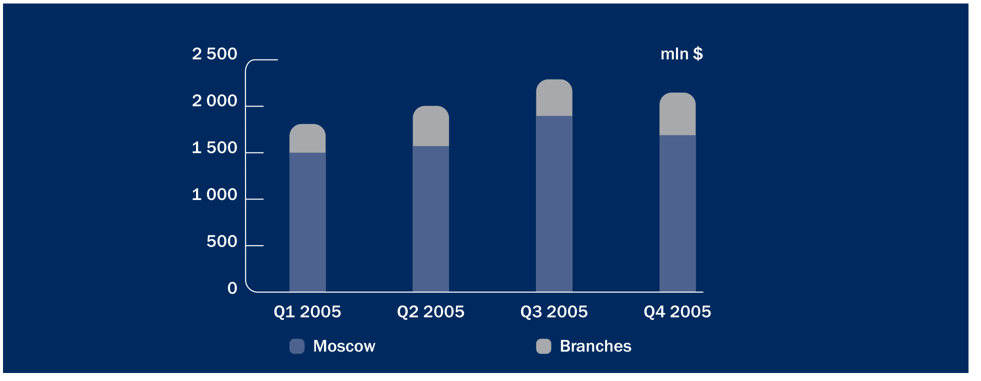
Our Private Banking division offers four main investment strategies that can be tailored to the requirements of each client – conservative, balanced, growth and maximum growth. Based on our understanding of the clients' needs, we build customised portfolios and offer ongoing support in managing assets. We rely on a global network of product experts and investment specialists to develop and implement investment strategy.

MDM Bank has also succeeded in creating an open architecture platform that gives clients access to world-class investment managers typically available only to institutional investors or private investors with portfolios of institutional size. MDM Bank continuously monitors manager performance in a comprehensive and cost-effective manner.

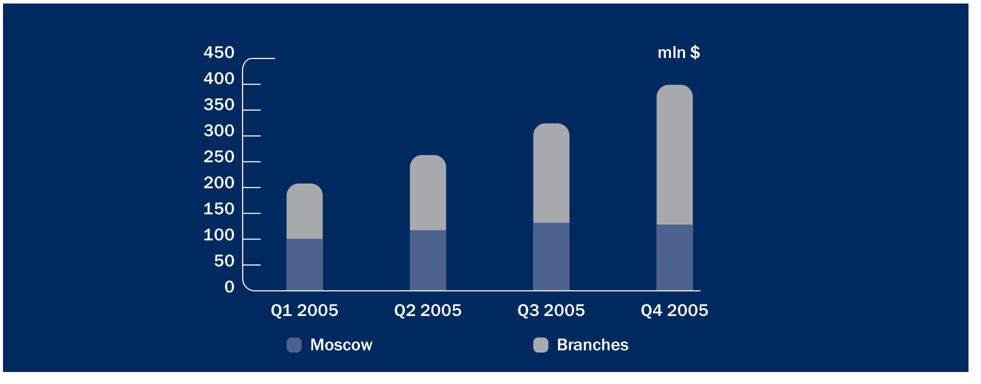
# REGIONAL BRANCH NETWORK

**Over 2005, we leveraged our extensive network of regional branches to significantly develop both our corporate and retail businesses. Our corporate loan portfolio in the regional branches grew by more than 80%, bringing total outstanding loans to slightly more than US$ 600 million. In the second half of the year alone, we gained 382 new corporate clients.**

**Corporate Loans**




**Car Loans**




We actively promoted retail credit products through our regional network, which allowed us to triple the outstanding loan portfolio during 2005. Car loans were the strongest driver of our retail lending business, and during the year our auto loan portfolio grew by 88.7%. Over 2005, we added 17,000 new retail clients to our customer base.

Future growth of most of our retail and, to a significant extent, our corporate business is reliant upon an effective regional branch network. In recognition of this, we are planning to significantly increase our investment in the network over the next few years, including increasing the quantity and quality of staff, locations and infrastructure.

# INFORMATION TECHNOLOGY

Over the past year, a principal goal of the Bank's IT strategy was to expand the technology that supports our retail banking business. We have made significant strides in upgrading our systems. In particular, the technology tracking and accounting for transactions at every step - from point-of-sale to back office – in the process of delivering express credit were significantly enhanced.

We have also improved our ATM network, and now offer through ATM machines a wide range of self-service options that include currency exchange and the ability to replenish card accounts. Given the high volume of cash transactions in Russia, selected ATMs also dispense coins and accept large volume cash deposits.

The installation of call centre software was the first step in offering online access for retail accounts. We also initiated an upgrade of our card processing platform, which we believe will be instrumental in increasing the future profitability of our plastic card business. As of year-end 2005, MDM Bank had more than 17,000 POS terminals across the country. Over 2006, developing the technological infrastructure to support our retail business will continue to be a high priority.

The Bank is also focused on enhancing the technology that supports our Investment Banking and Financial Markets Unit. In 2005, separate systems supporting broker-dealer services on the money market and foreign exchange markets were consolidated into one programme, and a unified risk management system was installed.

We have also upgraded our electronic archiving and storage capabilities, and now more than 80% of RUB-denominated payment documentation is archived in electronic format.

Significantly, we place a high priority on monitoring our information technology systems to safeguard our clients and their assets. In 2005, we introduced an integrated system that will help us ensure that our technology continues to function efficiently and support our business activities. Today, all bank technology has been integrated into this automated monitoring system.

# INTERNAL CONTROL & AUDIT

## Internal Control

Over the medium term, we aspire to attain high international standards in internal control and are beginning to benchmark ourselves against these standards.

To take stock of where we are in terms of internal controls and overall efficiency of key business processes, in 2005 and 2006 we conducted two major studies with the aid of the Big Four international firms in the area of tax, credit, key business processes and IT. We are planning to use the findings of these reports to enhance the efficiency of our business and control processes.

The Bank's functional departments exercise internal control through control procedures built into the processes and operations. The main principles of our internal control system organisation are continuity in operations, independence, objectivity and professional competence.

The Bank is constantly developing its internal control system in order to align it with best international practices. A sound internal control system is able to give sufficient assurance for the fair presentation of financial data as well as the efficiency of the processes. The internal audit methodology being developed is aimed specifically at providing assurance on the functioning of the Bank's internals control. The internal audit function is viewed as a valuable tool for assessing and improving the internal controls that are being established.

## Internal Audit

The Bank follows internationally recognised benchmark practices of corporate governance, which stipulate that specific attention is paid to the Bank's internal control system and the Bank's internal audit function as the primary element of control.

In 2005, the Internal Control Service and the Audit and Control Department were reorganised to form the Internal Audit Department (the IAD). The IAD is an independent structural subdivision that reports directly to the Board of Directors and the Chairman of the Board. The Head of the IAD and its staff do not participate in the activity of any executive bodies of the Bank, nor are they members of the management team.

The scope of IAD's responsibility includes assisting the Bank's management in ensuring that operations are carried out efficiently by using a systemised and consistent approach to evaluate internal controls and ensure improvements in their effectiveness and to evaluate risk management and corporate governance.

The main areas of IAD audit work cover:
• Operational audits on specific types of transactions;
• Audits of branches and sub-divisions of Moscow region;
• Computer-audit.

The IAD regularly analyses and evaluates the effectiveness of existing internal controls, provides recommendations and proposals for improving the internal control environment, and also gives recommendations aimed at improving the corporate governance process. The IAD also identifies the existing processes of recognising, analysing and minimising the Bank's risks and evaluates the economic efficiency of Bank's operations as well as the reliability, completeness, integrity, objectivity and timeliness of accounting information and financial statements.

During 2005, the IAD continued to enhance its audit methodologies and practices. The IAD has adopted an action plan for the development and improvement of the internal audit function to align it with best recognised practices and develop a fully risk-based audit methodology.

At the end of 2005, a high-level review of the current state of the Bank's internal audit function was performed by one of the Big Four international companies accompanied by an action plan. The Bank was presented with recommendations for improving internal audit planning, execution, reporting, monitoring and quality review processes to increase the internal audit function effectiveness and efficiency.

The action plan consists of three main phases. The main components of the action plan for 2006 include developing IAD's mission and strategy and defining the internal audit function in general as well as developing a risk assessment methodology for internal audit. This will set the Bank's internal audit objectives and develop a strategy for achieving these objectives and goals.

Other issues to be considered at the next phases include: developing a sound system of resources planning and allocation, improving and unifying the internal audit methodology and IAD's performance evaluation methodology, and further developing working policies and procedures.

IAD also revised standard audit reports, which have become more structured and informative, for the purpose of adding value to management function. The IAD is also developing the operational audit methodology in addition to formalising the compliance audit methodology.

The Bank places very strong emphasis on the internal audit staff's professional qualifications. All IAD employees successfully completed a one-week professional course on progressive approaches to internal audit and best international practices that was conducted by one of the Big Four consulting firms. A detailed training plan is also being developed to provide customised training for all IAD employees. A number of internal auditors are in the process of passing exams for professional degrees in auditing and accounting.

A number of IAD employees are also active members of the Institute of Internal Auditors (the IIA). IAD employees take part in IIA's Finance section meetings throughout the year to remain current with changes in internal audit methodologies.

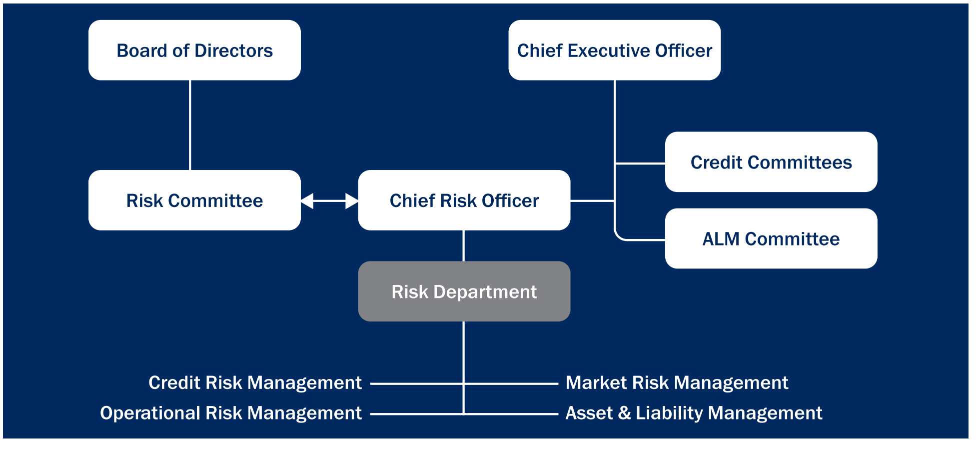
In 2005, the IAD continued to hire personnel as planned in order to meet the demands of the growing business. Employees of the IAD have a sound background from their experience in audit gained in external and internal auditing, accounting and IT. At present, the IAD continues to recruit new auditors, focusing on professional experience and knowledge of up-to-date audit techniques.

# RISK MANAGEMENT

The Bank's approach to managing risks is composed of three key elements: (1) risk governance, (2) risk identification and (3) risk assessment, management and control.

## Risk Governance

**At the overall Bank level**, *the Board of Directors* is responsible for determining the policy and overseeing the management of risks that are key to the success of the Bank's strategy: defining its risk appetite and reviewing its key risk management policies and procedures as well as approving significantly large exposures. *The Risk Committee of the Board* provides oversight and reviews all significant exposures in addition to assessing the effectiveness of current risk management policies and procedures. It meets on a monthly basis and provides to the Board of Directors recommendations on policies and major exposures as well as its view on developments in risk positions and the quality of risk management. (See the Risk Committee report on page 27). *The Executive Management Board* ensures the implementation of risk mitigation measures in order to avoid incurring unacceptable losses and make sure that the Bank operates within the established risk parameters. *The Chief Risk Officer (CRO)* is responsible for the Bank's overall risk management function, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to the CEO and also to the Risk Committee.




**At the business unit level,** both portfolio and transactional risks are managed and controlled by respective committees. In order to facilitate efficient decision-making, we have established a hierarchy of committees depending on the type and amount of the exposure.

## Committees for corporate and retail credit risk exposures

- The Main Credit Committee reviews and approves all loan applications from our corporate customers above US$ 5 million, as well as approving all credit risk management policies and procedures. It is chaired by the Head of the Credit Products Department.

- The Junior Credit Committee reviews and approves all loan applications from our corporate customers between US$ 1 and 5 million.

- The Small Corporate Loans Credit Committee reviews and approves all loan applications by corporate customers up to US$ 1 million.

- The Credit Committee for Standard Credit Products reviews and approves all applications for our off-the-shelf products (overdrafts, leasing, loans to car dealers, etc.) utilising our in-house electronic credit decision system.

- The Small Retail Loans Committee reviews and approves all loan applications for our off-the-shelf retail credit products as well as individual loans to our retail customers up to US$ 1 million. All loans to individuals above US$ 1 million are passed on to the Main Credit Committee.

## Committees for counterparty credit risk exposures

- The Main Credit Committee on Financial Institutions reviews credit exposures to sovereign borrowers and the Bank's main counterparties and approves settlement limits above US$ 25 million.

- The Junior Credit Committee on Financial Institutions reviews credit exposures to counterparties and approves settlement limits between US$ 5 and US$ 25 million.

- The Small Credit Committee on Financial Institutions reviews credit exposures to counterparties and approves settlement limits up to US$ 5 million.

Starting from July 2005, all credit exposures to both corporate customers and financial institutions above US$ 75 million are additionally reviewed by the Risk Committee. Those above US$ 100 million must also be approved by the Board of Directors.

## The Asset and Liability Management Committee (ALCO)

The Asset and Liability Management Committee (ALCO) is responsible for managing balance sheet risks, including interest rate risk, liquidity risk and market risk.

All of the above Committees are composed of senior managers, including heads of business units as well as risk management units such as Credit Risk Management, Market Risk Management and Asset and Liability Management. Reporting directly to the CRO, these units are responsible for independent transactional and portfolio risk analysis as well as controlling risk management policies and procedures. The CRO sits on the Main Credit Committee, Main Committee on Financial Institutions and ALCO as a voting member.

## Risk Identification

Both external and internal risk factors are identified and managed throughout the Bank's organisational structure. Particular attention is being given to developing risk maps to identify the full range of risk factors and use as a basis for determining the level and location of assurance over the current risk mitigation procedures. Once finalised, this will provide us with a full risk register that will be regularly reviewed and updated. Apart from the standard credit and market risk analysis, the Risk Department monitors financial and non-financial risks by holding regular meetings with business and operational units in order to obtain expert judgments in their areas of expertise. The risk maps will be updated on a quarterly basis and any significant changes in the risk profile are communicated to the Executive Management Board together with proposed action steps aimed at mitigating such risks.

An overview of the Top 10 Key Risks are also communicated to the Board of Directors as part of a *Quarterly Risk Management Report* covering credit, market, liquidity, operational and reputational risks. *A Monthly Risk Management Report* on risk positions is presented to the Risk Committee by the CRO.

## Risk Assessment and Control

The Bank's risk assessment, reporting and control procedures vary by risk type, but share a common methodology developed and updated by the Risk Department's methodological unit.

## Credit Risk Management

**Corporate credit applications** are originated by the relevant client managers and are then passed on to our Credit Products Department, which is responsible for the Bank's corporate loan portfolio. Reports produced by the department's credit officers are based on structured analysis focusing on the customer's business and financial performance. The credit application and the report are then independently reviewed by the Risk Department's credit risk managers and a second opinion is given accompanied by a check that credit policy requirements have been met. The Credit Committee reviews the credit application on the basis of submissions by the Credit Products Department and Risk Department. Individual transactions are also reviewed by our Legal, Accounting and Tax departments depending on the specific risks and pending final approval of the Credit Committee.

This multi-stage review process has enabled us to maintain sound asset quality as the Bank has expanded its lending activities in the middle market corporate segment. As of January 1, 2006, non-performing loans (NPLs) were 1.5% of the Bank's total corporate loan portfolio. The Bank plans to build upon this experience and develop its new SME lending business by combining an emphasis on credit quality with simplification of the credit procedures to accommodate the needs of our SME customers.

Apart from individual customer analysis, the whole loan portfolio is assessed by the Risk Department with regard to concentration and market risks. All loans are rated and priced using our internal rating model based on borrower's default probability and recovery estimates.

The Bank continuously monitors the performance of individual loans and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Bank. In light of this information, the borrower's internal credit rating may be revised. The current market value of collateral is regularly assessed by either independent appraisal companies or the Bank's specialists, and in the event of negative movements in market prices the borrower is usually requested to put up additional security.

**Retail credit applications** are reviewed and approved by the Bank's Retail Banking Division through the use of scoring models and personal data verification procedures developed together with the Risk Department. The Small Retail Loans Credit Committee reviews and approves all non-standard loan applications of up to US$ 1 million. As of January 1, 2006, non-performing loans (NPLs) were 0.76% of the Bank's total retail loan portfolio.

## Market Risk Management

Market risk is managed primarily through daily mark-to-market procedures and control of position limits in various types of financial instruments, as well as stop-loss limits and pre-settlement limits. We also utilise Value-at-Risk methodology for most of our trading positions and stress test those that do not have a liquid market. However, we do not solely rely on our VaR calculations since we acknowledge the inherent risk in VaR usage, especially in less liquid markets. All market risk limits are approved by ALCO based on recommendations of the Risk Department's Market Risk Management unit.

## Asset and Liability Management

The Bank manages its balance sheet risks by continuously monitoring its liquidity and interest rate exposures. ALCO is responsible for aligning the current asset and liability structure with the Bank's business strategy by determining current and future funding requirements and making sure that funds are available to meet the needs of the growing business. It also sets interest rate risk limits in order to avoid potential losses due to the volatile interest rate environment. The

Bank's *Treasury Department* is responsible for daily liquidity and interest rate risk management. It utilises an internal Funds Transfer Pricing mechanism to manage the Bank's interest rate exposure and a dynamic liquidity management model that is adjusted on a weekly basis.

## Operational Risk Management

Although we are not required to implement Basel approaches, we have set up an operational risk management framework that allows us to benefit from a better understanding of any current control inefficiencies and at the same time progress steadily towards Basel standards.

The Risk Department is closely working with the Bank's Operations and IT departments in upgrading our current operational risk database and mapping. However, we do not solely rely on data when assessing operational risk levels and control procedures. We believe that significant assurance over operational risk control can be achieved by constantly improving our processes and technologies. Together with a Big Four consultancy, we have launched a major project aimed at analysing our current business and IT processes in order to achieve short-term efficiencies as well as develop an IT strategy closely aligned with our business goals.

## Future Developments

In 2006, the Bank will continue to develop its risk management policies and procedures to accommodate its expansion into new business segments, at the same time keeping its risk profile at an acceptable level. The Risk Department is launching two major projects aimed at implementing an upgraded scoring model for our retail credit products and a new internal credit rating model. On both of the projects we are teaming with top international companies specialising in credit risk management.

We are also acutely aware of the importance of managing reputational risk. Our general approach is to make sure that reputation issues do not arise in the first place through managing our risks properly. However, we also recognise that effective systems need to be in place to manage situations that do arise through effective communication with our customers, regulators and the media.

The major risk and process mapping exercise that is underway will help us identify and monitor risks, assess the quality of the mitigation and ensure that risk management and control processes are working at the required level.

We are confident that we have in place a sound basis for effective risk management and control. We will continue to invest in systems and resources that will enable us to keep progressing towards the implementation of processes that are in line with international standards.

# MANAGEMENT DISCUSSION AND ANALYSIS

MDM Bank Group[2] (as opposed to MDM Financial Group) prepared its consolidated IFRS financial statements only for the first time as of 30 June 2005, which makes it impossible to compare 2005 financial results with those of the year before. Nevertheless, comparison of performance in the second half of 2005 with performance in the first half suggests that MDM Bank is on an upward growth trend.

