VOLKSBANK INTERNATIONAL

Annual Report 2010

Volksbank International

Grenzen erweitern. Extending borders.

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20 YEARS OF CEE EXPERIENCE

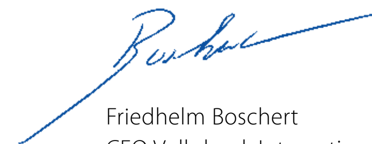
In 1991, Österreichische Volksbanken established a bank in Bratislava. In the meantime, the VBI Group now boasts more than 20 years of experience operating in the CEE region.

We support our core target group – retail customers as well as small and medium-sized enterprises – with traditional banking products. We are organised as a retail bank, featuring more than 540 outlets in 9 countries: proximity to the customer and strong in the region.

As an internationally operating Group, we have succeeded in bringing together many different people and cultures and building up an economically successful network. VBI mastered the difficult 2010 financial year quite well as shown by its ongoing good operational income.

In line with our corporate motto, "Grenzen erweitern. Extending borders", we face all future challenges with optimism.

Yours,



Friedhelm Boschert
CEO Volksbank International

CONTENT

A CONVERSATION WITH THE MANAGING BOARD 4
KEY FACTS 2004–2010 6
KEY FACTS 2010 7
ABOUT VBI BANKS 8
NETWORK 9
CR STATEMENT BY THE VBI AG MANAGING BOARD 10
GROUP MANAGEMENT REPORT FOR THE 2010 BUSINESS YEAR 14
CONSOLIDATED FINANCIAL STATEMENTS 29
- Income statement 30
- Statement of financial position 31
- Changes in the group's equity 32
- Cash flow statement 33
- Notes to the consolidated financial statements 34
  - General information 34
  - Presentation and changes in the scope of consolidation 34
  - Accounting principles 36
- Notes to the income statement 56
- Notes to the consolidated balance sheet 63
- Supplementary information 81
  - Segment reporting 87
  - Risk report 90
- Governing bodies 117

INDEPENDENT AUDITOR'S REPORT 118
Credits 120

Mr. Boschert, since you joined the Managing Board of Volksbank International in 2005, the development of the network of banks in Central and Eastern Europe has been marked by continuous growth. 2010 figures are significantly below those of previous years. What is the reason for this?

Friedhelm Boschert: VBI mastered, with persistent operational results, what was undeniably one of the most difficult years since its inception. This was primarily due to the effects of the financial crisis, which were fully felt at our banks in Central and Eastern Europe in 2010 only. As a result, we had to increase risk provisions once more. In total, we provided EUR 238 million in credit. This represents an increase of 36.4 % compared to the already high level in 2009. Of this, Romania received almost two thirds.

VBI mastered a difficult year with continued good operational results.

Friedhelm Boschert

Why did the effects of the crisis reflect on VBI banks in 2010 only?

Armin Huber: Our business structure differs from that of most of our competitors. Our emphasis lies in private mortgages and small and medium-sized enterprises. The effects of the crisis were delayed for both these target groups. We reacted appropriately by increasing our risk provisions.

In 2010, the earnings of the VBI Group before taxes were EUR 2 million, and after taxes, minus EUR 21.8 million. Can this result in fact be attributed to the crisis alone?

Christophe Descos: The 2010 pre-tax result is definitely not comparable with previous years, since several once-off special factors came into effect during this period. Banking taxes in Hungary, exceeding EUR 7.7 million, as well as goodwill write-off of Volksbank, Ukraine, amounting to EUR 14.8 million, are both included in the net result of the VBI Group.

Some of the VBI banks could still improve on their performance. What do you consider to be the weaknesses in the VBI network?

Friedhelm Boschert: Six out of the ten VBI banks were able to improve their result compared to 2009, despite 2010 being a difficult year. Only Volksbank, Romania realised a significant minus.

What is the future of Volksbank, Romania?

Armin Huber: We have achieved much in the past year. We have developed and implemented a new business model for Romania, in which internal processes are reviewed and streamlined. In addition, we have also put risk assessment systems to the test and created completely new rules for the collection of overdue loans. Currently, we are also bringing the bank back on track by offering a number of several sales initiatives – including some completely new products. We are expecting Romania to generate a profit again in 2011.

What are your expectations for the VBI Group as a whole?

Friedhelm Boschert: I am optimistic. Let's consider the profitability of the VBI Group: In 2010, we increased the operational result before risk to EUR 263.4 million. That is an increase of 8.1 % compared to the previous year. The strong net interest income – that we were able to increase by 2.1 % to EUR 416.6 million despite margin pressure and weak new business – played a significant part. Although net fee and commission income were below our expectations, they nevertheless increased by 1.5 % to EUR 81.4 million. Our earnings base of close to EUR 500 million is thus strong. We were therefore able to carry our burden by our own means – and hence our confidence in coming years.

How are deposits and credit volumes developing?

Christophe Descos: Well! Primary deposits increased by 3.2 % to EUR 5.1 billion, and credit volumes increased by 4.6 % to EUR 10.0 billion. The total assets of VBI was EUR 13.7 billion, a decline of –0.9 %.

We focus on strong sales, based on our strategically good market position.

Christophe Descos

What about costs? Will you cut back on staff?

Armin Huber: In 2010, administrative expenses increased by 3.4 % to EUR 258 million. These expenses included once-off reconstruction costs in Romania. Personnel costs as such, increased by a mere 1.1 %. In 2010, the number of employees was reduced by 120. By year end, the VBI Group had a total of 5,362 employees. This reduction will only be noticeable in the 2011 income statement. When looking at the cost-income-ratio it becomes clear that the VBI is moving in the right direction when it comes to efficiency. It is now at a very good level of 54.5 %. In 2004, it was still at 88 %. The results of our measures to improve efficiency are already visible.