## INCOME STATEMENT REVIEW

### Revenues

MDM Bank continued to focus on improving earnings quality, measured by growth in core operating income (net interest income plus net fees and commissions).

Despite the ongoing sector trend of falling net interest margins, MDM Bank was able to offset the margin decline with volume growth, as well as an increase in net fees and commissions. MDM Bank's core income (net interest fees and commissions) increased in the second half of 2005 by 12.1%, and as of the end of 2005 core income reached US$ 250.8 million. The increase in the second half of 2005 resulted mainly from a significant increase in interest income of 30.6% or US$ 32.3 million. The volume of commissions earned in the first half of 2005 was significantly higher than in the second half of the year and at the end of 2005 totalled US$ 18.6 million for the year as a whole.

| US$ million | 2H 2005 | 1H 2005 | % change |
|---|---|---|---|
| Commissions | 5.7 | 12.9 | –55.8% |
| Net Interest Income | 137.7 | 105.4 | 30.6% |
| Other Income | 40.7 | 23.0 | 77.0% |

[2] Referred to below in the section as “MDM Bank”.

## Loan Loss Provisions

**In 2005, MDM Bank allocated US$ 11.9 million to provisions, net of write-backs. In the second half of 2005, the provision charge increased by US$ 9.0 million compared to the first half as a result of loan portfolio growth.**

**MDM Bank's loan loss provisions at the end of 2005 amounted to 3.4% of gross loans, broadly in line with sector averages, and represented a comfortable cushion against identified non-performing loans.**

| % | 2H 2005 | 1H 2005 | % change |
|---|---|---|---|
| Loan Loss Provisions as % of Gross Loans | 3.4% | 3.3% | 3.0% |

## Operating Expenses

**MDM Bank costs rose by 20.4% to US$ 89.3 million in the second half of 2005, compared with US$ 74.2 million in the first half of 2005. This increase in operating expenses was driven mainly by staff costs, which in turn were determined by growth in staff numbers at MDM Bank in connection with the expansion of the branch network and the retail and SME businesses.**

**Staff increased from 4,031 in the first half of 2005 to 4,332 at year-end. The average cost per employee for 2005 amounted to US$ 25,000, which reflected the market trend of growth in salaries for highly qualified personnel.**

| % | 2H 2005 | 1H 2005 | % change |
|---|---|---|---|
| Cost / Income Ratio | 51.0% | 53.6% | –4.9% |
| Costs as % of Average Assets * | 6.9% | 6.7% | 3.0% |

* annualised for 1H 2005

## Taxation

**In the second half of 2005, MDM Bank's tax expense decreased by 4%, from US$ 19.4 million in the first half of 2005 to US$ 18.5 million, representing an effective tax rate of 25% or US$ 37.9 million for the whole of 2005.**

# BALANCE SHEET REVIEW

## Total Assets

At the end of 2005, MDM Bank's total assets amounted to US$ 4.822 billion (1H 2005: US$ 4.217 billion). During the second half of 2005, its total assets rose by 14.3% or US$ 605 million. The main funding source for asset growth was an increase in client accounts, which grew by 13% or US$ 223.2 million during the second half of 2005.

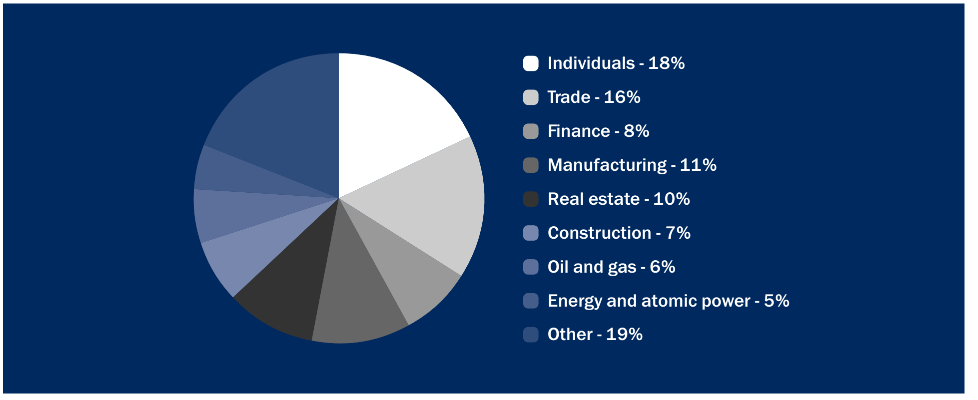
## Loan Portfolio

MDM Bank's lending strategy entails improving the diversification and profitability of its loan portfolio. As a result, corporate loan growth remained moderate together with a continued trend of the gradual replacement of large loans with smaller loans to new borrowers. The retail book increased by almost 44% to US$ 514 million during the second half of 2005.

| US$ million | 2005 | 1H 2005 | % change |
|---|---|---|---|
| Loans to corporate entities: | | | |
| Commercial loans | 2 206.3 | 2 084.9 | 5.8% |
| Net investment in finance leases | 46.9 | 33.2 | 41.3% |
| Reverse sale and repurchase agreements | 122.3 | 188.5 | –35.1% |
| Loans to individuals | 513.9 | 357.5 | 43.7% |
| **Gross loans and advances to customers** | **2 889.3** | **2 664.1** | **8.5%** |
| Provision for loan impairment | –99.0 | –86.9 | 13.9% |
| **Net loans and advances to customers** | **2 790.4** | **2 577.2** | **8.3%** |

During the second half of 2005, MDM Bank's exposure to its top 10 borrowers as a percentage of gross loans fell further, from 37% to 22%. Industry-wise, the portfolio has become more evenly spread, with no one sector accounting for more than 20% of gross loans. Loans to individuals – consisting mainly of car loans - have become the largest element of the loan portfolio (18% of gross loans).

**Sector Concentrations**




< * Other includes sectors with concentrations less than 5%

# Asset Quality

The loan portfolio as at 31 December 2005 includes overdue loans totalling US$ 41.9 million. Included in this are loans to a Russian agricultural company issued in 2003 with contractual maturities from February to April 2004 of US$ 24.8 million against which a loan impairment allowance of US$ 24.8 million was created. MDM Bank believes this to be an isolated incident, not representative of a trend in asset quality.

# Trading Securities

In the second half of 2005, total trading securities decreased by 38% from US$ 371.9 million to US$ 231.3 million and stabilised at 5% of total assets.

| US$ million | 2005 | 1H 2005 |
|---|---|---|
| **Government bonds** | | |
| Municipal bonds issued by Russian municipalities | 13.9 | 12.9 |
| Russian Federal loan bonds (OFZ) | 0.1 | 27.6 |
| **Corporate debt and equity securities** | | |
| Corporate bonds | 149.5 | 198.3 |
| Promissory notes | 60.9 | 123.9 |
| Corporate shares | 6.9 | 9.2 |
| **Total trading securities** | **231.3** | **371.9** |

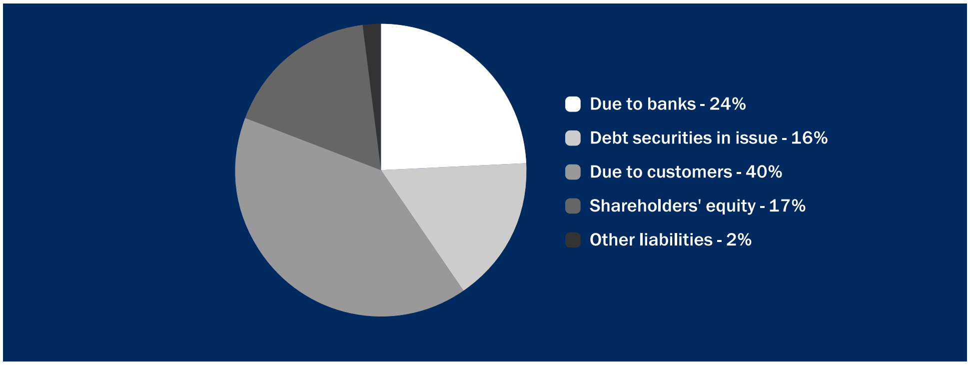
# Customer Accounts

During the second half of 2005, customer accounts increased by 13% from US$ 1.7 billion to US$ 1.9 billion. As at 31 December 2005, aggregate balances of the ten largest customers (or groups of customers) totalled US$ 759.7 million or 39% of total customer accounts.

# Funding

The funding structure is fairly diversified for a Russian privately owned financial institution. Customer deposits were the fastest-growing funding source.

**Composition of Liabilities**



## Shareholders’ Equity and Capital Adequacy

At the end of 2005, MDM Bank was very well capitalised, with a Tier 1 capital ratio of 17.7% and a Total Capital Adequacy Ratio of 19.2%, well above MDM Bank’s target Tier 1 CAR of 13%.

## Dividend Distribution

No dividends on preference or ordinary shares have been declared by MDM Bank for the year ending 31 December 2005.

## Related Parties

MDM Bank has maintained a self-imposed limit of 10% of total assets on exposure to related parties. MDM Bank’s related party exposure significantly decreased as a percentage of loans in the second half of 2005. Going forward, we are planning to maintain a low level of related party exposures, focusing on non-related party business.

MDM Bank conducts business with related parties on a commercial, arm’s-length basis. The market-based terms applied to this business prevent cross-subsidisation and ensure the transparency of value creation for shareholders. This commitment is reinforced by a covenant in MDM Bank’s Eurobond, other agreements with international institutions and is confirmed by the auditors of the Group’s IFRS financial statements. MDM Bank regards its related party exposures as being of above-average quality.

As at 31 December, 2005, total (on and off balance sheet) exposure to all related parties was US$ 105.8 million, or 2.2% of total assets (related party exposures as of 30 June 2005, totalled US$ 405 million, or 9.6% of total assets).

# MDM-BANK Consolidated Financial Statements

for the Year Ended 31 December 2005

Audited by KPMG in accordance
with International Standards on Auditing

# Contents

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Moscow 119019
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# Independent Auditors' Report

To the shareholders of "MDM-Bank"

We have audited the accompanying consolidated balance sheet of "MDM-BANK" and its subsidiaries (the "Group") as at 31 December 2005 and the related consolidated statements of income, changes in equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The consolidated financial statements do not include corresponding figures as at 31 December 2004 and for the year then ended, which is required by International Financial Reporting Standard IAS 1 *Presentation of Financial Statements.*

In our opinion, except for the omission of the information described in the preceding paragraph, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2005, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO KPMG

ZAO KPMG
17 April 2006

**(expressed in thousands of Russian Roubles – refer to Note 3)**

| | Note | 31 December 2005 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | 5 | 31 346 157 |
| Mandatory cash balances with central banks | | 2 140 820 |
| Due from other banks | 6 | 6 329 097 |
| Trading securities | 7 | 6 655 226 |
| Other financial instruments at fair value through profit or loss | 8 | 2 484 002 |
| Loans and advances to customers | 9 | 80 313 339 |
| Assets pledged under sale and repurchase agreements | 10 | 3 423 774 |
| Current income tax prepayments | | 570 014 |
| Other assets | 11 | 1 011 041 |
| Premises and equipment | 12 | 4 520 083 |
| **Total assets** | | **138 793 553** |
| **Liabilities** | | |
| Due to other banks | 13 | 33 129 168 |
| Customer accounts | 14 | 55 972 965 |
| Debt securities in issue | 15 | 22 682 199 |
| Current income tax payable | | 15 139 |
| Other liabilities | 16 | 1 450 655 |
| Deferred tax liability | 23 | 1 044 320 |
| **Total liabilities** | | **114 294 446** |
| **Equity** | | |
| Share capital | 17 | 1 736 529 |
| Share premium | | 9 587 618 |
| Revaluation reserve for premises and equipment | | 1 944 307 |
| Cumulative translation reserve | | (41 561) |
| Retained earnings | | 10 936 046 |
| Total equity attributable to equity holders of the parent | | 24 162 939 |
| Minority interest | | 336 168 |
| **Total equity** | | **24 499 107** |
| **Total liabilities and equity** | | **138 793 553** |

**Approved for issue by the Management Board of "MDM-BANK" and signed on its behalf on 17 April 2006.**

**Vladimir Rykunov**
**Deputy Chairman of the Management Board**

**Andrey Ilyin**
**Chief Financial Officer**

**The notes set out on pages 76–121 form an integral part of these consolidated financial statements.**

**MDM-BANK**
(expressed in thousands of Russian Roubles – refer to Note 3)
73 MDM Bank

| | Note | 2005 |
|---|---|---|
| Interest income | 18 | 11 199 102 |
| Interest expense | 18 | (4 202 586) |
| **Net interest income** | | **6 996 516** |
| Loan impairment losses | 19 | (312 800) |
| **Net interest income after provision for loan impairment** | | **6 683 716** |
| Gains less losses arising from trading activities | 20 | 1 261 949 |
| Foreign exchange translation gains less losses | | 139 622 |
| Fee and commission income | 21 | 1 525 702 |
| Fee and commission expense | 21 | (989 976) |
| Gains less losses from other financial instruments at fair value through profit or loss | 8 | 81 231 |
| Charge to provision for losses on credit related commitments | 26 | (29 507) |
| Other operating income | | 352 410 |
| **Operating income** | | **9 025 147** |
| Operating expenses | 22 | (4 705 065) |
| **Profit before taxation** | | **4 320 082** |
| Income tax expense | 23 | (1 091 456) |
| **Profit for the year** | | **3 228 626** |
| **Attributable to** | | |
| Equity holders of the parent | | 3 151 280 |
| Minority interest | | 77 346 |
| **Earnings per share** | | |
| Ordinary shares (number of shares) | | 2 149 950 |
| Earnings per ordinary share | | 1.466 |

**The notes set out on pages 76–121 form an integral part of these consolidated financial statements.**

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
74 MDM Bank

| | Note | 2005 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Interest received | | 11 010 268 |
| Interest paid | | (3 893 711) |
| Gains from trading in securities | | 235 385 |
| Gains from trading in foreign currencies | | 618 209 |
| Gains from trading in precious metals | | 69 448 |
| Dividends received | | 49 249 |
| Commissions received | | 1 552 432 |
| Commissions paid | | (1 127 064) |
| Other operating income received | | 301 727 |
| Operating expenses paid | | (4 296 495) |
| Income tax paid | | (4 577 264) |
| | | **(57 816)** |
| **Changes in operating assets and liabilities** | | |
| Net increase in mandatory cash balances with central banks | | (72 757) |
| Net decrease in short-term deposits with central banks | | 45 000 000 |
| Net decrease in due from other banks | | 9 670 754 |
| Net decrease in trading securities | | 1 104 924 |
| Net increase in other financial instruments at fair value through profit or loss | | (2 074 640) |
| Net increase in loans and advances to customers | | (8 315 831) |
| Net increase in assets pledged under sale and repurchase agreements | | (3 052 929) |
| Net increase in due to other banks | | 5 488 670 |
| Net decrease in the current account of the Russian government judiciary agency | | (58 256 204) |
| Net increase in other customer accounts | | 8 557 048 |
| Net increase in promissory notes issued and deposit certificates | | 1 016 970 |
| Net increase in other assets less other liabilities | | 410 737 |
| **Net cash used in operating activities** | | **(581 074)** |
| **Cash flows from investing activities** | | |
| Purchase of premises and equipment | | (374 969) |
| Proceeds from sale of premises and equipment | | 217 407 |
| **Net cash used in investing activities** | | **(157 562)** |
| **Cash flows from financing activities** | | |
| Loan participation notes issued | | 8 622 700 |
| Loan participation notes repaid | | (6 866 553) |
| **Net cash from financing activities** | | **1 756 147** |
| Effect of exchange rate changes on cash and cash equivalents | | 302 579 |
| **Net increase in cash and cash equivalents** | | **1 320 090** |
| Cash and cash equivalents at the beginning of the year | | 30 026 067 |
| **Cash and cash equivalents at the end of the year** | 5 | **31 346 157** |

**The notes set out on pages 76–121 form an integral part of these consolidated financial statements.**

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
75 MDM Bank ANNUAL REPORT 2005

| | Attributable to equity holders of the parent | | | | | | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Revaluation reserve for premises and equipment | Cumulative translation reserve | Retained earnings | Total | | |
| **Balance as at 1 January 2005** | **1 736 529** | **9 587 618** | **679 787** | **14 000** | **7 784 766** | **19 802 700** | **291 026** | **20 093 726** |
| Profit for the year | - | - | - | - | 3 151 280 | 3 151 280 | 77 346 | 3 228 626 |
| Revaluation of premises, net (Note 12) | - | - | 1 264 520 | - | - | 1 264 520 | - | 1 264 520 |
| Currency translation differences | - | - | - | (55 561) | - | (55 561) | (32 204) | (87 765) |
| **Total income and expense for the year** | **-** | **-** | **1 264 520** | **(55 561)** | **3 151 280** | **4 360 239** | **45 142** | **4 405 381** |
| **Balance as at 31 December 2005** | **1 736 529** | **9 587 618** | **1 944 307** | **(41 561)** | **10 936 046** | **24 162 939** | **336 168** | **24 499 107** |

**The notes set out on pages 76–121 form an integral part of these consolidated financial statements.**

(expressed in thousands of Russian Roubles – refer to Note 3)

# 1 Organisation of the Group and its Principal Activities

These consolidated financial statements comprise the financial statements of “MDM-BANK” (the “Parent company”, or the “Bank”, or MDM-BANK) and its subsidiaries. The Parent company and its subsidiaries are hereinafter collectively referred to as the “Group”. The activities of the Group are conducted principally in Russia, although the Group also conducts operations on international markets.

For the purposes of these consolidated financial statements, the management of the Group, collectively, is referred to as “Management”.

### (a) Subsidiaries

As at 31 December 2005, the Group operates a total of two banks, one bank in the Russian Federation and one in Latvia. MDM-BANK, the lead operating entity of the Group, is an open joint stock company and is registered in the Russian Federation to carry out banking and foreign exchange activities since 1993. The Bank operates under a general banking license issued by the Central Bank of the Russian Federation. MDM-BANK was accepted into the state deposit insurance scheme in December 2004.

The table below summarises information about the banking branch network of the Group and the number of employees.

| | | 31 December 2005 | |
|---|---|---|---|
| Name of the bank | Registered office | Number of branches | Number of employees |
| MDM-BANK | Kotelnicheskaya nab., 33, Moscow, Russia | 34 | 4 272 |
| Latvian Trade Bank | Grecinieku iela, 4, Riga, LV-1048, Latvia | 1 | 60 |
| **Total** | | **35** | **4 332** |

All branches, except for the branch of Latvian Trade Bank, are located within the Russian Federation. The Group also operates a number of sub-branches in the Russian Federation and cash exchange offices and a network of retail micro offices in Moscow.

The Group also owns and operates an asset management company, a leasing company and a real estate company which owns and maintains the majority of the Group’s premises used in operating activities.

During the year ended 31 December 2005 there were no material changes in the composition of the Group.

The banks in the Group operate in two main business areas: Commercial banking and Investment banking and financial markets. Commercial banking activities (comprising corporate and retail banking activities) include deposit taking and commercial lending in freely convertible currencies and Russian Roubles, settlements and cash operations. Commercial banking services also include trade finance, syndications, a forfait financing and export credit agency financing, and a range of banking card products provided for retail customers. Investment banking and financial markets includes corporate finance, debt and equity capital markets, brokerage and securities, foreign exchange, precious metals and banknote trading.