And the closing of sales outlets?

Christophe Descos: In 2010, we again investigated all branches in our network in terms of their service and profitability. The result was that we had to close 35 sales outlets, leaving us with 547 sales outlets today. The investigation is still ongoing in Romania where additional changes can be expected.

Risk provisions only peaked in 2010 and are already declining in 2011

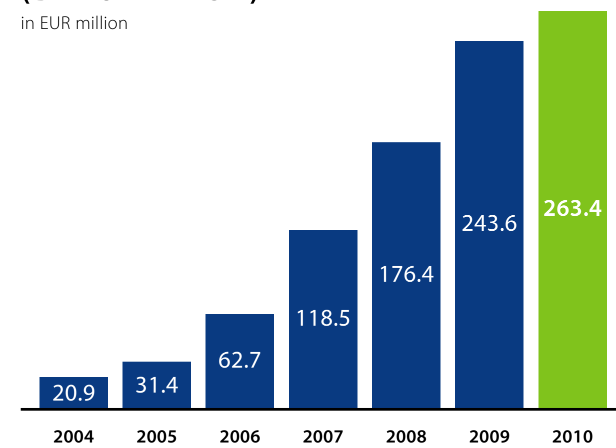
Armin Huber

How do you see the future economic development of the VBI banks?

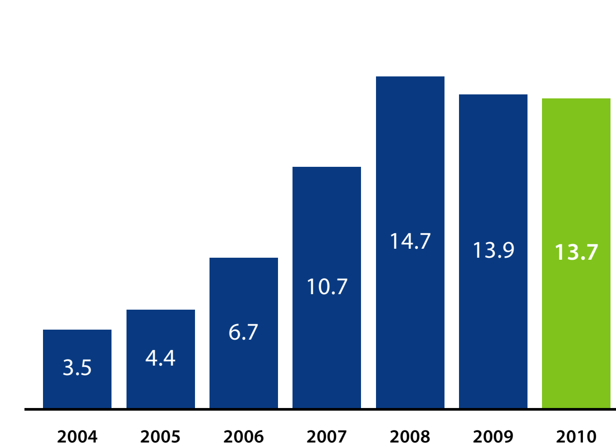
Friedhelm Boschert: If we look at the economic forecast for coming years, we see that the economies in Central and Eastern Europe are expected to show significant growth compared to those of the euro zone. Much catching up in various aspects of life are still needed in these countries, when compared with Western Europe. This continues to make the region economically interesting. VBI is present in nine differently developed CEE countries, where we are strategically well diversified with our 10 banks that act as reliable partners for foreign investors and companies, as well as for private customers. We can build on this solid foundation and increase the confidence in the successful development of our banks.

KEY FACTS 2004–2010

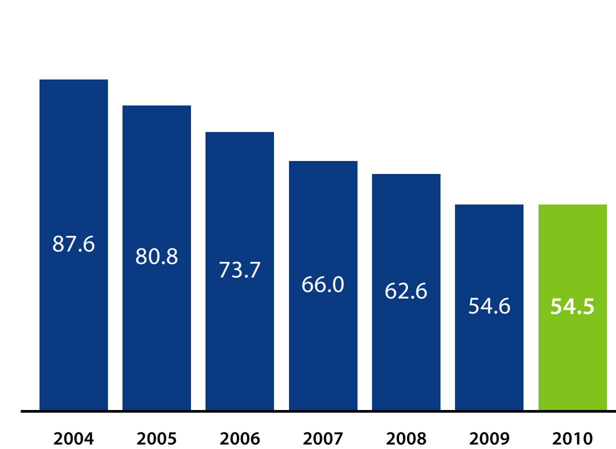
OPERATIONAL INCOME (BEFORE RISK)
in EUR million



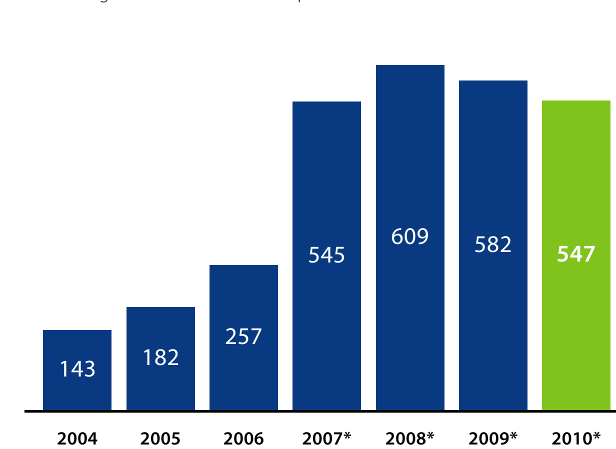
TOTAL ASSETS
in EUR billion



COST INCOME RATIO
in %



SALES OUTLETS
* including Franchise and Bank Shops



KEY FACTS 2010

- 20 years of CEE know-how
- Operational income (before risk) increased to EUR 263.4 million (+ 8.1 %)
- Interest income risen to EUR 416.6 million (+ 2.1 %)
- New allocation of risk provisions amounting to EUR 238.0 million
- Profit achieved: EUR 2.0 million
- Total assets: EUR 13.7 billion
- Loan volume: EUR 10.0 billion (+ 4.6 %)
- Primary deposits: EUR 5.1 billion (+ 3.2 %)
- High core capital ratio: 11.9 %
- Cost income ratio slightly improved to reach 54.5 %
- General administrative expenses slightly increased by 3.4 %
- 1.5 million customer accounts
- 547 sales outlets and 5,362 employees
- 10 full service banks in 9 CEE countries

ABOUT VBI BANKS

	Foundation	Total assets 2010 in EUR million	Sales outlets	Employees *)
Volksbank, Slovakia	1991	1,330	41	563
Volksbank, Czech Republic	1993	1,968	45	614
Volksbank, Hungary	1993	1,818	62	632
Volksbank, Slovenia	1993	938	11	184
Volksbank, Croatia	1997	1,053	29	391
Volksbank, Romania	2000	4,817	236	1,373
Volksbank, Bosnia-Herzegovina	2000	422	26	330
Volksbank, Banja Luka	2007	217	19	228
Volksbank, Serbia	2003	794	26	421
Volksbank, Ukraine	2007	273	52	563
VBI banks total		**13,630**		**5,299**
Other		101		63
VBI Group total		**13,731**	**547**	**5,362**

*) as of 31 December 2010 full-time equivalent

NETWORK

Austria
www.vbi.at

Slovakia
www.volksbank.sk

Czech Republic
www.volksbank.cz

Hungary
www.volksbank.hu

Slovenia
www.volksbank.si

Croatia
www.volksbank.hr

Romania
www.volksbank.ro

Bosnia-Herzegovina
www.volksbank.ba · www.volksbank-bl.ba

Serbia
www.volksbank.rs

Ukraine
www.volksbank.ua

We aim to support the economic development and growth of the communities we serve:

"Acting in a sustainable manner means to us delivering quality products and services to clients, providing jobs, careers and a good working environment to our employees, and managing our ethical and environmental impacts".

"We do not separate sustainability issues from our daily business activities as a Banking Group. Banks acting in a sustainable manner should create good things for society – facilitating the business success and wealth creation of their clients, thus generating direct and indirect employments, economic stabilisation and growth. A bank and the decisions it makes influence deeply its communities and environment: the bank has thus the ability to safeguard existing jobs and create new ones, by lending supportively to households and businesses".

CORPORATE RESPONSIBILITY UPDATE

VBI Group Responsible Banking Review 2010:

Our sustainability approach revolves not only around sustainable ("responsible" or "social") banking, but is about defining the role our Banks take in their communities:

To us, sustainability is focusing on the broader needs of our *Stakeholders*: Our sustainability activities cannot be seen separated from our daily banking business: Keeping in constant contact and receiving our stakeholders' insight and feedback on our programs helps shape its future direction and promotes dialog.

Our shareholders, co-operative banking structures in western European countries, were pioneers of what is now often called *"social banking"* and *"community development banking"*: it is our challenge to transfer this approach to stakeholders and business into the CEE context. We do this by taking an active part in the development of the communities where our banking network is present.

Our engagement with Stakeholders:

- First of all, we are developing appropriate *banking products and services for client segments* that constitute the "pillars of society", by providing credit based on our clients' ability to repay and by assisting our clients in setting up their businesses.

  A focal point is thus *client satisfaction*, and providing comprehensive information to our clients as we strive to set up long-term relations with them: In order to communicate more intensely with our international clients, back in 2006 we launched a special business service named *CEE UNLIMITED*: this means accompanying western European clients "step by step" in their business relations with eastern European partners. The CEE UNLIMITED tool box is containing working tools for both the account managers of our international partner banks and their clients. In October 2010, our re-launched CEE UNLIMITED Website went online – with a special focus on information on sustainable industry sectors in the CEE regions. This makes the CEE UNLIMITED tool box useful not only to clients but tailor-made for anyone of our stakeholders interested in retrieving information on the geography and sustainable business environment in the VBI countries.

- We are committed to *looking after our local communities*, by investing in the neighbourhoods in the countries where we operate, engaging with local stakeholders to support the initiatives which matter most to them.

  Volksbank Ukraine, for example, participated in the *Lviv Meeting of Regions* which took place in May 2010, and which was hosted by the Ukrainian president and the Lviv regional government. Topics at these meetings comprised economic and social reforms and sustainable regional development. Also, *VB Ukraine* is involved in the *European Business Association Lviv*, which co-ordinates with political leaders and authorities to promote the business framework of the Lviv region and foreign investments.

  VBI AG, Vienna has long been promoting the *Vienna Economic Forum* initiatives, also by providing inputs for the meetings taking place both in Vienna and locally. In March 2010, "MeetBIH in Vienna", was staged, with the foremost purpose of informing foreign investors about possibilities to improve the Bosnian infrastructure, and promoting dialog among 160 participants from 13 countries.

  Another important topic to our Banks is promoting the traditions and how they can come alive: *Volksbank Ukraine* traditionally sponsors *Easter festivities* taking place at the outdoor museum at Shevchenkivskij Haj near Lviv, with the purpose of preserving cultural identity, and in 2010 acted as main sponsor of the *"Welykodni Hajiwky"* musical festival in Lviv.
  Volksbank Slovakia has been supporting the initiative *"Biela pastelka"* which assists visually impaired people, with its employees initiating donations for this charitable association.

  VBI AG, Vienna initiatives include our traditional support for the *Mirno More Peace Fleet*, as well as integration and intercultural communication measures: in summer 2010, VBI sponsored the *"StepStones"* Program which invites children from Romania to come to Vienna and meet another culture and attend German language courses.

Doing sustainable business: Our "Sustainable Banking projects"

Of course, as a banking group an important focus is on what we sell: We are working to systematically develop our range of products and services, based on fair and transparent pricing and promotion. Providing access to credit based on our customers' ability to repay is imperative to us.