### (b) Beneficiaries of the Group

As at 31 December 2005, the Bank’s parent company is Banking Holding MDM. Banking Holding MDM is a 100% subsidiary of MDM Financial Holding (Cyprus), which is a 100% subsidiary of MDM Holding GmbH, the parent company of MDM Financial Group. As at 31 December 2005, MDM Holding GmbH, an Austrian limited liability company, is owned 50% each by two companies, the ultimate beneficiaries of which are, respectively, Messrs. Andrey Melnichenko and Sergey Popov (together, the “Beneficiaries"). Refer to Note 28 for information on related party transactions.

## 2 Operating Environment of the Group

Whilst there have been improvements in recent years in the economic situation in the Russian Federation, the economy of the Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, and relatively high inflation.

In addition, the banking sector in the Russian Federation is particularly sensitive to adverse currency fluctuations and economic conditions. Furthermore, the need for further developments in bankruptcy laws, the absence of formalised procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the issues experienced by banks currently operating in the Russian Federation. The ongoing political stabilisation has been a positive contributing factor for the further development of the political and legal environment.

The prospects for future economic stability in the Russian Federation are largely dependent upon the effectiveness of economic measures undertaken by the government, together with legal, regulatory and political developments, which are beyond the Group's control.

In addition, economic conditions continue to limit the volume of activity in the financial markets. Market quotations may not be reflective of the values for financial instruments which would be determined in an efficient, active market involving willing buyers and willing sellers. Management has therefore used the best available information to adjust market quotations to reflect their best estimate of fair values, where considered necessary.

## 3 Basis of Preparation

### (a) Statement of compliance

The Group prepares its consolidated financial statements in accordance with the requirements of International Financial Reporting Standards ("IFRSs").

The Group adopted the revised version of IFRSs which were effective for accounting periods beginning on 1 January 2005.

The consolidated financial statements meet the requirements of IFRSs, except that they do not include corresponding figures as of 31 December 2004 and for the year ended 31 December 2004, which is required by IAS 1 "Presentation of Financial Statements".

### (b) Basis of measurement

These consolidated financial statements are prepared on the historical cost basis except that financial instruments held for trading, other financial instruments held at fair value through profit or loss and available-for-sale financial instruments are stated at fair value, and certain classes of premises and equipment are stated at revalued amounts.

### (c) Functional and presentation currency

Functional currency for each group company has been determined as the currency of the primary economic environment in which the company operates. The Russian Rouble ("RUR") has been selected as the functional currency for group companies domiciled in the Russian Federation and group companies domiciled outside of the Russian Federation, where it reflects the economic substance of the underlying events and circumstances. For other group companies the currencies of the respective countries in which these companies are domiciled have been selected as their functional currencies.

The Russian Rouble has been selected as the presentation currency for the consolidated financial statements of the Group.

The Group presented its consolidated interim financial statements for the six-month period ended 30 June 2005 in US Dollars ("US$"). The Russian Rouble has been selected as the presentation currency for these consolidated financial statements for the sake of comparability with other financial institutions operating within the Russian Federation.

Amounts in Russian Roubles have been rounded to the nearest thousand.

### (d) Convenience translation

In addition to presenting the consolidated financial statements in RUR, the supplementary consolidated financial information for the year ended 31 December 2005 in US$, including the consolidated balance sheet as at 31 December 2005 in US Dollars and the consolidated statement of income for the year then ended in US Dollars, has been prepared for the convenience of users of the consolidated financial statements. The supplementary consolidated financial information does not form part of these consolidated financial statements.

All amounts in US Dollars included in the supplementary consolidated financial information have been translated to US$ from the amounts in these consolidated financial statements at the official rate of the Central Bank of the Russian Federation as at 31 December 2005 of RUR 28.7825 to US$ 1.

All financial information presented in US$ has been rounded to the nearest thousand.

RUR is not a readily convertible currency outside of the Russian Federation and, accordingly, any conversion of RUR to US$ should not be construed as a representation that the RUR amounts have been, could be, or will be in the future, convertible into US$ at the exchange rate disclosed, or at any other exchange rate.

### (e) Use of estimates and judgements

The preparation of consolidated financial statements in conformity with IFRSs requires Management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expense. 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 making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Although these estimates are based on Management's best knowledge of current events and actions, actual results ultimately may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to 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 current and future periods.

Information about significant areas of estimation uncertainty and critical judgments made by Management in the application of IFRSs that have significant effect on these consolidated financial statements are described in the following notes:

- Note 4 (l) "Significant accounting policies" and Note 9 "Loans and advances to customers" in respect of loan impairment allowance.
- Note 12 "Premises and equipment" in respect of valuation of premises.
- Note 26 (b) "Contingent liabilities, commitments and derivative financial instruments" in respect of tax contingencies.

## 4 Significant Accounting Policies

The following significant accounting policies have been applied in the preparation of the consolidated financial statements.

### (a) Basis of consolidation

#### *(i) Subsidiaries*

Subsidiaries are entities controlled by the Parent company. Control exists when the Parent company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Parent company controls another entity. Subsidiaries are fully consolidated from the date on which effective control is transferred to the Parent company and are removed from consolidation from the date that control ceases.

Special purpose entities ("SPEs") are consolidated when the substance of relationship between the Group and the SPE indicates that the SPE is controlled by the Group, even if the Group does not have any direct or indirect shareholdings in the entity.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured at the fair value of the assets given, equity instruments issued or liabilities incurred or assumed at the date of acquisition, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contin-

gent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately in the consolidated statement of income.
Intercompany transactions, balances and unrealised gains on transactions between the Group companies are eliminated. Unrealised losses are also eliminated, but only to the extent that there is no evidence of impairment. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

*(ii) Minority interest*

Minority interest is that part of the profit or loss and net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries, by the Parent company.
Minority interest is presented in the consolidated balance sheet within equity, separately from the equity attributable to equity holders of the parent. Minority interest in the profit or loss of the Group is separately disclosed in the consolidated statement of income as an allocation of profit or loss for the period attributable to minority interest.
If losses applicable to the minority in a consolidated subsidiary exceed the minority interest in the subsidiary's equity, the excess, and any further losses applicable to the minority, are allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the subsidiary subsequently reports profits, such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

*(iii) Acquisition and disposal of minority interests*

Any difference between the consideration paid to acquire a minority interest, and the carrying amount of that minority interest, is recognised directly in the equity attributable to equity holders of the parent.
Any difference between the consideration received upon disposal of minority interest, and the carrying amount of that portion of the Group's interest in the subsidiary is recognised directly in the equity attributable to equity holders of the parent.

*(iv) Associates*

Associates are entities over which the Group has significant influence, but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates, from the date that significant influence effectively commences until the date that significant influence effectively ceases. The Group's share of the post-acquisition profits or losses of associates is recognised in the consolidated statement of income, and the Group's share of changes recognised directly in the associates' equity is recognised directly in the Group's equity and is disclosed in the statement of changes in equity. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group's carrying amount is reduced to nil and the Group does not recognise further losses unless the Group has incurred legal or constructive obligations or made payments on behalf of the associate.
Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of impairment.

### (b) Foreign currency translation

Transactions in foreign currencies are translated to the functional currency of the relevant group entity at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to the functional currency at the foreign exchange rate ruling at the date of the transaction. Foreign exchange differences arising on translation are recognised in the consolidated statement of income.

### (c) Accounting for the effects of hyperinflation

In periods prior to 1 January 2003 the Russian Federation experienced relatively high levels of inflation and was considered to be a hyperinflationary economy as defined by IAS 29 "Financial Reporting in Hyperinflationary Economies".
As from 1 January 2003, the Russian Federation is no longer considered to be a hyperinflationary economy, and therefore from this date the consolidated financial statements have not been adjusted for inflation. The carrying amounts of the Group's assets, liabilities and equity items at 1 January 2003 form the basis for subsequent accounting.

### (d) Cash and cash equivalents

Cash and cash equivalents are items, which can be converted into cash within a day. All short-term interbank placements, excluding overnight deposits, are included in due from banks. Amounts which relate to funds that are of a restricted nature are excluded from cash and cash equivalents.

### (e) Financial assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, and available-for-sale financial assets. Management determines the appropriate classification of financial assets at the time of the purchase.
Purchases and sales of financial assets are recognised on the trade date, which is the date on which the Group commits to purchase or sell the asset. Loans originated by the Group are recognised when cash is advanced to the borrowers.
The fair values of financial assets quoted in active markets are based on last bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Where discounted cash flow techniques are used, estimated future cash flows are based on Management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.
Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

#### *(i) Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held for trading, financial instruments designated at fair value through profit or loss at initial recognition, and derivative financial assets. A financial instrument is classified as held for trading if it is acquired principally for the purpose of selling it in the near term or it is a part of a portfolio for which there is evidence of a recent actual pattern of short-term profit-taking, or it is a derivative.
Financial assets at fair value through profit or loss are recognised initially, and are subsequently carried, at fair value. Gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the consolidated statement of income in the period in which they arise.

#### *(ii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group intends to sell immediately or in the near term, which are classified as held for trading, or those which the Group designates at initial recognition as at fair value through profit or loss or available-for-sale. Loans and receivables include due from other banks, including central banks, loans and advances to customers, and other receivables.
Loans and receivables are initially recorded at fair value, which is the fair value of the consideration given to originate or purchase those loans and receivables plus any related transaction costs, and subsequently are carried at amortised cost using the effective interest method.
Loans originated at interest rates different from market rates are re-measured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar loans. The difference between the fair value and the nominal value at origination is credited or charged to the consolidated statement of income as gains on origination of assets at rates above market or losses on origination of assets at rates below market. Subsequently, the carrying amount of such loans is adjusted for amortisation of the gains/losses on origination and the related income/expense is recorded in interest income within the consolidated statement of income using the effective interest method.

### *(iii) Held-to-maturity investment*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity.

Held-to-maturity investments are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of these investments and are subsequently carried at amortised cost using the effective interest method.

### *(iv) Available-for-sale financial assets*

Available-for-sale financial assets are non-derivative financial assets that are not classified as loans and receivables, held to maturity investments or financial instruments at fair value through profit or loss. Available-for-sale financial assets may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Available-for-sale financial assets are recognised initially, and are subsequently carried, at fair value. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, except for impairment and the effect of changes in foreign exchange rates. When the financial asset is derecognised the cumulative gain or loss previously recognised in equity is recognised in the consolidated statement of income.

### *(v) Mandatory balances with central banks*

Mandatory balances with central banks represent mandatory reserve deposits that are not available to finance the Group's day-to-day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated balance sheet and consolidated statement of cash flows.

### *(vi) Sale and repurchase agreements*

Sale and repurchase ("repo") agreements are treated as secured financing transactions. Assets sold subject to repurchase agreements are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to other banks or to customers, as appropriate.

Assets purchased under agreements to resell ("reverse repo") are recorded as due from banks or customers as appropriate. The differences between the sale and repurchase prices are treated as interest and accrued over the life of the repo agreement using the effective interest method.

### *(vii) Securities lending and borrowings*

Securities lent to counterparties are retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return them is recorded at fair value as a trading liability.

### *(viii) Promissory notes purchased*

Promissory notes purchased are included in trading securities or in loans and advances to customers or in due from other banks, depending on their substance and are subsequently remeasured and accounted for in accordance with the accounting policies described above for these categories of assets.

## (f) Precious metals

Precious metals are stated at lower of net realizable value and cost. The net realizable value of precious metals is estimated based on quoted market prices. The cost of precious metals is assigned using the first-in, first-out cost formula. Precious metals are recorded within other assets.

Precious metals lent to counterparties are retained in the consolidated financial statements.

Precious metals borrowed are recognised in the consolidated financial statements. If the borrowed precious metals are held by the Group, the obligation to return them is recorded in the balance sheet at the carrying value of the precious metals borrowed and related accrued interest. If the borrowed precious metals are sold to third parties, the obligation to return the borrowed precious metals is recorded in the balance sheet at its fair value.

### (g) Derivative financial instruments

Derivative financial instruments include forward, futures and spot transactions in foreign exchange, precious metals and stock markets.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in the consolidated statement of income and are included in gains less losses from trading in foreign currency, gains less losses from trading in securities or gains less losses from trading in precious metals depending on the related contracts.

An embedded derivative is separated from the host contract and it is accounted for as a 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 instrument with the same terms as the embedded derivative would meet the definition of a derivative; and the combined instrument is not measured at fair value with changes in fair value recognised in profit or loss. Derivatives embedded in financial assets or financial liabilities at fair value through profit or loss are not separated.

Although the Group trades in derivative instruments for hedging purposes, these instruments do not qualify for hedge accounting.

### (h) Premises and equipment

Premises and equipment are stated at historical cost or revalued amounts, as described below, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Where an item of premises and equipment comprises major components having different useful lives they are accounted for as separate items of property and equipment. Subsequent expenditure incurred to replace a component of an item of premises and equipment that is accounted for separately, is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised if future economic benefits will arise from the expenditure. All other expenditures, including repairs and maintenance expenditures, are recognised in the consolidated statement of income as an expense as incurred.

Premises of the Group are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. A revaluation increase on an item of premises is recognised directly in equity except to the extent that it reverses a previous revaluation decrease recognised in the consolidated statement of income, in which case it is recognised in the consolidated statement of income. A revaluation decrease on an item of premises is recognised in the consolidated statement of income except to the extent that it reverses a previous revaluation increase recognised directly in equity, in which case it is recognised directly in equity.

Construction in progress is carried at cost less impairment losses. Upon completion, assets are transferred to premises and equipment at their carrying value. Construction in progress is not depreciated until the asset is available for use.

Gains and losses on disposal of premises and equipment are determined by reference to their carrying amount and are recorded in the consolidated statement of income within other operating income.

### (i) Intangible assets

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Development costs that are directly associated with the production of identifiable and unique software products controlled by the Group are capitalised and an internally generated intangible asset is recognised only if it is probable that it will generate economic benefits exceeding costs beyond one year and the development costs can be measured reliably. An internally generated intangible asset is recognised only if the Group has the technical feasibility, resources and intention to complete the development and to use the product. Direct costs include software development employee costs and an appropriate portion of relevant overheads. Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates.

Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred.

Intangible assets, which have finite useful lives, are stated at cost less accumulated amortisation and impairment losses.

### (j) Depreciation and amortisation

Depreciation/amortisation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Depreciation/amortisation is applied on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives are as follows:

| | years |
|---|---|
| Premises | 40 |
| Fixtures and fittings | 6 - 10 |
| Office, computer and other equipment | 4 - 6 |
| Intangible assets | 3 - 5 |

Land is not depreciated.
The assets residual values and useful lives are reviewed annually, and adjusted if appropriate.

### (k) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate undertaking at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate.

Goodwill is stated at cost less impairment losses. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired and is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Negative goodwill arising on an acquisition is recognised immediately in the consolidated statement of income.

### (l) Impairment

The carrying amounts of the Group's assets, other than deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets recoverable amounts are estimated. For goodwill and intangible assets that are not yet available for use, the recoverable amount is estimated at each annual balance sheet date.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the consolidated statement of income unless the asset is recorded at a revalued amount in which case it is treated as a revaluation decrease.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in the consolidated statement of income even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in the consolidated statement of income is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in the consolidated statement of income.

### *(i) Recoverable amount*

The recoverable amount of financial instruments at fair value through profit or loss and financial assets available-for-sale is their fair value. The recoverable amount of the Group's investments in held-to-maturity securities and loans and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate that is the effective interest rate computed at initial recognition of these financial assets (refer to "Loan impairment allowance" Note below).

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

### *(ii) Reversals of impairment*

An impairment loss in respect of a held-to-maturity security, a loan or a receivable carried at amortised cost is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. An impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through the consolidated statement of income. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be related objectively to an event occurring after the impairment loss was recognised in the consolidated statement of income, then the impairment loss is reversed, with the amount of the reversal recognised in the consolidated statement of income.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### *(iii) Loan impairment allowance*

The Group reviews its loan portfolio to assess impairment at least on a quarterly basis. A loan (or a group of loans) is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan and that event (or events) has an impact on the estimated future cash flows of the loan (or the group of loans) that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for loans and advances to customers that are individually significant, and individually or collectively for loans and advances to customers that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, it includes the loan in a group of loans with similar credit risk characteristics and collectively assesses them for impairment. Loans that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in the collective assessment of impairment.

If there is objective evidence that an impairment loss on a loan has been incurred, the amount of the loss is measured as the difference between the loan carrying amount and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral (excluding future losses that have not been incurred) discounted at the loan original effective interest rate.

Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan 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 limited available historical data relating to similar borrowers. In such cases, the Group uses its experience and judgement to estimate the amount of any impairment loss. The assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the provision for loan impairment in the consolidated statement of income.

### (m) Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Subsequently to initial recognition, borrowings are stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the consolidated statement of income over the period of the borrowings using the effective interest method.

Borrowings include debt securities in issue, due to other banks, customer accounts and other borrowed funds. Debt securities in issue include promissory notes, certificates of deposit and loan participation notes issued by the Group. Promissory notes are instruments issued by the Group to its customers, which carry a fixed date of repayment. These may be issued against cash deposits or as a payment instrument, which the customer can discount in the over-the-counter secondary market.

If the Group purchases its own debt, it is removed from the consolidated balance sheet and the difference between the carrying amount of a liability and the consideration paid is recognised in the consolidated statement of income.

Borrowings originated at interest rates different from market rates are remeasured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar borrowings. The difference between the fair value and the nominal value at origination is credited or charged to the consolidated statement of income as gains on origination of liabilities at rates below market or losses on origination of liabilities at rates above market. Subsequently, the carrying amount of such borrowings is adjusted for amortization of the gains/losses on origination and the related income/expense is recorded in interest expense within the consolidated statement of income using the effective interest method.

### (n) Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

### (o) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

### (p) Credit related commitments

In the normal course of business, the Group enters into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Specific provisions are recognised against credit related commitments when losses are considered probable and can be measured reliably.

### (q) Distributions to shareholders

Distributions to shareholders are recorded in equity in the period in which they are declared. Distributions to shareholders declared after the balance sheet date are disclosed as a subsequent event.

### (r) Income taxes

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the consolidated statement of income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Taxation has been provided for in the consolidated financial statements in accordance with applicable legislation currently in force in the respective countries in which the Group operates. Current tax expense is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Taxes, other than on income, are recorded within operating expenses.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill, the initial recognition of assets or liabilities that affects neither accounting nor taxable profit; and investments in subsidiaries where the Parent company is able to control the timing of the reversal

of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.
The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.
A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.
Deferred tax assets and liabilities are netted only within the individual entities of the Group.

### (s) Income and expense recognition

With the exception of financial assets held for trading and other financial instruments at fair value through profit or loss, interest income and expense are recognised in the consolidated statement of income using the effective interest method. Interest income on financial assets held for trading and on other financial instruments at fair value through profit or loss comprises coupon interest only. Accrued discount and premium on financial assets held for trading and on other financial instruments at fair value through profit or loss is recognised in gains less losses arising from trading activities.
Fees, commissions and other income and expense items are generally recognised on an accrual basis when the service has been provided. Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recorded as an adjustment to the effective interest on the loan. Fees for provision of credit related commitments and other forms of financial insurance are recognised over the term of the related contract.
Portfolio and other management advisory and service fees are recorded based on the applicable service contracts.
Non-interest expenses are recognised at the time the products are received or the services are provided, unless the expenses result from a constructive obligation, against which a liability and related expense are recognised in the consolidated financial statements.
Dividend income is recognised in the consolidated statement of income on the date that the dividend is declared.

### (t) Pension costs

Companies within the Group which operate in the Russian Federation contribute to the Russian Federation state pension schemes, social insurance and employment funds in respect of their employees. The contributions to these funds are expensed as incurred and included within staff costs in the consolidated statement of income. The Group has no further payment obligation once the contribution has been paid.