- *Microfinance* is considered a countercyclical industry within the financial sector, i.e. it can act as a stability buffer against the potentially crushing impact of the economic downturn.
  Micro-borrowers typically have a robust capacity to generate cash flow through their business, and they have a strong incentive to repay the microloans since these are their only source of capital. A welcome side-effect of this approach is the

raising of the financial literacy of these clients whose repayment rate is on average above 90 %.

In 2010, as a start we focused on finding ways to support small and medium-sized businesses, as well as micro-businesses which constitute the backbone of society and economy in CEE. On average, 99.7 % out of 100 businesses in the EU 27 countries are classified as SMEs or micro-enterprises. They account for more than two thirds of employments and approximately 60 % of value-added. Thus, microfinance products that were originally thought fit for third world countries come in useful for promoting entrepreneurship and economic upswing in the CEE countries.
The VBI Group entered into co-operation with *CoopEst*, a subsidiary of the French Crédit Co-opératif, headquartered in Brussels and already active in providing microloans in several CEE countries, by purchasing a shareholding in this microfinance provider in December 2010.

- Our second focus in enlarging our sustainable product range was creating a framework for all our Banks to be able to finance *renewable energy projects* and *projects promoting energy efficiency*. By focusing on these projects, the VBI Group contributes to easing the transition to a lower carbon economy in the countries in which our banking group is present. In selected VBI Banks, the loan portfolio regarding renewable energy projects makes up a significant part of the total, e.g. in VB CZ it amounted to 11.8 % as of December 2010.

Looking after our employees and the environment

As a bank, any of our environmental and social impacts can only be indirect and arise through our business relationships and, as another focus, on the opportunities we provide to our employees, and to our supply chain providers.

- The VBI Groups offers quite a variety of *local training programs including programs offered centrally* to all employees at the VBI Banks, i.e. 5,362 employees at 10 Banks in 9 CEE and SEE countries.
  In order to distribute know-how and enable our employees to choose the fields of business they think suitable to their personal preferences, *Volksbank Ukraine* has developed an *"Internal Learning Center"* which enables them to improve and exchange their knowledge on business, language, IT, sales, HR and legal matters regarding the banking business.

  A centrally promoted initiative is the so-called *Network Career Program* for high-potential graduates, initiated back in 2006 by Volksbank International, comprising a three-year-training tailored to employees interested in taking over management positions at the VBI Group in the near future.

- Our first project regarding the *saving of energy in our VBI buildings and environment* regards the setting up of a centrally managed *"Green" IT-Hub*: Initiating the Green IT-HUB program, VBI has made a strong commitment to limit its environmental footprint. The fundamental idea behind the program is to consolidate all IT infrastructure from the VBI banks into two data centers and in this way to better manage the hardware, floor space as well as power consumption and thus effectively reduce carbon emissions. The savings potential for the VBI Group is significant: Estimations amount to a reduction of 1,800 tons in carbon dioxide emissions p.a.

Outlook 2011

As a Banking Group present in nine countries that differ considerably among each other, with regard to economic, ecologic and social conditions, we are aware that we are only at the beginning of what could be called a "level" sustainable banking approach and culture.

The core functions of banking are all essential ingredients of a modern and efficient economy. Our job, put simply, is to help our clients achieve their financial goals. *How* we conduct our business is, however, just as important as what we do. It covers managing the environmental impact of how we invest, lend, and run our businesses. It covers how we price, the fairness of our terms of business, transparency, and the basis upon which we act as important employers in our communities.

In 2011, we will address further client groups that were "underserved" until now, as well as diversity issues. We will also tackle the issue of improving internal communication within our banking group. It will also be our focus to measure progress by tracking delivery of our sustainable banking approach and how we can develop our corporate culture, firmly anchored in our co-operative roots, further into the future.

REPORT ON BUSINESS DEVELOPMENT AND THE ECONOMIC SITUATION

Economic environment 2010

The global economic environment was characterised by robust growth in demand in emerging countries and a noticeable recovery in most industrialised nations. The development of exports was favourable in most of the core markets of Volksbank International AG (VBI). The increased demand for raw materials led to a marked rise in raw material prices during the year. Prices for the various types of oil increased by more than 15 %[1]. Gold increased in price by almost 30 %[1], mainly due to its role as "safe haven". The prices of most other metals also grew significantly.

In the euro zone, growth was boosted above all by the export sector, which benefited from the temporary weakness of the euro and from stronger demand. Private and public spending also had a positive impact. A support programme worth EUR 440 billion was set up for Greece in May in a cooperation agreement between the International Monetary Fund (IMF) and the European Union (EU). This was supplemented in June by a general aid programme (European Financial Stability Facility). The first country which made use of funds from this programme is Ireland. In the second quarter 2011, Portugal applied for support from this program.

There was a strong recovery in industrial production. In the euro zone, only production of consumer goods remained relatively weak, while intermediate consumption and energy rose year-on-year and capital goods even recorded substantial double-digit growth rates. The development of incoming orders was even more positive, with the order intake up around 15 %[2] year-on-year at the beginning of the fourth quarter. Construction output stagnated last year.

The annual inflation rate, which was still around 1 %[3] at the beginning of the year, rose steadily over the course of the year and stood at 2.2 %[3] in December. Inflation remained low in the USA, Japan and Switzerland, causing central banks to ease their monetary policy further. In contrast, the ECB cut back part of its "exceptional measures". This withdrawal, however was slowed down in view of the growing problems arising for the financial sector as a result of the debt problems of individual countries and the falling prices of bonds of these countries. The base rate remained unchanged at 1 %[4] and serves as a basis for the main refinancing transactions, which are still organised as volume tenders (rather than price tenders, as previously). The ECB is to maintain its 3-month refinancing transactions for the first quarter of 2011 at least.