### (u) Leases

#### *(i) Finance leases*

The inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As the inception of the lease the amounts to be recognised at the commencement of the lease term are determined.
The commencement of the lease term is the date from which the lessee is entitled to exercise its right to use the leased asset. The commencement of the lease is considered to be the date of the lease agreement, or commitment if earlier. For purposes of this definition, a commitment should be in writing, signed by the parties with interest in the transaction, and should specifically set forth the principal terms of the transaction. However, if the property covered by the lease has yet to be constructed, installed or has not been acquired by the Group at the date of the lease agreement or commitment, the commencement of the lease is deemed to be the date when construction and installation of the property is completed or the property is acquired by the Group.
On commencement of the lease term, when the Group enters into a finance lease as a lessor, the present value of the lease payments (“net investment in leases”) is recorded as part of loans and advances to customers. The difference between the gross receivable and the present value of the receivable is unearned finance income. Finance income is recognised over the term of the lease using the effective interest method, which reflects a constant periodic rate of return.
Any advance payments made by the lessee prior to commencement of the lease are recorded as a reduction in the net investment in the lease.
Finance income from leases is recognised as part of interest income on loans and advances to customers.

### *(ii) Operating leases*

Where the Group is the lessee, the total payments made under operating leases are charged to the consolidated statement of income on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

### (v) Fiduciary assets

The Group provides custody, trustee, asset management and other fiduciary services that result in holding or placing of assets on behalf of third parties. These assets and income arising thereon are excluded from these consolidated financial statements as they are not assets of the Group. Commissions received from such business are shown as fees and commissions received in the consolidated statement of income.

### (w) Segment reporting

The Group's primary format for reporting segment information is by business segments. As the majority of operations, credit related commitments, capital expenditure, and revenues of the Group relate to residents of the Russian Federation, the Group does not have a secondary format for reporting segment information by geographical segments.

A segment is a distinguishable component of the Group that is engaged in providing products or services, which is subject to risks and rewards that are different from those of other segments. Segments whose revenue, results or assets are ten per cent or more of all the combined segments are reported separately.

### (x) Change in presentation

Included in other financial instruments at fair value through profit or loss are investments in first to default credit-linked notes of RUR 2 484 002 thousand, as at 31 December 2005 (Refer to Note 8). These investments were included in due from other banks in the consolidated interim financial statements of the Group for the six-month period ended 30 June 2005. A portion of coupon income of RUR 56 054 thousand was included within fee income as commission for assuming credit risk under first to default credit-linked notes in the consolidated interim financial statements of the Group for the six-month period ended 30 June 2005. This income is included in interest income from other financial instruments through profit or loss for the year ended 31 December 2005. Management believes that classification of these investments as other financial instruments at fair value through profit or loss reflects the nature of these financial instruments and results in more appropriate presentation of such transactions.

### (y) New Standards and Interpretations not yet adopted

The following new Standards and Interpretations, that are relevant to operations of the Group, are not yet effective and have not been applied in preparing these consolidated financial statements. The Group plans to adopt these pronouncements when they become effective. The Group has not yet fully analysed the likely impact of these new standards on its consolidated financial statements.

The amendment to IAS 1 “Presentation of Financial Statements”, which is effective for annual periods beginning on or after 1 January 2007, provides disclosure requirements for the entity's objectives, policies and processes for managing capital, including, when an entity is subject to externally imposed capital requirements, the nature of these requirements and how these requirements are incorporated into the management of capital. The Group is currently subject to externally imposed capital requirements in relation to its debt securities issued, and the banks in the Group are subject to capital requirements imposed by the regulatory authorities.

The amendments to IAS 39 “Financial Instruments: Recognition and Measurement” and IFRS 4 “Insurance Contracts”, which are effective for annual periods beginning on or after 1 January 2006, provide guidance for the accounting treatment of financial guarantee contracts by the issuer. Management of the Group believes that these amendments will not have a significant impact on the consolidated financial statements of the Group.

The amendments to IAS 39 “Financial Instruments: Recognition and Measurement”, which are effective for annual periods beginning on or after 1 January 2006, allow the entity to designate a financial instrument as at fair value through profit or loss only if certain conditions are met. Management of the Group believes that financial instruments which are currently designated at fair value through profit or loss as at 31 December 2005 comply with these conditions.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
88 MDM Bank

IFRS 7 "Financial Instruments: Disclosures", which is effective for annual periods beginning on or after 1 January 2007, provides disclosure requirements regarding the significance of financial instruments to the entity's financial position and performance, and qualitative and quantitative information about the nature and extent of risks arising from financial instruments. The Standard supersedes IAS 30 "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" and the disclosure requirements in IAS 32 "Financial Instruments: Presentation and Disclosure". A large portion of existing disclosure requirements in IAS 32 "Financial Instruments: Presentation and Disclosure" is transferred to the new Standard. The title of IAS 32 is amended to IAS 32 "Financial Instruments: Presentation". Management of risks arising from financial instruments is fundamental to the business of the Group and is an essential element of the Group's operations.

## 5 Cash and Cash Equivalents

| | 31 December 2005 |
|---|---|
| Cash on hand | 3 901 363 |
| Correspondent accounts with central banks | 2 954 429 |
| Correspondent accounts and overnight deposits with other banks | 24 490 365 |
| **Total cash and cash equivalents** | **31 346 157** |

As at 31 December 2005, the Group has one counterparty with aggregated balances on correspondent accounts and overnight deposits greater than 10% of equity. The total aggregate amount of these balances is RUR 5 614 874 thousand or 17.9% of total cash and cash equivalents, as at 31 December 2005.
Geographical and currency analysis of cash and cash equivalents is disclosed in Note 25.

## 6 Due from Other Banks

| | 31 December 2005 |
|---|---|
| Current interbank loans | 5 650 889 |
| Reverse sale and repurchase agreements | 678 208 |
| **Due from other banks** | **6 329 097** |

Included in due from other banks are loans to a major Russian state-owned bank of RUR 1 018 630 thousand, or 16.1% of due from other banks, as at 31 December 2005. In addition to this exposure, the Group also owns debt securities issued by this bank of RUR 1 422 994 thousand. Refer to Note 7.
Securities purchased under reverse sale and repurchase agreements are corporate bonds and equity securities with a fair value of RUR 834 847 thousand, as at 31 December 2005.
Geographical and currency analysis, effective interest rates and maturity structure of due from other banks are disclosed in Note 25.

**MDM-BANK**
(expressed in thousands of Russian Roubles – refer to Note 3)
89 MDM Bank

## 7 Trading Securities

| | 31 December 2005 |
|---|---|
| **Government bonds** | |
| Municipal bonds issued by Russian municipalities | 398 756 |
| Russian Federal loan bonds (OFZ) | 2 497 |
| VneshEconomBank (VEB) 3% coupon bonds (“MinFins”) | 754 |
| **Corporate debt and equity securities** | |
| Corporate bonds | 4 302 815 |
| Promissory notes | 1 753 020 |
| Corporate shares | 197 384 |
| **Total trading securities** | **6 655 226** |

Municipal bonds are securities issued by Russian municipalities denominated in Russian Roubles. The Group’s portfolio of municipal bonds consists mainly of bonds issued by the Moscow municipality. The bonds have maturity dates from 25 May 2006 to 21 July 2014 and annual coupon rates ranging from 8.0% to 15.0% per annum. As at 31 December 2005, their yields to maturity range from 3.9% to 8.0% per annum. As at 31 December 2005, municipal bonds of RUR 119 895 thousand are pledged with the Central Bank of the Russian Federation as collateral for overnight deposits.

Russian Federal loan bonds (OFZ) are Russian Rouble denominated securities. The Group’s portfolio of OFZ consists of bonds issued by the Government of the Russian Federation with maturity dates from 30 April 2008 to 24 November 2021, with annual coupon rates varying from 6.3% to 11.0% per annum and yields to maturity ranging from 6.2% to 6.8% per annum.

VEB bonds are US Dollar denominated bearer securities, which carry the guarantee of the Ministry of Finance of the Russian Federation, and are commonly referred to as “MinFin bonds”. The bonds are currently traded at a discount to nominal value and carry an annual coupon of 3%. The bonds have a maturity date of 14 November 2007 and their yield to maturity is 5.7% per annum, as at 31 December 2005.

Corporate bonds are interest-bearing securities, issued by Russian companies, and are freely tradable in the Russian securities markets. The annual coupon rates on bonds denominated in Russian Roubles range from 6.9% to 17.0% per annum; these bonds have maturity dates from 22 February 2006 to 26 March 2012 and their yields to maturity range from 3.8% to 15.2% per annum, as at 31 December 2005. The annual coupon rates on bonds denominated in US dollars range from 6.0% to 12.0% per annum; these bonds have maturity dates from 3 April 2006 to 22 December 2015 and their yields to maturity range from 4.6% to 9.9% per annum, as at 31 December 2005.

Included in corporate bonds are credit linked leveraged notes issued by a major international bank of RUR 28 415 thousand, the repayment amount of which is linked to the market price of a certain bond issued by a Russian entity. Maximum losses of the Group under these bonds are limited to the amount of the Group’s investments in the notes.

Included in promissory notes are Russian Rouble denominated debt securities of a major Russian state-owned bank of RUR 1 422 994 thousand, or 21.4% of total trading securities, as at 31 December 2005. These securities are traded in the over-the-counter market and are stated at their fair value estimated based on quoted market prices. In addition to this exposure, the Group also provided loans to this bank of RUR 1 018 630 thousand, as at 31 December 2005. Refer to Note 6.

The majority of corporate shares are shares of Russian companies traded in the Moscow Interbank Currency Exchange (MICEX) or the Russian Trading System (RTS).

In addition to trading securities noted in the table above, additional trading securities of RUR 3 208 637 thousand are pledged by the Group under sale and repurchase agreements, as at 31 December 2005. These securities are presented within assets pledged under sale and repurchase agreements. Refer to Note 10.

Geographical and currency analysis, effective interest rates and maturity structure of trading securities are disclosed in Note 25. Information on related party transactions is disclosed in Note 28.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
90 MDM Bank

## 8 Other Financial Instruments at Fair Value through Profit or Loss

| | 31 December 2005 |
|---|---|
| First to default credit-linked notes | 2 484 002 |
| **Total other financial instruments at fair value through profit or loss** | **2 484 002** |

First to default credit-linked notes are US Dollar denominated fixed coupon notes with a nominal value of US$ 75 000 thousand, or RUR 2 158 688 thousand, as at 31 December 2005, issued by a major international bank, repayment of which is dependent on certain government, municipal and corporate bonds being repaid by their issuers in full (the "reference bonds"). In case of default of any of these bonds, the major international bank has the right to transfer to the Group defaulted bonds with the nominal amount equal to the nominal amount of first to default credit-linked notes held by the Group without any further payments to the Group under the notes. Included in first to default credit-linked notes as at 31 December 2005 are first to default credit-linked notes with a nominal amount of US$ 25 000 thousand, or RUR 719 563 thousand, with a coupon rate of 15.6% per annum and a maturity date of 5 March 2008 and first to default credit-linked notes with a nominal amount of US$ 50 000 thousand, or RUR 1 439 125 thousand, with a coupon rate of 15.5% per annum and a maturity date of 6 May 2008.
The issuers of the reference bonds are as follows:

| Types of issuers | Number of issuers | Range of international credit ratings of the issuers as at the time of purchase of credit-linked notes | Range of international credit ratings of the issuers as at 31 December 2005 |
|---|---|---|---|
| Governments | 5 | B1-A2 | B1-A2 |
| Municipal authorities | 1 | Baa3 | Baa3 |
| Corporate companies | 8 | B2-Baa3 | B1-Baa3 |
| Financial institutions | 10 | Ba1-Aa1 | Ba1-Aa1 |

These instruments were priced using a valuation technique which is based on estimated probabilities of default for the reference bonds. Statistical methods used in this valuation technique are commonly used by market participants for valuation of first to default credit-linked notes. Observable market data on yields to maturity for debt securities of the issuers of the reference bonds has been used as an input for the valuation model. The valuation technique used by the Group has demonstrated to provide reliable estimates of prices for first to default credit-linked notes obtained in actual market transactions or quotes obtained for these instruments from major market participants.
The movement in other financial instruments at fair value through profit or loss for the year ended 31 December 2005 is as follows:

| | 2005 |
|---|---|
| **Other financial instruments at fair value through profit or loss as at 1 January** | - |
| Acquisition of instruments | 2 074 640 |
| Interest income accrual | 245 015 |
| Gains less losses | 81 231 |
| Effect of foreign currency translation | 83 116 |
| **Other financial instruments at fair value through profit or loss as at 31 December** | **2 484 002** |

Geographical and currency analysis, effective interest rates and maturity structure of other financial instruments at fair value through profit or loss are disclosed in Note 25.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
91 MDM Bank

## 9 Loans and Advances to Customers

| | 31 December 2005 |
|---|---|
| Loans to corporate entities | |
| - Commercial loans | 63 502 360 |
| - Reverse sale and repurchase agreements | 3 519 119 |
| - Net investment in finance leases | 1 350 557 |
| Loans to individuals | |
| - Direct loans | 14 164 495 |
| - Reverse sale and repurchase agreements | 625 413 |
| **Gross loans and advances to customers** | **83 161 944** |
| Less: loan impairment | (2 848 605) |
| **Net loans and advances to customers** | **80 313 339** |

Securities held as collateral under reverse sale and repurchase agreements are marketable securities with a fair value of RUR 6 961 055 thousand, as at 31 December 2005. Included in this amount as at 31 December 2005 are securities of RUR 2 900 028 thousand pledged by the Group under sale and repurchase agreements. Refer to Notes 13 and 14.

Included in the loan portfolio as at 31 December 2005 are loans to corporate entities of RUR 248 372 thousand pledged to a non-Russian bank under a loan granted to the Group.

The majority of direct loans to individuals are loans to finance the purchase of cars, which are secured by the underlying cars.

As at 31 December 2005, credit exposure to the ten largest borrowers (or groups of borrowers) are RUR 18 215 665 thousand or 21.9% of the gross loan portfolio of the Group.

As at 31 December 2005, the Group has one borrower with aggregated loan amounts greater than 10% of equity. The total aggregate amount of these loans is RUR 4 106 611 thousand or 4.9% of the gross loan portfolio.

Movements in loan impairment are as follows:

| | 2005 |
|---|---|
| **Loan impairment as at 1 January** | **2 562 412** |
| Loans written off during the year as uncollectible | (64 467) |
| Charge to loan impairment during the year (Note 19) | 312 800 |
| Effect of foreign currency translation | 37 860 |
| **Loan impairment as at 31 December** | **2 848 605** |

As described in Note 4, the Group uses its experience and judgement to estimate the amount of impairment loss for loans and advances to customers. As commercial lending to small and medium enterprises and retail lending are relatively new to Russia, the Group and the industry have limited historical experience in this type of lending on which to base the assessment of impairment.

In relation to loans to corporate entities the Group has reviewed its loan portfolio and identified loans with a gross amount of RUR 2 990 682 thousand, which have indications of impairment and has recognised loan impairment for these loans of RUR 1 338 093 thousand, as at 31 December 2005. In respect of the remaining loans to corporate entities, collective impairment of RUR 1 212 500 thousand has been recognised.

In relation to loans to individuals, the Group estimates loan impairment on its retail loan portfolio based on its past historic loss experience for these types of loans, portfolio delinquency and collection rates and overall economic conditions. The Group has reviewed its retail loan portfolio and identified loans with a gross amount of RUR 97 011 thousand which have indications of impairment and has recognised loan impairment for these loans of RUR 97 011 thousand, as at 31 December 2005. In respect of the remaining loans to individuals, collective impairment of RUR 201 001 thousand has been recognised. Changes in collection estimates could affect the loan impairment allowance. To the extent that the net present value of estimated cash flows differs by plus/minus one percent, the loan impairment as at 31 December 2005 would be estimated RUR 803 133 thousand lower/higher.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
92 MDM Bank

Should actual repayments be less than Group's Management estimates, the Group would be required to record additional loan impairment losses.

The following table shows gross loans and advances to customers and related loan impairment, as at 31 December 2005:

| | Gross loans | Impairment | Net loans |
|---|---|---|---|
| Loans to corporate entities | | | |
| - Commercial loans | | | |
| Individually assessed for impairment | 2 990 682 | (1 338 093) | 1 652 589 |
| Collectively assessed for impairment | 60 511 678 | (1 186 029) | 59 325 649 |
| - Reverse sale and repurchase agreements | 3 519 119 | - | 3 519 119 |
| - Net investment in finance leases | | | |
| Collectively assessed for impairment | 1 350 557 | (26 471) | 1 324 086 |
| Loans to individuals | | | |
| - Direct loans | | | |
| Individually assessed for impairment | 97 011 | (97 011) | - |
| Collectively assessed for impairment | 14 067 484 | (201 001) | 13 866 483 |
| - Reverse sale and repurchase agreements | 625 413 | - | 625 413 |
| **Total loans and advances to customers** | **83 161 944** | **(2 848 605)** | **80 313 339** |

The loan portfolio as at 31 December 2005 includes overdue loans totalling RUR 1 205 920 thousand. Included in overdue loans as at 31 December 2005 are loans to a Russian agricultural company issued in 2003 with contractual maturities from February to April 2004 of RUR 713 408 thousand against which a loan impairment allowance of RUR 713 408 thousand was created.