The European money market showed signs of normalisation in the course of the year, after the ECB allowed some of its exceptional monetary policy measures to expire. The 3-month Euribor rose to over 1 %[5] again. Longer-term bond yields fell during the year in both the "safe haven" of Germany and in the USA, but began to rise again towards the end of the year. The abovementioned support for Greece and the provision of the European Financial Stability Fund, EFSF, both of which are set to run until mid-2013, did not stabilise the European government bond market. Consultations about the course of action from 2013 onwards were stepped up towards the end of the year.

1 Source: Bloomberg
2 Source: Eurostat press release 12/2010
3 Source: Eurostat press release 9/2010
4 Source: ECB
5 Source: Thomson Reuters

Uncertainty about public finances of individual member states placed a significant strain on the euro in the first half of the year. At the beginning of June, the exchange rate of the euro stood at USD 1.19[5], its lowest point since 2006. This was followed by a brief increase to USD 1.42[5], supported by the relaxed monetary policy of the FED. By the end of the year, the euro had declined in value by almost 7 %[5] in relation to the US dollar. The Swiss franc appreciated steadily during the year, a trend that was interrupted only in the third quarter. The franc reached a historic high of CHF 1.24[5] per euro at the end of the year. This represented an appreciation of more than 15 %[5] compared with the beginning of the year. Share prices moved sideways for large parts of the year. A significant rise in share prices was seen in the last quarter, which was attributable to the expected extension of the "quantitative easing" policy of the US central bank, to the fact that company results were predominantly good and to the publication of some positive economic data.

The Czech Republic, Slovakia and – with certain restrictions – Hungary also reported economic dynamism comparable to the core euro zone in the third quarter, albeit at very different levels. Ukraine, Serbia and Bosnia-Herzegovina benefited from the robust industrial sector both within and outside the euro zone, while some South-Eastern European markets emerged from the recession only slowly.

The individual countries:

Bosnia-Herzegovina

Despite a rise in exports, domestic demand and lending remained too weak to allow a powerful economic recovery. Nevertheless, low positive growth in GDP is expected for 2010. Public finances represent a major element of uncertainty, as so far no viable government has emerged from the parliamentary elections in October that could have approved a draft budget for 2011.

Croatia

After a continued decline in GDP in the first half of the year, an annual rate of just over 0 %[6] was recorded again in the third quarter, which was due in particular to a rise in net exports (starting from a low base). At the same time, public spending and gross capital expenditure in particular fell year-on-year. Direct investments were down around 30 %[6] year-on-year in the first nine months.

Romania

The recession continued in the third quarter with negative growth of –0.7 %[7] compared with the previous quarter and –2.2 %[7] year-on-year, after positive quarterly growth was achieved at least temporarily in the second quarter. The increase of five percentage points in value added tax, along with salary and pension cuts in the public sector, placed a strain on consumer spending,

6 Source: National Statistic Office (via Reuters)
7 Source: Eurostat

although they helped to achieve the national budget targets agreed with the IMF. The Romanian currency declined further in value against the euro in 2010.

Serbia

The official end of the recession was confirmed by the data for the second quarter, which showed an increase in GDP of 2.0 %[6] year-on-year; driving factors were the export-oriented sectors of the manufacturing industry. At the end of the third quarter, however, seasonally adjusted industrial production was down again year-on-year, which means that we can not yet assume that this is a genuine upturn. Despite repeated intervention by the central bank, the dinar noticeably declined in value against the euro in 2010.

Slovakia

Owing to its high level of openness, Slovakia has been hit harder than most other countries by fluctuations in the European economy. In the third quarter, the Slovakian economy continued its robust growth, with a quarterly growth rate of 1 %[7] and annual growth of 3.8 %[7]. Growth was driven by the build-up of inventories and, for the first time since the third quarter of 2008 and in the same way as for the Czech Republic, gross capital expenditure, while consumer spending fell compared with the previous quarter. The monthly data indicate further above-average growth.

Slovenia

Following relatively strong signs of recovery in the second quarter, the Slovenian economy continued its recovery in the third quarter. It was beginning to lose momentum, however, with growth of 0.3 %[7] compared with the previous quarter and of 1.7 %[7] year-on-year (second quarter: 1 %[7] growth compared with the previous quarter and 2.1 %[7] growth year-on-year). The most important factors driving growth were net exports, while capital expenditure and construction output declined.

Czech Republic

The Czech economy remained on track for recovery in the third quarter. Economic growth accelerated to 1 %[7] compared with the previous quarter and 2.8 %[7] year-on-year, which represented the strongest growth since the second quarter of 2008. While the recovery was initially due mainly to net exports, gross capital expenditure rose by an annual rate of 14 %[7] in the third quarter. However, the first monthly figures from the fourth quarter indicate that growth has slowed.

Hungary

The improved export results put an end to the recession in 2010. In view of the sharp decline in GDP in 2009 and the preceding period of economic weakness, however, the accelerated growth in GDP in the third quarter, which stood at 0.8 %[7]

6 Source: National Statistic Office (via Reuters)
7 Source: Eurostat

compared with the previous quarter and 1.7 %[7] year-on-year, cannot yet be regarded as a sign of strong growth. The fact that national debt remains high, together with fluctuations in the exchange rates with the euro and the Swiss franc, still represents a substantial risk for continued economic recovery.

Ukraine

Following a powerful recovery driven by exports in the first half of the year, the Ukrainian economy lost momentum. The annual growth rate dropped from 5.9 %[8] in the second quarter to 3.5 %[8] in the third quarter.