Loans and advances to customers include finance lease receivables, which are analysed as follows:

| | 31 December 2005 |
|---|---|
| Gross investment in finance leases, receivable: | |
| - Not later than 1 year | 695 258 |
| - Later than 1 year and not later than 5 years | 1 052 919 |
| Less: Unearned finance income | (397 620) |
| **Net investment in finance leases** | **1 350 557** |

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
93 MDM Bank

**Net investment in finance leases are analysed as follows:**

| | 31 December 2005 |
|---|---:|
| Net investment in finance leases, receivable: | |
| - Not later than 1 year | 537 123 |
| - Later than 1 year and not later than 5 years | 813 434 |
| **Net investment in finance leases** | **1 350 557** |

**As at 31 December 2005, the allowance for uncollectible finance lease receivables included in the loan impairment allowance amounts to RUR 26 471 thousand.**

**Economic sector risk concentrations within the customer loan portfolio are as follows:**

| | 31 December 2005 | |
|---|---:|---:|
| | Amount | % |
| Individuals | 14 789 908 | 18 |
| Trade | 13 470 071 | 16 |
| Manufacturing | 8 895 663 | 11 |
| Real estate | 8 302 783 | 10 |
| Finance | 6 955 208 | 8 |
| Construction | 6 142 214 | 7 |
| Oil and gas | 5 229 322 | 6 |
| Energy and atomic power | 4 113 589 | 5 |
| Food and agriculture | 3 580 908 | 4 |
| Metallurgy | 2 459 249 | 3 |
| Coal | 1 842 782 | 2 |
| Transport | 1 434 456 | 2 |
| Communication | 1 387 002 | 2 |
| Ore exploration | 765 744 | 1 |
| Chemicals | 502 769 | 1 |
| Other | 3 290 276 | 4 |
| **Gross loans and advances to customers** | **83 161 944** | **100** |

**Geographical and currency analysis, effective interest rates and maturity structure of loans and advances to customers are disclosed in Note 25. Information on related party transactions is disclosed in Note 28.**

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
94 MDM Bank

## 10 Assets Pledged under Sale and Repurchase Agreements

| | 31 December 2005 |
|---|---|
| **Corporate debt securities** | |
| Corporate bonds | 3 208 637 |
| **Precious metals** | |
| Gold bullion | 215 137 |
| **Total assets pledged under sale and repurchase agreements** | **3 423 774** |

**Assets pledged under sale and repurchase agreements are trading securities with a total fair value of RUR 3 208 637 thousand and precious metals with a carrying value of RUR 215 137 thousand pledged as collateral under sale and repurchase agreements. Refer to Notes 13 and 14.**
**Geographical and currency analysis, effective interest rates and maturity structure of assets pledged under sale and repurchase agreements are disclosed in Note 25.**

## 11 Other Assets

| | 31 December 2005 |
|---|---|
| Net amounts in course of settlement | 494 500 |
| Settlements on securities transactions | 109 318 |
| Trade debtors and prepayments | 158 114 |
| Prepaid taxes | 126 691 |
| Derivative financial instruments (Note 26) | 33 476 |
| Precious metals | 30 482 |
| Other | 58 460 |
| **Total other assets** | **1 011 041** |

**Geographical and currency analysis and maturity structure of other assets are disclosed in Note 25. Information on related party transactions is disclosed in Note 28.**

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
95 MDM Bank

## 12 Premises and Equipment

The reconciliation of the carrying amount of premises and equipment as at 31 December 2005 and as at 1 January 2005 is presented below:

| | Premises | Office, computer and other equipment | Fixtures and fittings | Intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| **Net book amount as at 1 January 2005** | **2 270 813** | **327 490** | **211 620** | **31 411** | **57 690** | **2 899 024** |
| **Cost or valuation** | | | | | | |
| Opening balance | 2 347 721 | 786 232 | 245 735 | 83 357 | 57 690 | 3 520 735 |
| Additions | 83 746 | 289 908 | 1 315 | - | - | 374 969 |
| Disposals | (68 893) | (219 100) | (125 521) | (73 581) | - | (487 095) |
| Transfers | 28 900 | 28 790 | - | - | (57 690) | - |
| Elimination of accumulated depreciation of revalued assets | (133 197) | - | - | - | - | (133 197) |
| Revaluation | 1 663 845 | - | - | - | - | 1 663 845 |
| **Closing balance** | **3 922 122** | **885 830** | **121 529** | **9 776** | **-** | **4 939 257** |
| **Accumulated depreciation and impairment** | | | | | | |
| Opening balance | 76 908 | 458 742 | 34 115 | 51 946 | - | 621 711 |
| Depreciation charge | 61 653 | 141 381 | 32 226 | 1 508 | - | 236 768 |
| Disposals | (5 364) | (216 017) | (36 894) | (47 833) | - | (306 108) |
| Elimination of accumulated depreciation of revalued assets | (133 197) | - | - | - | - | (133 197) |
| **Closing balance** | **-** | **384 106** | **29 447** | **5 621** | **-** | **419 174** |
| **Net book amount as at 31 December 2005** | **3 922 122** | **501 724** | **92 082** | **4 155** | **-** | **4 520 083** |

As at 31 December 2005 premises of the Group were revalued by Management based on the results of independent appraisals performed by an independent firm of appraisers, which resulted in a revaluation increase of RUR 1 663 845 thousand.

The primary basis used for the appraisal was the income capitalization approach. The income capitalization approach considers income and expense data relating to the property being valued and estimates fair value through a capitalization process. The market approach was used to assess the reasonableness of the results of the income capitalization approach. The market approach was based upon an analysis of the results of comparable sales of similar premises.

The following key assumptions were used in applying the income capitalization approach:

- annual cash flows were projected based on estimated rental income net of operating and maintenance expenses based on current market rental rates and actual average operating and maintenance expenses;
- vacancy and collection losses were estimated as 5% to 10% from potential gross rent income;
- discount rates of 12% to 14% and 15% to 22% were applied to capitalise annual cash flows for Moscow premises and premises located in other regions, respectively.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
96 MDM Bank

Changes in the estimates above could effect the value of premises. For example, to the extent that the net present value of the estimated cash flows differs by plus/minus ten percent, the premises valuation as at 31 December 2005 would be RUR 392 212 thousand higher/lower.

The last preceding revaluation of the majority of the Group's premises was carried out by an independent firm of appraisers as at 31 December 2003. Certain premises not valued as at 31 December 2003 were valued by an independent firm of appraisers as at 31 December 2004.

Included in the above net book value of premises is RUR 2 558 297 thousand representing the revaluation surplus.

The net book value of premises that would have been recognised under the historic cost method is RUR 1 419 290 thousand, as at 31 December 2005.

The gross book value of fully depreciated premises and equipment that is still in use is RUR 95 236 thousand, as at 31 December 2005.

As at 31 December 2005 and 1 January 2005 the Group does not have internally developed intangible assets.

## 13 Due to Other Banks

| | 31 December 2005 |
|---|---|
| Correspondent accounts and overnight deposits of other banks | 2 564 992 |
| Term deposits from other banks | 26 369 846 |
| Sale and repurchase agreements | 4 194 330 |
| **Total due to other banks** | **33 129 168** |

As at 31 December 2005, the Group has one counterparty with aggregate balances greater than 10% of equity. The total aggregate amount of these balances is RUR 4 256 058 thousand or 12.8% of due to other banks balances.

Securities sold under sale and repurchase agreements as at 31 December 2005 are securities with a total fair value of RUR 3 144 967 thousand. Refer to Note 10.

Precious metals sold under sale and repurchase agreements as at 31 December 2005 are precious metals with a carrying value of RUR 215 137 thousand. Refer to Note 10.

Securities purchased under reverse sale and repurchase agreements and sold under sale and repurchase agreements as at 31 December 2005 are securities with a total fair value of RUR 2 645 200 thousand. Refer to Note 9.

Geographical and currency analysis, effective interest rates and maturity structure of due to other banks are disclosed in Note 25.

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
97 MDM Bank

## 14 Customer Accounts

| | 31 December 2005 |
|---|---|
| **State and public organisations** | |
| - Current/settlement accounts | 1 775 404 |
| **Other legal entities** | |
| - Current/settlement accounts | 28 868 333 |
| - Term deposits | 14 802 554 |
| **Retail customers** | |
| - Current/demand accounts | 2 942 184 |
| - Term deposits | 7 584 490 |
| **Total customer accounts** | **55 972 965** |

Included in term deposits of other legal entities are sale and repurchase agreements of RUR 388 815 thousand, as at 31 December 2005.

Securities sold under sale and repurchase agreements as at 31 December 2005 are securities with a total fair value of RUR 63 670 thousand. Refer to Note 10.

Securities purchased under reverse sale and repurchase agreements and sold under sale and repurchase agreements as at 31 December 2005 are securities with a total fair value of RUR 254 828 thousand. Refer to Note 9.

Economic sector concentrations within customer accounts are as follows:

| | 31 December 2005 | |
|---|---|---|
| | Amount | % |
| Trade | 21 652 970 | 39 |
| Retail customers | 10 526 674 | 19 |
| Manufacturing | 8 000 274 | 14 |
| Finance companies | 6 648 921 | 12 |
| Mining and oil enterprises | 4 541 547 | 8 |
| Intergovernmental organisations | 2 153 570 | 4 |
| State and public organisations | 1 775 804 | 3 |
| Other | 673 205 | 1 |
| **Total other customer accounts** | **55 972 965** | **100** |

As at 31 December 2005, aggregate balances of the ten largest customers (or groups of customers) are RUR 21 864 691 thousand or 39% of total customer accounts.

Included in customer accounts as at 31 December 2005 is RUR 9 332 618 thousand held as collateral for irrevocable commitments under import letters of credit.

Geographical and currency analysis, effective interest rates and maturity structure of customer accounts are disclosed in Note 25. Information on related party transactions is disclosed in Note 28.

**MDM-BANK**
(expressed in thousands of Russian Roubles – refer to Note 3)
98 MDM Bank

## 15 Debt Securities in Issue

| | 31 December 2005 |
|---|---|
| Long-term loan participation notes | 12 840 357 |
| Promissory notes | 8 400 126 |
| Short-term loan participation notes | 1 441 716 |
| **Total debt securities in issue** | **22 682 199** |

Loan participation notes are unconditional debt instruments issued by the Bank.

As at 31 December 2005, long-term loan participation notes comprise 9.4% per annum loan participation notes maturing in September 2006 and 7.5% per annum loan participation notes maturing in December 2007 with effective rates of 9.9% and 8.0% per annum, respectively.

As at 31 December 2005, short-term loan participation notes comprise 3-month LIBOR plus 2.7% per annum loan participation notes maturing in December 2006 with an effective rate of 7.3% per annum.

Promissory notes are instruments issued by the Group to its customers, which carry a fixed date of repayment. These may be issued against cash deposits or as a payment instrument, which the customer can discount in the over-the-counter secondary market.

Geographical and currency analysis, effective interest rates and maturity structure of debt securities in issue are disclosed in Note 25. Information on related party transactions is disclosed in Note 28.

## 16 Other Liabilities

| | 31 December 2005 |
|---|---|
| Trade creditors | 623 790 |
| Accrued compensation expenses | 403 737 |
| Borrowings in precious metals | 215 137 |
| Provision for credit related commitments (Note 26) | 64 097 |
| Settlements on conversion operations | 60 073 |
| Taxation payable | 37 522 |
| Derivative financial instruments (Note 26) | 18 677 |
| Other | 27 622 |
| **Total other liabilities** | **1 450 655** |

Geographical and currency analysis, maturity structure of other liabilities are disclosed in Note 25. Information on related party transactions is disclosed in Note 28.

**MDM-BANK**
(expressed in thousands of Russian Roubles – refer to Note 3)
99 MDM Bank

## 17 Share Capital

The share capital of the Bank has been contributed by the shareholders in Russian Roubles, and they are entitled to dividends and any capital distribution in Russian Roubles.

As at 1 January 2005 and 31 December 2005, share capital of the Bank consisted of 2 149 950 authorized, issued and fully paid ordinary shares with a fixed nominal value of 500 Russian Roubles and 50 050 authorized, issued and fully paid preference shares with a fixed nominal value of 500 Russian Roubles.

Ordinary shares carry the right to vote at annual and general meetings, to receive dividends and a residual interest in the assets of the Bank after deducting all its liabilities on liquidation. All ordinary shares provide equal rights to their owners.

Preference shares have no right of conversion or redemption. Preference shares carry the right to vote at annual and general meetings in respect of issues that influence the interests of preference shareholders, including reorganisation and liquidation. Preference shares are entitled to receive the same dividends as dividends attributable to ordinary shareholders. If the dividend is not paid, preference shares carry the right to vote at annual and general meetings until dividends are paid. Dividends are not cumulative. In the event of liquidation preference shareholders are entitled to receive declared unpaid dividends and the par value of the preference shares (“liquidation value”). No dividends on preference shares have been declared during the year ended 31 December 2005.

| | Nominal value | Inflation adjustment | Total share capital |
|---|---|---|---|
| Ordinary shares | 1 074 975 | 534 145 | 1 609 120 |
| Preference shares | 25 025 | 102 384 | 127 409 |
| **Total share capital** | **1 100 000** | **636 529** | **1 736 529** |

## 18 Interest Income and Expense

| | 2005 |
|---|---|
| **Interest income** | |
| Loans and advances to customers | 9 318 861 |
| Overnight deposits and due from other banks | 1 046 853 |
| Trading securities | 588 373 |
| Other financial instruments at fair value through profit or loss | 245 015 |
| **Total interest income** | **11 199 102** |
| **Interest expense** | |
| Debt securities in issue | (1 550 805) |
| Due to other banks | (1 526 152) |
| Customer accounts | (1 125 629) |
| **Total interest expense** | **(4 202 586)** |
| **Net interest income** | **6 996 516** |

Included in interest income for the year ended 31 December 2005 is RUR 5 351 thousand in respect of interest income accrued on overdue loans.

Information on related party transactions is disclosed in Note 28.

(expressed in thousands of Russian Roubles – refer to Note 3)

## 19 Loan Impairment Losses

| | 2005 |
|---|---|
| Loans and advances to customers (Note 9) | 312 800 |
| **Charge to loan impairment losses** | **312 800** |

**Information on related party transactions is disclosed in Note 28.**

## 20 Gains less Losses Arising from Trading Activities

| | 2005 |
|---|---|
| Trading in securities | 603 614 |
| Trading in foreign currencies | 605 084 |
| Trading in precious metals | 53 251 |
| **Total gains less losses arising from trading activities** | **1 261 949** |

**Information on related party transactions is disclosed in Note 28.**

## 21 Fee and Commission Income and Expense

| | 2005 |
|---|---|
| Commission on settlement and trade finance transactions | 924 640 |
| Commission on cash transactions | 251 950 |
| Commission on foreign currency transactions | 181 604 |
| Commission for brokerage and other services of the investment banking nature | 143 612 |
| Other | 23 896 |
| **Total fee and commission income** | **1 525 702** |
| Commission on settlement transactions | (485 671) |
| Fees on transactions with entities of MDM Financial Group (Note 28) | (307 025) |
| Commission on foreign currency transactions | (104 949) |
| Commission on cash transactions | (70 384) |
| Other | (21 947) |
| **Total fee and commission expense** | **(989 976)** |
| **Net fee and commission income** | **535 726** |

**Information on related party transactions is disclosed in Note 28.**

(expressed in thousands of Russian Roubles – refer to Note 3)

## 22 Operating Expenses

| | 2005 |
|---|---|
| Staff costs | 3 117 256 |
| Depreciation and other expenses related to premises and equipment | 670 412 |
| Professional services | 231 805 |
| Advertising and marketing | 192 605 |
| Taxes other than on income | 141 589 |
| Software | 98 254 |
| Security | 93 900 |
| Telecommunications | 76 381 |
| Other | 82 863 |
| **Total operating expenses** | **4 705 065** |

Included in staff costs for the year ended 31 December 2005 is a management bonus relating to the year ended 31 December 2004 of RUR 60 329 thousand that was not accrued as at 31 December 2004 as it did not crystallise until August 2005 and could not be reliably measured at the date of issue of the consolidated financial statements for the year ended 31 December 2004. Refer to Note 28.

Included in professional services are fees of RUR 6 658 thousand paid to professional firms for services rendered to the Board of Directors of MDM-BANK during the year ended 31 December 2005.

The Group's principal auditor is ZAO KPMG. ZAO KPMG and its affiliated firms (together "KPMG") are also the auditors of MDM Financial Group and certain subsidiaries within MDM Financial Group. Audit fees paid by MDM Financial Group and its subsidiaries, including MDM-BANK, to KPMG are RUR 20 453 thousand for the year ended 31 December 2005.

During the year ended 31 December 2005 RUR 1 872 thousand was paid by the Group to KPMG for audit-related services, comprising mainly provision of comfort letters in respect of debt issues of the Group. These costs were capitalised.

During the year ended 31 December 2005, the Group's principal auditor, KPMG, did not provide any significant non-audit services to the Group or to MDM Financial Group.

## 23 Income Taxes

Income tax expense comprises the following:

| | 2005 |
|---|---|
| Current tax charge | 3 706 828 |
| Deferred taxation movement due to origination and reversal of temporary differences and movement in valuation allowance | (2 216 047) |
| Deferred tax charge recorded directly to equity | (399 325) |
| **Income tax expense** | **1 091 456** |

The income tax rate applicable to the majority of the Russian entities of the Group's income is 24%. The income tax rate applicable to income of Latvian Trade Bank is 15%.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
102 MDM Bank

The reconciliation between the expected and the actual income tax expense is provided below:

| | 2005 |
|---|---|
| **Profit before taxation** | **4 320 082** |
| Theoretical income tax expense at the applicable statutory rate | 1 036 820 |
| Tax effect of items taxed at different tax rates | (14 740) |
| Tax effect of items which are not deductible or assessable for taxation purposes, and other items of a non-temporary nature | 127 962 |
| Unrecognised net deferred tax asset movement | (58 586) |
| **Income tax expense** | **1 091 456** |

Movements in temporary differences for the year ended 31 December 2005:

| | 1 January 2005 | Movement | 31 December 2005 |
|---|---|---|---|
| **Tax effect of deductible temporary differences** | | | |
| Impairment allowances and provisions | 22 907 | (16 491) | 6 416 |
| Premises and equipment | 53 416 | (53 416) | - |
| Accruals | 112 271 | 85 510 | 197 781 |
| Securities | 29 025 | (29 025) | - |
| Other | 19 229 | (9 341) | 9 888 |
| **Gross deferred tax asset** | **236 848** | **(22 763)** | **214 085** |
| Less unrecognised deferred tax asset | (74 866) | 58 586 | (16 280) |
| **Net deferred tax asset** | **161 982** | **35 823** | **197 805** |
| **Tax effect of taxable temporary differences** | | | |
| Impairment allowances and provisions | (3 050 680) | 2 735 724 | (314 956) |
| Accruals | - | (3 497) | (3 497) |
| Premises and equipment | (153 730) | 7 536 | (146 194) |
| Revaluation of premises | (214 665) | (399 325) | (613 990) |
| Securities | (3 274) | (129 433) | (132 707) |
| Other | - | (30 781) | (30 781) |
| **Gross deferred tax liability** | **(3 422 349)** | **2 180 224** | **(1 242 125)** |
| **Total net deferred tax liability** | **(3 260 367)** | **2 216 047** | **(1 044 320)** |

Deferred income taxes are calculated on all temporary differences under the liability method using the income tax rates applicable to entities of the Group.

As at 31 December 2005, RUR 613 990 thousand of the deferred tax liability relates to revaluation of the Group's premises. Refer to Note 12.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
103 MDM Bank

In the context of the Group's current structure, tax losses and current tax assets of different companies may not be offset against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, a deferred tax asset of one company of the Group may not be offset against a deferred tax liability of another company.

As at 31 December 2005, a net deferred tax asset in respect of net deductible temporary differences of RUR 16 280 thousand has not been recorded as it is not probable that the relevant entity of the Group will have sufficient taxable profit that will allow the Group to benefit from the deferred tax asset.

## 24 Analysis by Segment

The Group's primary format for reporting segment information is by business segments. As the majority of operations, credit related commitments, capital expenditure, and revenues of the Group relates to residents of the Russian Federation, the Group does not have a secondary format for reporting segment information by geographical segments.

The Group is organised into two main business segments:

- Commercial banking – includes corporate and retail banking operations which include deposit taking and commercial lending in freely convertible currencies and Russian Roubles, settlements and cash operations. Commercial banking services also include trade finance, syndications, a *forfait* financing and export credit agency financing, and a range of banking card products.
- Investment banking and financial markets – includes corporate finance, debt and equity capital markets, brokerage and securities, foreign exchange, precious metals and banknote trading.

Segment breakdown of assets and liabilities of the Group is set out below:

| | 31 December 2005 |
|---|---|
| **Assets** | |
| Commercial banking | 76 794 223 |
| Investment banking and financial markets | 22 587 104 |
| Unallocated assets | 39 412 226 |
| **Total assets** | **138 793 553** |
| **Liabilities** | |
| Commercial banking | 84 013 394 |
| Investment banking and financial markets | 28 419 085 |
| Unallocated liabilities | 1 861 967 |
| **Total liabilities** | **114 294 446** |

**(expressed in thousands of Russian Roubles – refer to Note 3)**

**Segment information for the main reportable business segments of the Group for the year ended 31 December 2005 is set out below:**

| | Commercial banking | Investment banking and financial markets | Unallocated | Consolidated Group |
|---|---|---|---|---|
| External revenue | 10 280 120 | 3 663 557 | 476 717 | 14 420 394 |
| Net result from other segments | (1 227 281) | (43 261) | 1 270 542 | - |
| Impairment losses and provisions | (342 307) | - | - | (342 307) |
| Interest expense | (2 834 025) | (1 368 561) | - | (4 202 586) |
| Fee and commission expense | (568 720) | (92 284) | (328 972) | (989 976) |
| Operating expenses | (2 771 352) | (845 047) | (1 088 666) | (4 705 065) |
| **Segment result** | **2 536 435** | **1 314 404** | **329 621** | **4 180 460** |
| Taxation | | | (1 091 456) | (1 091 456) |
| Foreign exchange translation gains less losses | | | 139 622 | 139 622 |
| **Profit for the year** | | | | **3 228 626** |
| **Other segment items** | | | | |
| Capital expenditure | | | 374 969 | 374 969 |
| Depreciation charge | | | 236 768 | 236 768 |

**Net revenue from other segments represents income and expense from lending and borrowing between segments and a charge for the use of funds allocated to the segments.**

## 25 Financial Risk Management

**The risk management function within the Group is carried out in respect of financial risks (credit risk, market risk, including price risks, currency and fair value interest rate risks, and cash flow interest rate and liquidity risks), operational risk and legal risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks.**

### (a) Credit risk

**The Group takes on exposure to credit risk, which is the risk that a counterparty will fail to discharge the obligation in full when due. The Group structures the levels of credit risk it undertakes by placing limits on the amount of Group's risk accepted in relation to individual borrowers or groups of borrowers, and economic sectors. Limits on the level of credit risk by borrowers (or groups of borrowers), and economic sectors are approved by the Group's Credit Committee. The Credit Committee, which usually meets at least twice a week, is chaired by the Head of Credit Department of MDM-BANK.**

The Group's credit policy establishes:
• Procedures for review and approval of credit applications;
• Methodology for the credit assessment of borrowers;
• Methodology for the evaluation of proposed collateral;
• Credit documentation requirements;
• Procedures for the ongoing monitoring of loans.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. The Group operates an internal credit rating system whereby borrowers are assigned one of 25 ratings. These ratings reflect the risk assessment of the transaction and form the basis for transaction pricing. Exposure to credit risk is also managed, in part, by obtaining and monitoring collateral and corporate and personal guarantees.

The Group's maximum exposure to on balance sheet credit risk is generally reflected in the carrying amounts of financial assets on the balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

Credit risk for off balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same procedures and methodologies, as defined by the Group's credit policy, for approving credit related commitments (undrawn loan commitments, letters of credit and guarantees) as it does for on balance sheet credit obligations (loans). The Group's maximum exposure to off balance sheet financial instruments credit risk is reflected in Note 26 "Contingent liabilities, commitments and derivative financial instruments".

### (b) Market risk

The Group takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity financial instruments, which are exposed to general and specific market movements. The Group's Asset and Liability Committee, chaired by the Chief Executive Officer of the Group, sets limits on the level of market risk that may be accepted by the Group. This is monitored on a daily basis.

### (c) Currency analysis

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
106 MDM Bank

As at 31 December 2005, the Group had the following positions in different currencies:

| | RUR | US$ | EUR | Other currencies | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 7 055 630 | 20 575 831 | 3 328 828 | 385 868 | 31 346 157 |
| Mandatory cash balances with central banks | 1 822 676 | - | - | 318 144 | 2 140 820 |
| Due from other banks | 4 094 204 | 1 006 682 | 653 782 | 574 429 | 6 329 097 |
| Trading securities | 5 060 041 | 1 595 185 | - | - | 6 655 226 |
| Other financial instruments at fair value through profit or loss | - | 2 484 002 | - | - | 2 484 002 |
| Loans and advances to customers | 44 134 860 | 33 955 346 | 2 159 975 | 63 158 | 80 313 339 |
| Assets pledged under sale and repurchase agreements | 215 137 | 3 208 637 | - | - | 3 423 774 |
| Current income tax prepayments | 570 014 | - | - | - | 570 014 |
| Other assets | 777 764 | 136 393 | 16 731 | 80 153 | 1 011 041 |
| Premises and equipment | 4 503 695 | - | - | 16 388 | 4 520 083 |
| **Total assets** | **68 234 021** | **62 962 076** | **6 159 316** | **1 438 140** | **138 793 553** |
| **Liabilities** | | | | | |
| Due to other banks | 6 320 154 | 23 165 525 | 3 636 601 | 6 888 | 33 129 168 |
| Customer accounts | 21 654 419 | 31 204 574 | 2 677 787 | 436 185 | 55 972 965 |
| Debt securities in issue | 2 718 959 | 19 895 982 | 67 258 | - | 22 682 199 |
| Current income tax payable | 504 | - | - | 14 635 | 15 139 |
| Other liabilities | 1 013 856 | 77 510 | 43 647 | 315 642 | 1 450 655 |
| Deferred tax liability | 1 044 320 | - | - | - | 1 044 320 |
| **Total liabilities** | **32 752 212** | **74 343 591** | **6 425 293** | **773 350** | **114 294 446** |
| **Net balance sheet position** | **35 481 809** | **(11 381 515)** | **(265 977)** | **664 790** | **24 499 107** |
| **Off balance sheet net notional position** | **(8 941 918)** | **8 474 564** | **481 116** | **(13 762)** | **-** |
| **Credit commitments** | **5 835 666** | **10 782 153** | **3 161 229** | **57 412** | **19 836 460** |

Currency classification of monetary assets and liabilities is based on the currency in which they are denominated. Investments in equities have been attributed to the Russian Rouble as the issuers of these equity instruments are residents of the Russian Federation. Currency classification of tangible assets (premises and equipment), goodwill arising on acquisition of subsidiaries and prepayments has been based on the functional currency used to record them.

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream of the borrower, the possible appreciation of the currencies in which loans and advances have been extended against the Russian Rouble may adversely affect the borrower's repayment ability and therefore increase the likelihood of future loan losses.

**MDM-BANK**
(expressed in thousands of Russian Roubles – refer to Note 3)
107 MDM Bank

### (d) Interest rate risk

The Group is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may also reduce or create losses in the event that unexpected movements arise. The Group's Asset and Liability Committee is responsible for the Group's asset and liability management and sets limits on the level of interest rate mismatch which may be undertaken.

The table below summarises the effective average interest rate, by major currencies, for major monetary financial instruments. The analysis has been prepared on the basis of weighted average interest rates for the various financial instruments using year-end effective interest rates.

| | 31 December 2005, % | | |
|---|---|---|---|
| | RUR | US$ | EUR and Other currencies |
| **Assets** | | | |
| Due from other banks: | | | |
| - Current interbank loans | 8.3 | 4.9 | 2.8 |
| - Reverse sale and repurchase agreements | 10.7 | - | - |
| Trading securities: | | | |
| - Municipal bonds issued by Russian municipalities | 5.7 | - | - |
| - Russian Federal loan bonds (OFZ) | 6.5 | - | - |
| - VneshEconomBank (VEB) 3% coupon bonds ("MinFins") | - | 5.7 | |
| - Corporate bonds | 8.5 | 6.8 | - |
| - Promissory notes | 7.9 | 7.5 | - |
| Other financial instruments at fair value through profit or loss | - | 13.3 | - |
| Loans and advances to customers: | | | |
| - Loans and advances | 13.0 | 11.4 | 7.8 |
| - Reverse sale and repurchase agreements | 11.1 | 8.9 | - |
| Assets pledged under sale and repurchase agreements | 8.1 | 6.8 | - |
| **Liabilities** | | | |
| Due to other banks: | | | |
| - Term deposits from other banks | 6.1 | 5.6 | 2.5 |
| - Sale and repurchase agreements | - | 5.8 | - |
| Customer accounts: | | | |
| - Term deposits | 7.3 | 6.7 | 3.9 |
| - Sale and repurchase agreements | - | 3.9 | - |
| Debt securities in issue: | | | |
| - Long-term loan participation notes | - | 8.9 | - |
| - Promissory notes | 7.3 | 6.7 | 3.8 |
| - Short-term loan participation notes | - | 7.3 | - |

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
108 MDM Bank ANNUAL REPORT 2005

The table below summarises the Group's exposure to interest rate risks, as at 31 December 2005. Included in the tables are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates:

| | 2005 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Less than 1 month | From 1 to 3 months | From 3 to 6 months | From 6 to 12 months | More than 1 year | Non-interest bearing | Total |
| **Assets** | | | | | | | |
| Cash and cash equivalents | 31 346 157 | - | - | - | - | - | 31 346 157 |
| Mandatory cash balance with central banks | - | - | - | - | - | 2 140 820 | 2 140 820 |
| Due from other banks | 4 117 528 | 548 810 | 132 684 | 1 018 630 | 511 445 | - | 6 329 097 |
| Trading securities | 32 664 | 319 328 | 1 629 858 | 407 329 | 4 068 663 | 197 384 | 6 655 226 |
| Other financial instruments at fair value through profit or loss | - | - | - | - | 2 484 002 | - | 2 484 002 |
| Loans and advances to customers | 5 042 022 | 15 391 829 | 16 316 101 | 20 973 493 | 22 589 894 | - | 80 313 339 |
| Assets pledged under sale and repurchase agreements | - | - | - | - | 3 208 637 | 215 137 | 3 423 774 |
| Current income tax prepayments | - | - | - | - | - | 570 014 | 570 014 |
| Other assets | - | - | - | - | - | 1 011 041 | 1 011 041 |
| Premises and equipment | - | - | - | - | - | 4 520 083 | 4 520 083 |
| **Total assets** | **40 538 371** | **16 259 967** | **18 078 643** | **22 399 452** | **32 862 641** | **8 654 479** | **138 793 553** |
| **Liabilities** | | | | | | | |
| Due to other banks | 14 516 085 | 13 998 092 | 3 121 948 | 977 204 | 515 839 | - | 33 129 168 |
| Customer accounts | 39 007 020 | 5 652 659 | 5 237 604 | 4 395 148 | 1 680 534 | - | 55 972 965 |
| Debt securities in issue | 2 973 091 | 1 884 680 | 1 323 067 | 9 441 950 | 7 059 411 | - | 22 682 199 |
| Current income tax payable | - | - | - | - | - | 15 139 | 15 139 |
| Other liabilities | - | - | - | - | - | 1 450 655 | 1 450 655 |
| Deferred tax liability | - | - | - | - | - | 1 044 320 | 1 044 320 |
| **Total liabilities** | **56 496 196** | **21 535 431** | **9 682 619** | **14 814 302** | **9 255 784** | **2 510 114** | **114 294 446** |
| **Interest rate sensitivity gap** | **(15 957 825)** | **(5 275 464)** | **8 396 024** | **7 585 150** | **23 606 857** | **6 144 365** | **24 499 107** |

### (e) Liquidity risk

Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions, including the Group. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
109 MDM Bank ANNUAL REPORT 2005

**The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates. Decisions on the Group's liquidity management are made by the Group's Asset and Liability Committee and implemented by the Treasury of the Group.**

**The table below shows assets and liabilities of the Group by their remaining contractual maturity, with the exception of trading securities, which are shown in the category "Demand and less than 1 month" based on the fact that Management believes that all of these trading securities could be liquidated within one month in the normal course of business.**

**The liquidity position of the Group as at 31 December 2005 is set out below:**

| | Demand and less than 1 month | From 1 to 3 months | From 3 to 6 months | From 6 to 12 months | More than 1 year | No stated maturity | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and cash equivalents | 31 346 157 | - | - | - | - | - | 31 346 157 |
| Mandatory cash balances with central banks | 1 275 895 | 331 812 | 231 241 | 255 163 | 46 709 | - | 2 140 820 |
| Due from other banks | 4 117 528 | 548 810 | 132 684 | 1 018 630 | 511 445 | - | 6 329 097 |
| Trading securities | 6 655 226 | - | - | - | - | - | 6 655 226 |
| Other financial instruments at fair value through profit or loss | - | - | - | - | 2 484 002 | - | 2 484 002 |
| Loans and advances to customers | 5 042 002 | 15 252 519 | 15 877 058 | 20 988 576 | 23 153 184 | - | 80 313 339 |
| Assets pledged under sale and repurchase agreements | 2 556 441 | 867 333 | - | - | - | - | 3 423 774 |
| Current income tax prepayments | - | - | 286 462 | 283 552 | - | - | 570 014 |
| Other assets | 978 832 | - | 31 094 | 1 115 | - | - | 1 011 041 |
| Premises and equipment | - | - | - | - | - | 4 520 083 | 4 520 083 |
| **Total assets** | **51 972 081** | **17 000 474** | **16 558 539** | **22 547 036** | **26 195 340** | **4 520 083** | **138 793 553** |
| **Liabilities** | | | | | | | |
| Due to other banks | 12 078 214 | 8 566 173 | 4 745 599 | 6 637 529 | 1 101 653 | - | 33 129 168 |
| Customer accounts | 39 007 020 | 5 652 659 | 5 237 604 | 4 395 148 | 1 680 534 | - | 55 972 965 |
| Debt securities in issue | 2 973 091 | 442 965 | 1 323 067 | 10 883 665 | 7 059 411 | - | 22 682 199 |
| Current income tax payable | - | 15 139 | - | - | - | - | 15 139 |
| Other liabilities | 1 335 596 | 17 195 | 63 562 | 16 416 | 17 886 | - | 1 450 655 |
| Deferred tax liability | - | - | - | - | - | 1 044 320 | 1 044 320 |
| **Total liabilities** | **55 393 921** | **14 694 131** | **11 369 832** | **21 932 758** | **9 859 484** | **1 044 320** | **114 294 446** |
| **Net liquidity gap** | **(3 421 840)** | **2 306 343** | **5 188 707** | **614 278** | **16 335 856** | **3 475 763** | **24 499 107** |
| **Cumulative liquidity gap** | **(3 421 840)** | **(1 115 497)** | **4 073 210** | **4 687 488** | **21 023 344** | **24 499 107** | **-** |

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
110 MDM Bank ANNUAL REPORT 2005

As at 31 December 2005, the contractual maturities of trading securities are: RUR 32 664 thousand in “Demand and less than 1 month”, RUR 319 328 thousand in “From 1 to 3 months”, RUR 1 629 858 thousand in “From 3 to 6 months”, RUR 407 329 thousand in “From 6 to 12 months”, RUR 4 068 663 thousand in “More than 1 year” and RUR 197 384 thousand in “No stated maturity”.

Management believes that in spite of a substantial portion of deposits from customers being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group, would indicate that these deposits provide a long-term and stable source of funding for the Group.

### (f) Geographical analysis

The majority of the operations of the Group are located in Russia. The geographical analysis of the Group’s assets and liabilities as at 31 December 2005 is set out below:

| | Russia | OECD countries | Non-OECD countries | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 10 133 416 | 19 672 925 | 1 539 816 | 31 346 157 |
| Mandatory cash balances with central banks | 1 822 676 | - | 318 144 | 2 140 820 |
| Due from other banks | 5 307 717 | 14 444 | 1 006 936 | 6 329 097 |
| Trading securities | 6 655 226 | - | - | 6 655 226 |
| Other financial instruments at fair value through profit or loss | 2 484 002 | - | - | 2 484 002 |
| Loans and advances to customers | 80 173 588 | 139 058 | 693 | 80 313 339 |
| Assets pledged under sale and repurchase agreements | 3 208 637 | 215 137 | - | 3 423 774 |
| Current income tax prepayments | 570 014 | - | - | 570 014 |
| Other assets | 925 932 | 8 530 | 76 579 | 1 011 041 |
| Premises and equipment | 4 503 695 | - | 16 388 | 4 520 083 |
| **Total assets** | **115 784 903** | **20 050 094** | **2 958 556** | **138 793 553** |
| **Liabilities** | | | | |
| Due to other banks | 12 248 375 | 15 826 164 | 5 054 629 | 33 129 168 |
| Customer accounts | 31 173 721 | 18 678 261 | 6 120 983 | 55 972 965 |
| Debt securities in issue | 6 076 231 | 16 568 551 | 37 417 | 22 682 199 |
| Current income tax payable | 504 | - | 14 635 | 15 139 |
| Other liabilities | 837 022 | 68 927 | 544 706 | 1 450 655 |
| Deferred tax liability | 1 044 320 | - | - | 1 044 320 |
| **Total liabilities** | **51 380 173** | **51 141 903** | **11 772 370** | **114 294 446** |

The majority of credit related commitments, as at 31 December 2005, relate to residents of the Russian Federation.

The geographical classification of financial assets, liabilities and credit related commitments has been based on the country in which the counterparty is located. The classification of tangible assets (precious metals, premises and equipment) has been based on the country in which they are physically held.

First to default credit-linked notes included within other financial instruments at fair value through profit or loss as at 31 December 2005 are presented in the above tables as being with Russian counterparties, as the majority of bonds, upon repayment of which repayment of first to default credit-linked notes is dependent, are issued by Russian issuers.

Loans and advances to customers of RUR 5 730 853 thousand, included in the above table as being with Russian counterparties, have actually been granted to subsidiaries and affiliates of these Russian counterparties located outside of the Russian Federation.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
111 MDM Bank

## 26 Contingent Liabilities, Commitments and Derivative Financial Instruments

### (a) Legal proceedings

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

### (b) Tax legislation

The Group operates in a number of tax jurisdictions. In the normal course of business, Management must interpret and apply existing legislation to transactions with third parties and its own activities. Current Russian tax legislation is principally based on the form in which transactions are documented and the underlying accounting treatment as prescribed by Russian Accounting Rules. The interpretation of Russian tax legislation by the tax authorities and court practice, which are constantly changing, in the future may focus less on the form rather than on the substance of a transaction. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation. Tax years remain open to normal audit by the Russian tax authorities for three years; during such time any change in interpretation or practice, even if there is no change in Russian tax legislation, could be applied retroactively. The interpretation and practice in other jurisdictions in which the Group operates are also changing, sometimes with retroactive effect.

The Group has taken steps to reduce its overall tax liability by structuring its operations. In Management's opinion, the Group is in substantial compliance with the tax and other laws governing its operations in Russia and in other tax jurisdictions. However, a risk remains that the relevant authorities could take different positions with regard to interpretative issues or that court practice could develop adversely to positions taken by the Group and the effect on these consolidated financial statements, should the authorities succeed in asserting their positions, could be significant.

### (c) Capital commitments

As at 31 December 2005, the Group has capital commitments mainly in respect of the development of its branch network and system enhancements, totalling approximately RUR 177 770 thousand.

### (d) Operating lease commitments

Where the Group is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

| | 31 December 2005 |
|---|---|
| Not later than 1 year | 57 231 |
| Later than 1 year and not later than 5 years | 94 150 |
| Later than 5 years | 107 989 |
| **Total operating lease commitments** | **259 370** |

During the year ended 31 December 2005 RUR 181 275 thousand was recognised as an expense in the consolidated statement of income in respect of operating leases.

### (e) Credit related commitments

Credit related commitments comprise letters of credit, guarantees and undrawn loans. The contractual amount of these commitments represents the value at risk should the contract be fully drawn upon, the client defaults, and the value of any existing collateral becomes worthless.

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
112 MDM Bank

Outstanding credit related commitments are as follows:

| | 31 December 2005 |
|---|---|
| Letters of credit | 13 272 307 |
| Undrawn loan commitments | 5 012 162 |
| Guarantees issued | 1 616 088 |
| Less: provision for losses on credit related commitments | (64 097) |
| **Total credit related commitments** | **19 836 460** |

Information on related party transactions is disclosed in Note 28.

Movements in provision for losses on credit related commitments are as follows:

| | 2005 |
|---|---|
| **Provision for losses on credit related commitments as at 1 January** | **33 840** |
| Charge to provision during the year | 29 507 |
| Effect of foreign currency translation | 750 |
| **Provision for losses on credit related commitments as at 31 December** | **64 097** |

This provision is recorded within other liabilities. Refer to Note 16.

The total outstanding contractual amount of guarantees, letters of credit and undrawn loan commitments does not necessarily represent future cash requirements, as these commitments may expire or terminate without being funded.