ECONOMIC DEVELOPMENT IN THE CORE MARKETS OF VOLKSBANK INTERNATIONAL AG 2008–2011

Real growth p.a. %	2008	2009	2010e	2011e
Austria	2.2	–3.9	2.0	1.7
Germany	1.0	–4.7	3.7	2.2
Euro zone	0.4	–4.1	1.7	1.5
Bosnia-Herzegovina	6.0	–2.8	1.9	3.5
Croatia	2.4	–5.8	–1.8	1.5
Romania	7.3	–7.1	–1.9	1.5
Serbia	5.5	–3.0	1.0	2.0
Slovakia	5.8	–4.8	4.1	3.0
Slovenia	3.7	–8.1	1.1	1.9
Czech Republic	2.5	–4.1	2.4	2.3
Ukraine	2.3	–15.1	3.8	4.5
Hungary	0.8	–6.7	1.1	2.8

Source: EU Commission, Vienna Institute for International Economic Studies, IHS Global Insight

8 Source: Estimates by the IMF and the Ukrainian government and Central Bank, published by Reuters

Business development

Thanks to its strong positioning, VBI held its own in the challenging environment of 2010 and increased the operating result of the Group.

Ten banks in nine countries

The VBI network consists of ten VBI banks in nine Central and Eastern European countries (Slovakia, the Czech Republic, Hungary, Slovenia, Croatia, Romania, Bosnia-Herzegovina, Serbia and Ukraine) as well as the Vienna-based Volksbank International AG. Since the foundation of the first VBI-bank in 1991, VBI Group has pursued a conservative risk policy and a strategy of focussing on business with retail customers and small and medium-sized companies, SMEs. In the future, Volksbank International AG plans to anchor its business with micro-enterprises more firmly in its business model.

Another core activity at VBI is its referral business for corporate customers of its Austrian, German, French and Italian partner banks.

Österreichische Volksbanken-Aktiengesellschaft is the majority shareholder of VBI with a 51 % interest. Since 2004, the German cooperative banks DZ BANK AG / WGZ BANK AG as well as Banque Populaire Caisse d'Epargne (BPCE), France, have each held a 24.5 % interest in VBI.

Operating result increased again

The result for the period before taxes dropped from EUR 47.5 million in 2009 to EUR 2.0 million in 2010, mainly due to the increased risk provisions and an impairment of goodwill of Volksbank Ukraine. Nevertheless, the VBI-Group managed to stay stable in their core business, respectively even improved this result in most of its countries.

In the 2010 financial year, VBI generated an operating result (without other operating result, result from financial investments and before risk) of EUR 263.4 million, representing a year-on-year growth of 8.1 %. In spite of the squeeze on margins and flagging new business, net interest income made a large contribution to the result with EUR 417 million. This represents a 2.1 % increase on 2009. While net fee and commission income did fall behind expectations, it rose nonetheless by 1.5 % to EUR 81 million.

VBI's core target groups, retail customers and SMEs, were particularly affected by the economic crisis during 2010 (e.g. higher unemployment and more bankruptcies). For this reason, the Group had to raise risk provisions significantly. At the end of the 2010 financial year, the profit & loss risk provisions amounted to EUR 238.0 million, a year-on-year increase of 36.4 %. Two thirds of this figure are attributable to Romania. The risk provision in balance was on a level of EUR 535.4 million

The cost income ratio – administrative expenses plus other operating result divided by net interest income, net fee result, trading result and income from financial investments – remained on a stable base of 54.5 % (2009: 54.6 %).

Sound business model proves a success

Focusing on qualitative development has proved a success in strategic terms. The subsidiary banks of VBI focus on traditional retail business with private individuals and small and medium-sized enterprises. VBI's robust and conservative business model, and consistent implementation of the latter, continued to prove successful, even against the difficult backdrop of 2010.

Total assets down slightly

VBI's total assets as per 31 December 2010 stood at EUR 13.7 billion (31 December 2009: EUR 13.9 billion). This represents a slight decrease of 1.0 % against the previous year. Volksbank Romania has the largest share, with total assets of EUR 4,8 billion, followed by the banks in the Czech Republic (EUR 2 billion), Hungary (EUR 1.8 billion), Slovakia (EUR 1.3 billion) and Croatia (EUR 1.1 billion).

The loan volume to customers increased by EUR 438.7 million (4.6 %) to EUR 10.0 billion (31 Decenber 2009: EUR 9.5 billion), which was on the one hand resulting from slightly increased customer business, but also on the other hand from the CHF appreciation at the end of the year 2010.

The VBI Group improved the deposit base from customers by EUR 154.7 million (3.3 %) to an ultimo status of EUR 4.9 billion (31 December 2009: EUR 4.7 billion), while it also succeeded in order to reduce the refinancing source from banks by EUR 257.8 million (–3.5 %) to EUR 7.2 billion (31 December 2009: EUR 7.5 billion).

The core capital ratio of 11.9 % (31 December 2009: 12.8 %) of VBI-Group still reflects a sound capital ratio. The core capital reduced slightly from end of 2009 (EUR 987.9 million) to a status of EUR 984.2 million as at 31 December 2010.

Retail business resilient in the crisis

VBI's retail business in the CEE region remained extremely robust in 2010, especially in view of the challenging market conditions. Total returns in the Retail segment – consisting of net interest, fee and commission income – increased by 1.6 %, from EUR 300.1 million in 2009 to EUR 305.6 million in the period under review. The lending volume in the retail business of the VBI Group stood at EUR 5.6 billion (31 December 2009: EUR 5.4 billion) as at the end of 2010, while the deposit volume totaled EUR 2.8 billion (31 December 2009: EUR 2.8 billion).