### (f) Derivatives

Foreign exchange and other derivative financial instruments are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable and, thus, the aggregate fair values of derivative financial assets and liabilities can fluctuate significantly over time.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
113 MDM Bank ANNUAL REPORT 2005

The fair values of derivative instruments held are set out in the following table:

| | 31 December 2005 | | |
|---|---|---|---|
| | Contract/ notional amount | Fair values | |
| | | Assets | Liabilities |
| ***Foreign exchange derivative contracts*** | | | |
| - currency spot transactions | 13 662 538 | 11 404 | (5 059) |
| - currency forwards | 9 751 862 | 20 805 | (12 924) |
| - currency futures | 8 082 520 | - | - |
| ***Precious metals derivative contracts*** | | | |
| - precious metals forwards | 101 440 | 112 | (563) |
| ***Securities derivative contracts*** | | | |
| - securities forwards | 168 907 | 1 155 | (131) |
| - written securities put option | 287 825 | - | - |
| **Total recognised derivative assets/(liabilities)** | | **33 476** | **(18 677)** |

Derivatives with positive fair values are recorded within others assets, while derivatives with negative fair values are included in other liabilities. Refer to Notes 11 and 16, respectively.
Maturity, fair value and weighted average exchange rate breakdowns for forward and future currency contracts as at 31 December 2005 are set out in the following table:

| | Contract/ notional amount | Weighted average contracted exchange rates | Fair values | |
|---|---|---|---|---|
| | | | Assets | Liabilities |
| *Forwards* | | | | |
| **Buy US$ sell RUR** | | | | |
| Less than three months | 2 122 873 | 28.81 | 3 945 | (4 002) |
| Between three months and one year | 1 301 784 | 28.98 | 492 | (2 833) |
| **Buy RUR sell US$** | | | | |
| Less than three months | 3 504 575 | 28.85 | 8 211 | (2 918) |
| Between three months and one year | 577 650 | 28.88 | 623 | (445) |
| **Buy EUR sell US$** | | | | |
| Less than three months | 719 617 | 1.19 | 2 409 | - |
| **Buy US$ sell EUR** | | | | |
| Less than three months | 119 390 | 1.18 | - | (937) |

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
114 MDM Bank ANNUAL REPORT 2005

| | Contract/ notional amount | Weighted average contracted exchange rates | Fair values | |
|---|---|---|---|---|
| | | | Assets | Liabilities |
| **Buy GBP sell US$** | | | | |
| Less than three months | 696 105 | 1.73 | - | (1 770) |
| **Buy US$ sell GBP** | | | | |
| Less than three months | 701 231 | 1.74 | 5 125 | - |
| **Other** | | | | |
| Less than three months | 8 637 | - | - | (19) |
| ***Futures*** | | | | |
| **Buy US$ sell RUR** | | | | |
| Less than three months | 6 582 558 | 28.81 | - | - |
| Between three months and one year | 431 737 | 28.83 | - | - |
| **Buy RUR sell US$** | | | | |
| Less than three months | 634 775 | 28.84 | - | - |
| Between three months and one year | 433 450 | 28.90 | - | - |

Written securities put option is a put option expiring on 6 January 2007 written by the Group to a major international bank in respect of bonds issued by a Russian entity with a total nominal amount of US$ 10 000 thousand, or RUR 287 825 thousand. As at 31 December 2005, the market price of the underlying bonds was significantly above the exercise price. Further, the Group has the right to terminate the option before maturity under certain conditions. Based on these facts, Management of the Group believes that, as at 31 December 2005, the probability of losses under the option was remote.

Derivatives which are embedded in financial instruments measured at fair value through profit or loss are not included in the above table. These derivatives comprised credit derivatives embedded into first to default credit-linked notes of RUR 2 484 002 thousand included within other financial instruments through profit or loss (Refer to Note 8) and credit derivatives embedded into credit linked leveraged notes of RUR 28 415 thousand included in trading securities (Refer to Note 7), as at 31 December 2005. Maximum losses of the Group in respect of these embedded derivatives are limited to the carrying value of the related financial instrument.

### (g) Fiduciary assets

The Group provides custody services to its customers, whereby it holds securities on behalf of customers and receives fee income for providing these services. These securities are not assets of the Group and are not recognised in the consolidated balance sheet.

The Group provides trust services to individuals, trusts, retirement benefit plans and other institutions, whereby it holds and manages assets or invests funds received in various financial instruments at the discretion of the customer. The Group receives fee income for providing these services. Trust assets are not assets of the Group and are not recognised in the consolidated balance sheet. The Group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments. As at 31 December 2005, total assets held in trust by the Group on behalf of customers are RUR 515 317 thousand.

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
115 MDM Bank ANNUAL REPORT 2005

## 27 Fair Value of Financial Instruments

The Group has performed an assessment of its financial instruments, as required by IAS 32 "Financial Instruments: Disclosure and Presentation".

The estimated fair value of cash, correspondent accounts with central banks, correspondent accounts, overnight deposits with other banks and other floating rate placements is their carrying value.

The estimated fair value of fixed rate balances due from other banks, including central banks, is calculated based on discounted expected future principal and interest cash flows.

The estimated fair value of trading securities, derivative financial instruments and other financial instruments at fair value through profit or loss is based on quoted market prices at the balance sheet date without any deduction for transaction costs. For securities and derivative financial instruments not traded in an active market, the fair value is estimated by using valuation techniques, which include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

The estimated fair value of loans and advances to customers represents the discounted amount of estimated future cash flows expected to be received.

The estimated fair value of due to other banks and customer accounts balances, which are payable on demand, is their carrying value. The estimated fair value of due to other banks and customer accounts balances, which are not payable on demand, and other borrowed funds, which are not quoted in the active market, is calculated based on discounted expected future principal and interest cash flows.

The estimated fair value of debt securities in issue is based on quoted market prices at the balance sheet date without any deduction for transaction costs.

The estimated fair value of all other financial instruments represents the discounted amount of estimated future cash flows expected to be received.

The following table summarises the fair values of financial assets and liabilities which are not presented on the balance sheet at their fair value:

| | 31 December 2005 | |
|---|---|---|
| | Carrying value | Fair value |
| Mandatory cash balances with central banks | 2 140 820 | 2 104 760 |
| Due from other banks | 6 329 097 | 6 328 334 |
| Loans and advances to customers | 80 313 339 | 80 393 428 |
| Due to other banks | 33 129 168 | 33 042 265 |
| Customer accounts | 55 972 965 | 55 923 265 |
| Debt securities in issue | 22 682 199 | 22 776 531 |

Where discounted cash flow techniques are used, estimated future cash flows are based on Management's best estimates and the discount rate is a market related rate for a similar instrument at the balance sheet date.

The estimates of fair value are intended to approximate the amount for which a financial instrument could be exchanged between knowledgeable, willing parties in an arm's length transaction. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or settlement of liabilities.

(expressed in thousands of Russian Roubles – refer to Note 3)

## 28 Related Party Transactions

For the purposes of these consolidated financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties comprise ultimate beneficiaries of the Group, which have joint control over the Group, directors and key management personnel, entities of MDM Financial Group other than the subsidiaries of MDM-BANK, and other related parties. Other related parties are other entities, which are under common control with the Group, and other entities, which are significantly influenced by the Group's beneficiaries, directors and key management personnel. These include mainly Joint Stock Company Mineral and Chemical Company EuroChem (mineral fertilizers), Joint Stock Company Siberian Coal Energy Company (SUEK) (coal and energy), and TMK (pipes), and holding companies for these companies.

Banking transactions are entered into in the normal course of business with the related parties. These include settlements, loans, deposit taking, trade finance, securities and foreign currency transactions. These transactions are priced at market rates.

As at 31 December 2005, total balance sheet exposure to related parties (net of impairment) is RUR 2 919 887 thousand, or 2.1% of total assets. As at 31 December 2005, total (on and off balance sheet) exposure to related parties (net of impairment) is RUR 3 046 088 thousand, or 2.2% of total assets.

### (a) Transactions with beneficiaries of the Group

During the year ended 31 December 2005, no loans or credit related commitments were provided by the Group to its beneficiaries.

Term deposits of beneficiaries amount to RUR 400 410 thousand, as at 31 December 2005. The average effective rates for term deposits are 7.6% and 7.9% for deposits denominated in US dollars, and Euro, respectively, as at 31 December 2005. Term deposits from beneficiaries have remaining maturities less than one year. During the year ended 31 December 2005, the average balances of term deposits of beneficiaries were RUR 24 742 thousand, RUR 442 901 thousand and RUR 13 310 thousand for deposits in Russian Roubles, US Dollars and Euros, respectively. Interest expense on term deposits from beneficiaries amount to RUR 39 398 thousand for the year ended 31 December 2005.

Movements in term deposits of beneficiaries are as follows:

| | 2005 |
|---|---|
| **Term deposits as at 1 January** | **884 292** |
| Deposits received during the year | 483 923 |
| Interest expense for the year | 39 398 |
| Deposits repaid during the year | (1 024 255) |
| Effect of foreign currency translation | 17 052 |
| **Term deposits as at 31 December** | **400 410** |

### (b) Transactions with the members of the board of directors and key management personnel

The total remuneration of the members of the Board of Directors of MDM-BANK, including discretionary compensation, amounts to RUR 42 966 thousand for the year ended 31 December 2005.

Key management personnel comprise members of the Management Board of MDM-BANK and the Chief accountant of MDM-BANK.

The total remuneration of key management personnel, including discretionary compensation, amounts to RUR 442 155 thousand for the year ended 31 December 2005. Included in remuneration of key management personnel are salaries and bonuses of RUR 409 251 thousand, contributions to the Russian Federation State pension fund of RUR 625 thousand and termination benefits of RUR 32 279 thousand. Included in remuneration of key management personnel for the year ended

**(expressed in thousands of Russian Roubles – refer to Note 3)**

31 December 2005 is a management bonus relating to the year ended 31 December 2004 of RUR 60 329 thousand that was not accrued as at 31 December 2004 as it did not crystallise until August 2005 and could not be reliably measured at the date of issue of the consolidated financial statements for the year ended 31 December 2004. (Refer to Note 22).

The Group does not provide post-employment, share-based or other long-term benefits to the directors and key management personnel.

The outstanding loans to the directors and key management personnel as at 31 December 2005 are as follows:

| | 31 December 2005 |
|---|---|
| Loans | 55 951 |
| Reverse sale and repurchase agreements | 34 611 |
| **Loans to directors and key management personnel** | **90 562** |

Securities purchased under reverse sale and repurchase agreements are corporate shares with a fair value of RUR 43 276 thousand, as at 31 December 2005.

Loans to the directors and key management personnel of RUR 36 225 thousand and RUR 54 337 thousand have remaining maturities up to one year and from one to five years, respectively, as at 31 December 2005. As at 31 December 2005, the average effective interest rates on loans and advances to the directors and key management personnel are 10.5% and 10.0% for loans denominated in Russian Roubles and US Dollars, respectively. During the year ended 31 December 2005, the average balances of loans and advances to the directors and key management personnel were RUR 1 095 thousand and RUR 39 248 thousand for loans denominated in Russian Roubles and US Dollars, respectively. Interest income from loans to the directors and key management personnel amounts to RUR 4 683 thousand for the year ended 31 December 2005.

### (c) Transactions with entities of MDM Financial Group other than the subsidiaries of MDM-BANK

The outstanding balances as at 31 December 2005 with entities of MDM Financial Group other than the subsidiaries of MDM-BANK (“other entities of MDM Financial Group”) are as follows:

| | MDM Financial Holding (Cyprus) | Other | Total |
|---|---|---|---|
| Cash and cash equivalents | - | 3 546 | 3 546 |
| Due from other banks | - | 527 651 | 527 651 |
| Other assets | - | 13 | 13 |
| Due to other banks | - | 1 324 174 | 1 324 174 |
| Customer accounts | 1 507 319 | 768 775 | 2 276 094 |

(expressed in thousands of Russian Roubles – refer to Note 3)

The results of transactions with other entities of MDM Financial Group for the year ended 31 December 2005 are as follows:

| | MDM Financial Holding (Cyprus) | Other | Total |
|---|---|---|---|
| Interest income on due from other banks | - | 61 974 | 61 974 |
| Interest income on loans and advances to customers | 370 027 | 210 695 | 580 722 |
| Interest expense on due to other banks | - | (473 087) | (473 087) |
| Interest expense on customer accounts | (5 684) | (15 821) | (21 505) |
| Net fee and commission expense | (307 025) | (115 681) | (422 706) |
| Gains less losses arising from dealing in foreign currencies | (12 136) | 15 721 | 3 585 |
| Other income | - | 6 014 | 6 014 |

During the year ended 31 December 2005, the average cash and cash equivalents balances held with other entities of MDM Financial Group were RUR 173 110 thousand.

Due from other banks of MDM Financial Group comprise current interbank loans of RUR 527 651 thousand. Current interbank loans of RUR 16 704 thousand and RUR 510 947 thousand have remaining maturities up to one year and from one to five years, respectively, as at 31 December 2005. As at 31 December 2005, the average effective interest rates on current interbank loans to other banks of MDM Financial Group were 7.0%, 7.3% and 9.3% for balances denominated in Russian Roubles, US Dollars and Euros, respectively. During the year ended 31 December 2005, the average balances due from other banks of MDM Financial Group were RUR 387 671 thousand, RUR 591 330 thousand, and RUR 2 205 thousand for balances denominated in Russian Roubles, US Dollars, and Euros, respectively.

During the year ended 31 December 2005, the average balances of loans and advances to other entities of MDM Financial Group were RUR 262 389 thousand and RUR 6 927 274 thousand for loans denominated in Russian Roubles and US Dollars, respectively.

Due to other banks of MDM Financial Group comprise correspondent accounts of RUR 346 016 thousand and term deposits of RUR 978 158 thousand. Term deposits of RUR 959 296 thousand and RUR 18 862 thousand have remaining maturities up to one year and from one to five years, respectively, as at 31 December 2005. As at 31 December 2005, the average effective interest rates on term deposits due to other banks of MDM Financial Group are 15.2% and 4.7% for deposits denominated in Russian Roubles and US Dollars, respectively. During the year ended 31 December 2005, the average balances of term deposits due to other banks of MDM Financial Group were RUR 5 112 219 thousand and RUR 314 677 thousand for loans denominated in Russian Roubles and US Dollars, respectively. During the year ended 31 December 2005, the average balance of correspondent accounts due to other banks of MDM Financial Group were RUR 2 965 953 thousand.

Balances on customer accounts of other entities of MDM Financial Group comprise current accounts of RUR 1 497 762 thousand and term deposits of RUR 778 332 thousand, as at 31 December 2005. Balances on current accounts of related parties are repayable on demand and carry a standard rate applied by the Group for current accounts. Term deposits of RUR 33 214 thousand and RUR 745 118 thousand have remaining maturities up to one year and from one to five years, respectively, as at 31 December 2005. As at 31 December 2005, the average effective interest rates on term deposits of other entities of MDM Financial Group were 13.0% and 10.6% for deposits denominated in Russian Roubles and US Dollars, respectively. During the year ended 31 December 2005, the average balances of term deposits of other entities of MDM Financial Group were RUR 107 810 thousand and RUR 30 293 thousand for term deposits denominated in Russian Roubles and US Dollars, respectively.

**MDM-BANK**
**(expressed in thousands of Russian Roubles – refer to Note 3)**
119 MDM Bank ANNUAL REPORT 2005

### (d) Transactions with other related parties

**The outstanding balances as at 31 December 2005 with other related parties are as follows:**

| | EuroChem | SUEK | TMK | Other | Total |
|---|---|---|---|---|---|
| Trading securities | - | 786 | 36 746 | - | 37 532 |
| Loans and advances to customers (gross) | 105 | 1 373 580 | 932 091 | - | 2 305 776 |
| Loan impairment | (2) | (26 922) | (18 269) | - | (45 193) |
| Customer accounts | 87 529 | 398 540 | 103 | 49 238 | 535 410 |
| Promissory notes issued | - | 50 435 | - | - | 50 435 |
| Credit related commitments | - | - | 127 499 | - | 127 499 |
| Provision for credit related commitments | - | - | (1 298) | - | (1 298) |

**The results of transactions with related parties for the year ended 31 December 2005 are as follows:**

| | EuroChem | SUEK | TMK | Other | Total |
|---|---|---|---|---|---|
| Interest income on loans and advances to customers | 13 701 | 453 651 | 56 694 | 107 277 | 631 323 |
| Interest income received from securities issued by related parties | - | 12 560 | 15 054 | - | 27 614 |
| Loan impairment reversal/(losses) | 3 490 | 40 842 | (13 796) | - | 30 536 |
| Net trading gains from trading in securities issued by related parties | - | (364) | 6 989 | - | 6 625 |
| Net trading gains from trading in foreign currencies with related parties | 297 | 26 | - | 3 903 | 4 226 |
| Net fee and commission income | 1 231 | 8 341 | 13 200 | 4 | 22 776 |
| Other income | 81 | 14 778 | - | - | 14 859 |
| Operating expenses | - | (17 043) | - | - | (17 043) |

**As at 31 December 2005, trading securities issued by other related parties comprise corporate bonds denominated in Russian Roubles. Corporate bonds issued by other related parties of RUR 30 167 thousand and RUR 7 365 thousand have remaining maturities up to one year and from one to five years, respectively, as at 31 December 2005. As at 31 December 2005, the average yield to maturity of corporate bonds issued by other related parties is 7.8%. During the year ended 31 December 2005, the average balances of trading securities issued by other related parties were RUR 252 957 thousand.**

**Loans to other related parties of RUR 2 158 197 thousand and RUR 147 579 thousand have remaining maturities up to one year and from one to five years, respectively, as at 31 December 2005. As at 31 December 2005, the average effective interest rates on loans and advances to other related parties are 11.4% and 10.5% for loans denominated in Russian Roubles and US Dollars, respectively. As at 31 December 2005, the ranges of interest rates on loans and advances to other related parties are from 9.5% to 14.0% and from 10.0% to 11.0% for loans denominated in Russian Roubles and US Dollars, respectively. During the year ended 31 December 2005, the average balances of loans and advances to other related parties were RUR 1 352 933 thousand and RUR 4 223 331 thousand for loans denominated in Russian Roubles and US Dollars, respectively.**

MDM-BANK
(expressed in thousands of Russian Roubles – refer to Note 3)
120 MDM Bank

Movements in loans to other related parties are as follows:

| | 2005 |
|---|---|
| **Loans as at 1 January** | **4 111 538** |
| Loans issued during the year | 7 522 096 |
| Interest income for the year | 631 323 |
| Loans repayments during the year | (10 007 810) |
| Effect of foreign currency translation | 48 629 |
| **Loans as at 31 December** | **2 305 776** |

As at 31 December 2005, balances on customer accounts of other related parties comprise current accounts of RUR 535 410 thousand. Balances on current accounts of other related parties are repayable on demand and carry a standard rate applied by the Group for current accounts. During the year ended 31 December 2005, the average balances of current accounts of other related parties were RUR 948 672 thousand.

The average effective rate for promissory notes issued and sold initially to other related parties is 1.8% for promissory notes denominated in Russian Roubles, as at 31 December 2005. Promissory notes issued to other related parties have remaining maturities of less than one month, as at 31 December 2005. During the year ended 31 December 2005, the average balances of promissory notes issued to other related parties were RUR 7 319 thousand.

Credit related commitments with related parties comprise guarantees issued and letters of credit with remaining maturities of less than 1 year. During the year ended 31 December 2005, the average balances of guarantees and letters of credit issued to other related parties were RUR 220 289 thousand and RUR 30 287 thousand, respectively.