The Retail result made an important contribution to the success of the VBI Group in a remaining difficult environment. Nine of the banks recorded a profit. Only the Romanian bank posted a negative result, due to nonrecurring items. However, Volksbank Romania achieved a positive operating result.

Over several years, Volksbank Romania has positioned itself as a reliable partner in the area of mortgage lending. Although, as a universal bank, it offers the full range of banking services, Volksbank Romania's customers perceive it to be primarily a lender. The

bank is currently working to recreate its image, by communicating more strongly the entire range of products on offer and working on its positioning as a full-service bank. One key product focus is the acquisition of salary accounts and promotion of savings products.

Corporate business

The total return of the Corporate segment – consisting of net interest, fee and commission income – increased in 2010 from EUR 149.6 million by 6.9 % to EUR 159.9 million.

The lending volume in the corporate business of the VBI Group stood at EUR 4.3 billion (31 December 2009: EUR 4.1 billion) as at the end of 2010, while the deposit volume totaled EUR 1.9 billion (31 December 2009: EUR 1.8 billion). 26.5 % of the total lending volume or EUR 1.1 billion is attributable to the Volksbank in the Czech Republic, which further improved its successful positioning as a bank for SMEs. Of the total corporate lending volume of the VBI banks, approximately 51 % is attributable to loans to small and medium-sized enterprises, 28 % to real estate project financing, 16 % to large customers and 4 % to public finance and a small part to leasing companies.

Non-financial performance indicators

Human resources

The VBI Group employed 5,362 staff members at year-end 2010 (31 December 2009: 5,483). At average the VBI Group employed 5,400 staff members (2009: 5,617).

Employees of VBI can choose from a variety of training programmes. Training for basic service advisors and customer advisors is offered in the national language and combines e-learning with training days. Management Development CEE is a programme that trains junior staff. The three-year Network Career Programme serves to fill positions in top management. Train-the-Trainer is used to develop the skills of an instructor.

Successful internal communication begins at the individual level. Reviews for employees are already conducted. In 2011, these reviews will be further anchored in selected VBI Banks, with each employee being invited to individual orientation meetings more than once a year. Independent exchanges will be promoted via communication platforms.

Press relations & internal communications

In 2010, VBI Group attached a great importance to reliable and active communication with shareholders and employees as well as customers, partners and media.

Events of particular importance occuring after the reporting date

As set out in VBAG's "Strategy 2015", VBAG will focus on its defined core business in future. This encompasses its role as the central institution of the Volksbank sector, corporate customer business and real estate business. The core regions for these activities are Austria and the neighbouring countries. Options are currently being examined for activities and participations outside the core business. In this context, a process has been initiated that evaluates the possibility of disposing of Volksbank International AG and VB-Leasing International Holding GmbH. Exploratory steps are to take place over the coming months – supported by the mandated consultants – and may lead to the sale of these two participations. The data rooms were opened at the start of February for this purpose.

With effect of 17 February 2011 Mr. Ralf Weingartner left his appointment as managing board member of VBI.

REPORT ON THE COMPANY'S EXPECTED DEVELOPMENT AND RISKS

Economy and financial markets

Internal forecasts for the current year are slightly more cautious for most countries than the external sources cited above. This is due to the expected impact of the consolidation of national budgets, uncertainties on the government bond market and in the financial sector, the increase in the cost of raw materials and energy and the expiry of the inventory cycle. These effects will lead to increased inflation rates, particularly in the first half of the year. While this has already resulted in the raising of interest rates by central banks in emerging countries and some Central and South-Eastern European countries, monetary policy is not expected to be tightened in the USA, the euro zone, Switzerland and Japan until later in the year. In the described economies money and capital market interest rates should tend to rise slightly in this climate. The development of these economies has been largely parallel, therefore strong shifts in the exchange rates of the respective currencies are not expected. Progress in overcoming the debt crisis would increase the risk appetite of market participants and would help the euro to recover. However, setbacks in this process entail the corresponding downward potential, particularly in relation to the Swiss franc. The stock and corporate bond markets were hardly affected by the increased risk aversion in the last few months, prices developed positively at the beginning of 2011.

The asynchronous recovery in exports and domestic demand (consumption and capital expenditure) is likely to have had a slight negative impact on the growth potential of the CEE/SEE region, but the growth potential there nevertheless remains higher than in the "old EU". Moreover, for countries with high foreign and/or national debt, new risks arose in 2010 from the tense situation on the financial markets. While the necessary national consolidation should prove beneficial in the longer term, growth prospects for 2011 remain muted in the CEE/SEE region. Assuming that there is no escalation of the unstable development on the market for government bonds and that there are no other burdens on the international economy, the recession should be overcome throughout South-Eastern Europe this year. Croatia's planned accession to the EU in 2012, the fact that Serbia is approaching the EU, positive growth rates in bank deposits and loans in Romania, continued IMF support and an imminent revival in direct investments indicate that the region can catch up again in 2011.

According to Euroconstruct forecasts, increased construction activity can be expected in most countries and sectors from 2011/2012 onwards, with very strong growth anticipated in Central European markets this year.