Movements in credit related commitments with other related parties are as follows:

| | 2005 |
|---|---|
| **Credit related commitments as at 1 January** | **698 730** |
| Guarantees issued during the period | 647 823 |
| Guarantees matured during the period | (1 109 458) |
| Letters of credit matured during the period | (110 335) |
| Effect of foreign currency translation | 739 |
| **Credit related commitments as at 31 December** | **127 499** |

(expressed in thousands of Russian Roubles – refer to Note 3)

## 29 Principal Subsidiaries

Included in the table below is the list of the principal subsidiaries of the Group, as at 31 December 2005.

| Name | Jurisdiction | Voting rights/ Equity owned, % 31 December 2005 |
|---|---|---|
| **Banking** | | |
| Latvian Trade Bank | Latvia | 63.3 |
| **Asset management** | | |
| Petrovsky Fondovy Dom | Russia | 100.0 |
| **Leasing** | | |
| LeasingPromHold | Russia | 100.0 |
| **Real estate** | | |
| MVK Nedvizhimost | Russia | 100.0 |
| **Other** | | |
| MDM International Funding plc | Ireland | 100.0 |

## 30 Subsequent Events

In February 2006, the Group placed US$ 300 000 thousand of short-term notes under its loan participation note programme. The notes have a coupon rate of 6.8% and mature in February 2007.

**MDM-BANK**

**Unaudited Supplementary Consolidated Financial Information-Consolidated Balance Sheet as at 31 December 2005 in US Dollars (expressed in thousands of US Dollars – refer to Note 3)**

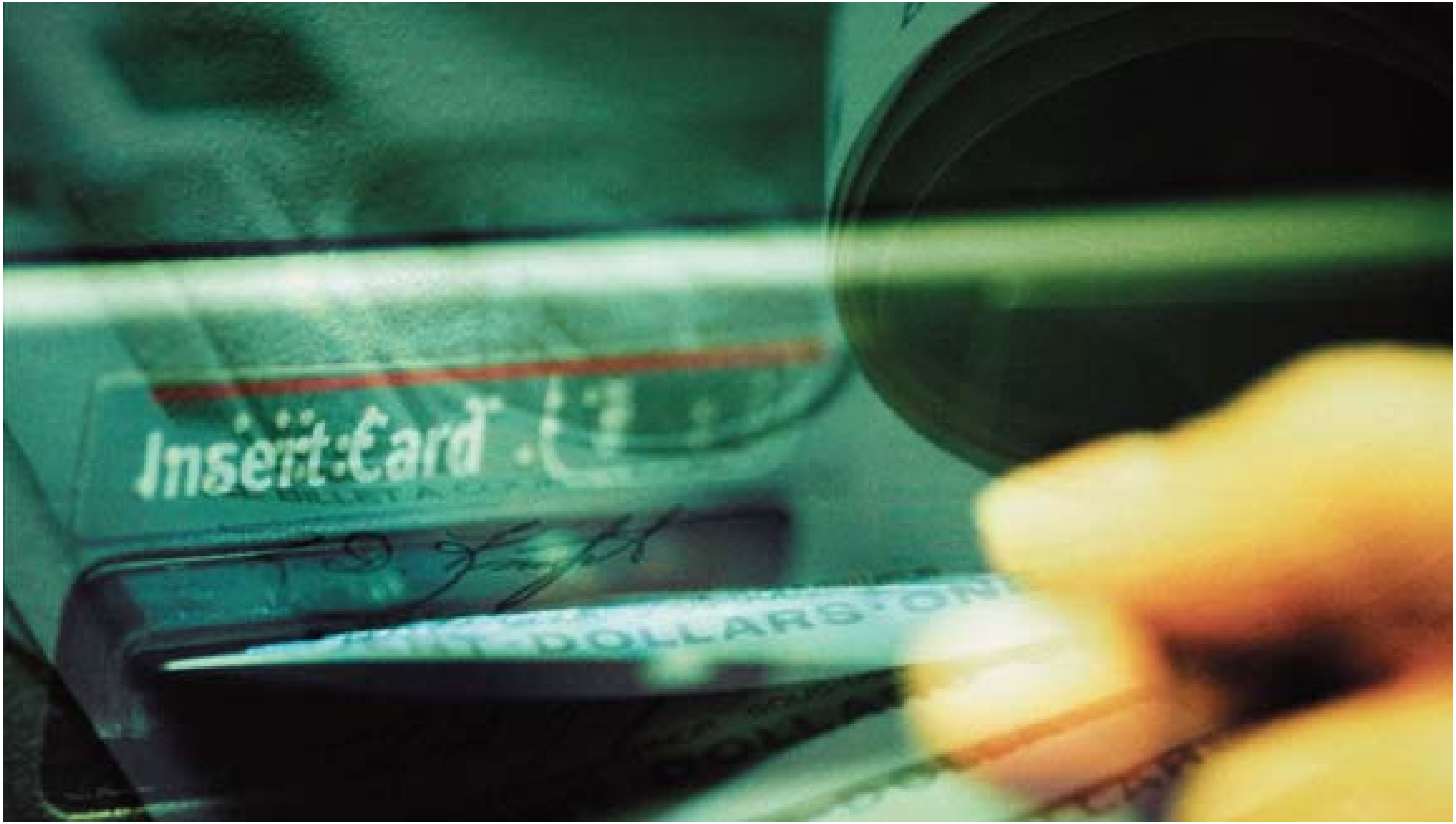
| | Unaudited 31 December 2005 |
|---|---|
| **Assets** | |
| Cash and cash equivalents | 1 089 070 |
| Mandatory cash balances with central banks | 74 379 |
| Due from other banks | 219 894 |
| Trading securities | 231 225 |
| Other financial instruments at fair value through profit or loss | 86 303 |
| Loans and advances to customers | 2 790 353 |
| Assets pledged under sale and repurchase agreements | 118 954 |
| Current income tax prepayments | 19 804 |
| Other assets | 35 126 |
| Premises and equipment | 157 043 |
| **Total assets** | **4 822 151** |
| **Liabilities** | |
| Due to other banks | 1 151 018 |
| Customer accounts | 1 944 687 |
| Debt securities in issue | 788 055 |
| Current income tax payable | 526 |
| Other liabilities | 50 401 |
| Deferred tax liability | 36 283 |
| **Total liabilities** | **3 970 970** |
| **Equity** | |
| Share capital | 60 333 |
| Share premium | 333 106 |
| Revaluation reserve for premises and equipment | 67 552 |
| Cumulative translation reserve | (1 444) |
| Retained earnings | 379 954 |
| Total equity attributable to equity holders of the parent | 839 501 |
| Minority interest | 11 680 |
| **Total equity** | **851 181** |
| **Total liabilities and equity** | **4 822 151** |

* The US Dollar figures are provided for information purposes only and do not form part of the consolidated financial statements for the year ended 31 December 2005 – refer to note 3(d).

**MDM-BANK**
Unaudited Supplementary Consolidated Financial Information-Consolidated Statement of Income for the Year Ended 31 December 2005 in US Dollars
(expressed in thousands of US Dollars – refer to Note 3)
123 MDM Bank

| | Unaudited 2005 |
|---|---|
| Interest income | 389 094 |
| Interest expense | (146 012) |
| **Net interest income** | **243 082** |
| Loan impairment losses | (10 867) |
| **Net interest income after provision for loan impairment** | **232 215** |
| Gains less losses arising from trading activities | 43 844 |
| Foreign exchange translation gains less losses | 4 851 |
| Fee and commission income | 53 008 |
| Fee and commission expense | (34 395) |
| Gains less losses from other financial instruments at fair value through profit or loss | 2 822 |
| Charge to provision for losses on credit related commitments | (1 025) |
| Other operating income | 12 244 |
| **Operating income** | **313 564** |
| Operating expenses | (163 470) |
| **Profit before taxation** | **150 094** |
| Income tax expense | (37 921) |
| **Profit for the year** | **112 173** |
| **Attributable to** | |
| Equity holders of the parent | 109 486 |
| Minority interest | 2 687 |
| **Earnings per share** | |
| Ordinary shares (number of shares) | 2 149 950 |
| Earnings per ordinary share | 0.051 |

* The US Dollar figures are provided for information purposes only and do not form part of the consolidated financial statements for the year ended 31 December 2005 – refer to note 3(d).


Insert Card
DOLLARS

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**Bloomberg:** MDMG
**Reuters:** MBWM, MDMM, MDMB
**X–400:** C: USSR, A: SOVMAIL
**SPRINT:** MDMBANK/CUSTOMERS
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**Suharevsky**
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**Fax:** 795-25-11 int. 21-29

## MINI OFFICES

**The Mini offices of MDM bank are located in the following car dealerships:**

**Roskon**
2-v, Yaroslavskoe Shosse, Moscow 129348
**Tel.:** 961-12-20
**Fax:** 961-12-29

**Active-Motors**
Moscow Region, Leninsky Rajon, Govorovo, 47th km of MKAD, inv. № 8590, lit. Д, № 1
**Tel.:** 721-33-15

**Avtomir**
46/2, block 2, bld.1, Ozernaya St., Moscow 101000
**Tel.:** 430-98-66

**Genser**
8/1, Novoyasenevsky proezd, Moscow 117574
**Tel:** 422-25-66

**Avtomir**
5/2, Proezd of Serp&Molot Factory, Moscow 111024
**Tel.:** 956-88-00 int.130
**Fax:** 362-59-07 int.128

**Azimuth SP**
138, Varshavskoe Shosse, Moscow 117519
**Tel.:** 363-96-96

**Avtomir**
9, Graphsky Pereulok, Moscow 129626
**Tel.:** 956-22-33 int. 265

**Avtosila**
10B/2, Vostryakovsky Proezd, Moscow 113403
**Tel.:** 234-29-00

**Lexus – Business-Car**
9a, 3rd Kolhoznaya St., Mytishy 141011, Moscow Region
**Tel.:** 729-33-44
**Fax:** 729-33-45

**Avtomir**
7, Yaroslavskoye Shosse, Moscow 129337
**Tel.:** 105-55-10 int. 40-70

**Boris Hoff**
36, Yaroslavskoe Shosse, Moscow 129348
**Tel.:** 745-11-11

**Avtomir**
5/6, block 1, Irkutskaya St., Moscow 107497
**Tel.:** 995-77-72

**Avtomir-Maryino**
19, Pererva St., Moscow 109383
**Tel.:** 741-08-88 int. 255

**Genser**
1, Novoryazanskoe Shosse, Lubertsy, Moscow Region
**Tel.:** 785-77-03

**Between April and July 2006, MDM Mini-office will commence operations at the following addresses:**

26, Pravda St., Office Center, Moscow

**Avtosila Car Showroom**
13, Ketcherskay, Moscow

**PerlovskyTrade Centre**
Moscow Region, Mytishy, Perlovka

**Avtomir Car Showroom**
2, 5th Verhny Mikhailovsky Proezd, Moscow

**Gorbushkin Dvor Trade Centre**
7/3, Bagrationovsky Proezd, Moscow

**Genser Car Showroom**
6, Novoyasenevsky Prospekt, Moscow

**Supermarket Gelert**
19, Konenkova St., Moscow

**Lexus Car Showroom**
72, Rublevskoye Shosse, Moscow

**Lexus Car Showroom**
Khimky, 78th km of MKAD, Moscow Region

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**Fax:** +7 (3843) 77-95-83
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+7 (383) 218-17-11 –
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+7 (383) 218-17-22 – Loans
+7 (383) 218-19-29 –
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+7 (383) 218-19-42 – Legal Department
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+7 (495) 255-23-78 – Reception
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+7 (4862) 76-34-18 – Reception
+7 (4862) 76-04-29 – Loans
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**E-mail:** refer.omsk@mdmbank.com
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+7 (8412) 56-55-34 – Loans
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Liana.Delibaltova.Penza@MDMBank.com
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**PERM**

**Perm Branch**
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614068, Russia
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+7 (342) 236-36-45 – Corporate Loans
+7 (342) 236-36-32 – Car Loans
+7 (342) 236-36-34 – Settlements
+7 (342) 236-36-51 – Chief Accountant
**Fax:** +7 (342) 236-33-66
**E-mail:** filial.perm@mdmbank.com
**Manager:** Sergey V. Yaremchenko

**ROSTOV-ON-DON**

**Rostov-on-Don Branch**
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Rostov-na-Donu 344022, Russia
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+7 (863) 295-06-40 – Reception
+7 (863) 295-06-41 – Cash Transactions
+7 (863) 295-06-45 – Loan Department
+7 (863) 263-25-33 – Consumer Loans
+7 (863) 263-25-24 – Corporate Business
**Fax:** +7 (863) 295-06-40
**E-mail:** rostovmdm@mdm.bank.com
**Manager:** Konstantin N. Leonov

**SAINT-PETERBURG**

**Saint Peterburg Branch**
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Petersburg 197022, Russia
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+7 (812) 326-93-95, 718-48-97 – Reception
+7 (812) 326-93-96 – Loans
**Fax:** +7 (812) 346-20-55
**E-mail:** info.spb@mdmbank.com
**Manager:** Andrey V. Atamas

**SAIANOGORSK**

**Saianogorsk Branch**

22a, Leningradskiy micro district,
Saianogorsk 655600, Khakassyia
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+7 (39042) 2-67-95; 2-01-83
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**SAMARA**

**Samara Branch**

57A, Chernorechenskaya St.,
Samara 443096, Russia
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+7 (846) 270-23-23 – Reception
+7 (846) 270-22-51, 270-21-98,
926-92-43, 242-87-18
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**SARATOV**

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+7 (4812) 61-01-63 – Chief Accountant
+7 (4812) 61-03-24 – Loans
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**Piatigorsk Operating Office**
**(to open in June-July 2006)**

46, Oktiabrskaya St., Piatigorsk, Russia

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+7 (3462) 51-62-12 – Accounting
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+7 (8212) 20-07-52 – Manager
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+7 (8212) 20-07-63 – Car Loans
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31, Kommunisticheskaya St.,
Syktyvkar 167000, Komi Republic,
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**E-mail:** mail.sktr@mdmbank.com
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+7 (3452) 469-369 – Loans
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**E-mail:** mdm.tumen@mdmbank.com
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20, Novotorzhkaya St., Tver 170100,
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olga.kiseleva.tvermdm@mdmbank.com
**Manager:** Ruslan V. Proshakov

**VLADIVOSTOK**
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414-356 – Reception
+7 (4232) 414-362 – Loans
+7 (4232) 410-116 –
Corporate Business
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**Manager:** Sergey N. Timofeev

**Tsentralniy Operating Office**
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**Gipermarket Operating Office**
54/a, Okeanskiy prospect,
Vladivostok 690091, Russia
**Telephone:** +7 (4232) 44-61-06
**Manager:** Irina Ya. Zinich

**VOLGOGRAD**
**Volgograd Branch**
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+7 (8442) 24-07-70 – Reception
+7 (8442) 24-07-71,
24-07-72, 24-07-80
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**Manager:** Konstantin N. Volosov

**VORONEZH**
**Voronezh Branch**
14, Lenina square, Voronezh
394018, Russia
**Telephone:**
+7 (4732) 53-25-16 – Reception
+7 (4732) 20-52-35 – Manager
+7 (4732) 20-52-40 –
Deputy Manager
+7 (4732) 20-52-42 –
Chief Accountant
+7 (4732) 20-57-00 – tel./fax –
Retail Loans
+7 (4732) 20-55-05 –
Corporate Business
**Fax:** +7 (4732) 53-25-16, 20-57-00
**E-mail:**
mdm.voronezh@mdmbank.com
**Manager:** Evgeny I. Zhukov

## PRINCIPAL CORRESPONDENT ACCOUNTS:

| | |
|---|---|
| **RUB** | Account № 30101–810–9–0000–0000466 in OPERU OF MOSCOVSKY GTU OF THE BANK OF RUSSIA |
| **US$** | Account № 890-0514-841 in BANK OF NEW YORK, One Wall str., 8th Floor, New York/NY, 10286 USA, S.W.I.F.T code: IRVTUS3N |
| **EUR** | Account № 0103110391 in OST-WEST HANDELSBANK AG, Stephanstrasse 1, 60313 Frankfurt/Main, Germany, S.W.I.F.T code: OWHBDEFF |
| **CHF** | Account № 0230-69226.05Z in UBS AG P.O. Box 8098, Zurich, CH, Global Services Financial Institutions, S.W.I.F.T code: UBSWCHZH80A |
| **GBP** | Account № 0314319 0000 GBP 000 LDN in DEUTSCHE BANK AG, Winchester House 1, Great Winchester Street, London, EC2N 2DB U.K., SORT CODE 405081, S.W.I.F.T code: DEUTGB2L |
| **SEK** | Account № 99-40-390-349 in SVENSKA HANDELSBANKEN, Blasiehomstorg 11, 106 70 Stockholm, Sweden, S.W.I.F.T code: HANDSESS |
| **NOK** | Account № 7001.02.05954 in DNB NOR BANK ASA, (formerly DEN NORSKE BANK ASA), Stranden 21, 0250 Oslo, Norway, S.W.I.F.T code: DNBANOKK |
| **DKK** | Account № 3996052575 in DEN DANSKE BANK, Holmens kanal 2-12, DK-092, Copenhagen K, Denmark, S.W.I.F.T code: DABADKKK |
| **JPY** | Account № 653-0423130 in BANK OF TOKYO – MITSUBISHI, 7-1 Marunouchi 2-Chome, Chiyoda-ku, Tokyo, 100, Japan, S.W.I.F.T code: BOTKJPJT |
| **KZT** | Account № 058169309 in HALYK SAVINGS BANK OF KAZAKSTAN Alma-ata, Kazakhstan, MFO 190501601, S.W.I.F.T code: HSBKKZKX |
| **BYR** | Account № 1702795061015 in BELVNESHECONOMBANK, Myasnikov str., 32, 220050 Minsk, Belarus, MFO 226, S.W.I.F.T code: BELBBY2X |
| **UAH** | Account № 073-00043-733 in LATVIJAS TIRDZNIECIBAS BANKA, 4 Trijadibas iela, LV-1048 Riga, Latvia, S.W.I.F.T code: LATCLV22 |

## LICENCES

| | |
|---|---|
| Activity: | **General banking license** |
| Issuing body: | Central Bank of Russia |
| Number and date: | № 2361 of 13/02/03 |
| | |
| Activity: | **Precious metals operations** |
| Issuing body: | Central Bank of Russia |
| Number and date: | № 2361 of 13/02/03 |
| | |
| Activity: | **Gold Export** |
| Issuing body: | Ministry of Economic Development and Trade of Russia |
| Number and date: | № 027505512613 of 26/08/05 |
| | |
| Activity: | **Silver Export** |
| Issuing body: | Ministry of Economic Development and Trade of Russia |
| Number and date: | № 0270605502139 of 06/03/2006 |
| | |
| Activity: | **Exchange Broker** |
| Issuing body: | Commission for Commodity Exchanges of the Ministry for Anti-Monopoly Policy and Enterprise Support of the Russian Federation |
| Number and date: | № 589 of 03/09/03 |
| | |
| Activity: | **Custody operations** (professional securities market participant) |
| Issuing body: | Federal Securities Market Commissions of Russia |
| Number and date: | № 177-03942-000100 of 15/12/00 |
| | |
| Activity: | **Brokerage operations (**professional securities market participant) |
| Issuing body: | Federal Securities Market Commissions of Russia |
| Number and date: | № 177-03942-000100 of 15/12/00 |
| | |
| Activity: | **Dealing operations** (professional securities market participant) |
| Issuing body: | Federal Securities Market Commissions of Russia |
| Number and date: | № 177-03942-000100 of 15/12/00 |
| | |
| Activity: | **Asset management operations** (professional securities market participant) |
| Issuing body: | Federal Securities Market Commissions of Russia |
| Number and date: | № 177-03942-000100 of 15/12/00 |

135 MDM Bank

design **Agey Tomesh**