CONSTRUCTION ACTIVITY IN INDIVIDUAL COUNTRIES AND IN THE ENTIRE REGION

(real increase or decrease in % compared with previous year's figure)

	2007	2008	2009	Estimate 2010	Forecast 2011	Forecast 2012	Outlook 2013
Austria	1.6	1.6	–6.0	–3.0	0.7	0.8	1.0
Germany	0.4	2.5	–0.9	3.4	1.3	1.6	1.7
Ireland	1.4	–5.4	–35.0	–28.3	–10.7	0.2	3.9
Spain	2.9	–19.1	–24.6	–16.1	–13.6	–2.3	1.3
UK	1.9	–0.3	–10.4	3.1	0.2	1.5	2.0
Czech Republic	7.3	2.7	–1.3	–10.0	–3.2	0.2	3.1
Poland	12.7	11.4	4.3	4.0	12.7	12.4	5.9
Hungary	–4.5	–3.4	–9.0	–3.8	5.2	7.5	10.1
Slovakia	6.0	11.0	–12.7	–6.3	6.2	2.5	3.1
Euroconstruct countries	**2.3**	**–3.4**	**–8.8**	**–3.3**	**–0.1**	**2.0**	**2.5**

Source: Euroconstruct

Business performance

The CEE states are still characterised by pent-up demand in various different areas – from the housing situation to salary levels, from account usage to insurance products, building society contracts and sophisticated deposit products. For this reason, Volksbank International Group has an optimistic view for the future.

As set out in the VBAG "Strategy 2015", the process has been initiated for evaluating the disposal of Volksbank International AG. The data rooms were opened at the start of February for this purpose.

Material risks and uncertainties

Risk management

Risk management is the responsibility of the Chief Risk Officer (CRO), who is a member of the managing board and is not involved in any market activities. The duties, competencies and responsibilities that make up the risk management process are also clearly defined and specified at all levels below this. This serves to ensure that risk-bearing organisational units (front office) are kept functionally separate from those organisational units that are responsible for the monitoring and communication of risks (back office), up to the level of the managing board. In this way, the organisational structure also enables the separation of the front office and back office functions required by the regulatory authorities.

A risk strategy is in place for the VBI Group, which follows the principles of the VBAG Group risk strategy. This VBI risk strategy lays down the basic principles how to deal with all kinds of risks, which VBI Group is exposed to. It also outlines the limits of the VBI Group's risk-appetite, and certain principles of credit procedures. Further this binding policy clearly defines the different responsibilities at the various levels of management, starting with the managing board of VBI AG and down to the risk responsible managing board member in the respective VBI banks.

Further details of risk management are given in the risk report in the notes of the consolidated financial statements.

Compliance

The compliance office of VBI Group is integrated in the compliance office of VBAG and follows the principles of the VBAG Group. The compliance office defines and monitors the procedures required to observe the regulations in the areas of securities compliance, management of conflicts of interest and prevention of money laundering and financing of terrorism. Compliance serves primarily to protect customers, although it also has the task of minimising risks to the bank's reputation.

Prevention of money laundering

In 2010, the VBI Group again expanded the bank's internal array of instruments for preventing and combating money laundering. Additional IT programs were implemented to check and stop prohibited or unwanted transactions. This significantly reinforced the cooperation of the compliance and money laundering officers of the subsidiary banks of the VBI Group as a whole. As a result, working methods and procedures were coordinated and standardised and a uniform security level has been ensured throughout the Group. The technical infrastructure is improved on an ongoing basis and was adapted in 2010 to meet continuously evolving monitoring requirements.

In addition to technical measures for prevention of money laundering and financing terrorism and to combat fraud, comprehensive and ongoing training for bank employees in these areas constitutes a key element in raising their awareness. In addition to "face-to-face" sessions, electronic learning programs on workstations give bank employees basic training and raise awareness. Employees are also informed regularly via a proprietary compliance database about current issues involving the fight against money laundering and fraud. This ensures in the best possible way that VBI Group complies fully with the regulatory requirements in this area.

Combating fraud:

The compliance office is responsible for combating white-collar crime throughout the Group. It is also the point of contact for authorities, customers and employees for questions relating to the issue of preventing internet, wire or document fraud. The compliance office has significantly improved the efficiency of measures for preventing fraud at VBI Group.

REPORT ON RESEARCH AND DEVELOPMENT

Time and again, VBI AG also assists students of university or of university of applied science with their diploma theses, but does not run own research and development activities.

REPORT ON KEY CHARACTERISTICS OF THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM WITH REGARD TO THE ACCOUNTING PROCESS

The purpose of the internal control system is to support management so that it is in a position to ensure effective internal controls with regard to accounting. The managing board is responsible for setting up and structuring an appropriate internal control and risk management system for the accounting process.

The internal auditing department also independently checks compliance with internal regulations in the field of accounting on a regular basis. As a department, auditing is assigned directly to the managing board and its head reports directly to the chairman of the managing board, as well as providing a quarterly report to the supervisory board.

Environment for controlling

The internal control system is a system for documenting all control activities that have been carried out and builds on all controls that have already been actively implemented within the organisation (operational controls/management controls).

In the Group guideline for internal control systems, the managing board sets out a group-wide framework for the implementation of the internal control system, whereby responsibility for implementation in the VBI Group has been assigned to process and guideline management at Österreichische Volksbanken-AG.

For the preparation of the consolidated financial statements, processes were set up that ensure that the data provided by Group subsidiaries is correctly transferred and processed. The data delivered firstly undergoes plausibility checks, both through comparisons with previous periods and through the analysis of typical transactions. The data is processed using consolidation software into which automatic checks have been integrated to ensure that the data has been recorded and processed in full. The results are monitored and plausibility checks are carried out by means of various reports. The monitoring and plausibility checks are based on the principle of dual control and are subject to further review by the department managers.

Risk assessment

Risks relating to the accounting process are recorded and monitored by the process managers. The focus here will be on risks considered significant.

For the preparation of the financial statements, estimates must be taken regularly in areas for which there is an intrinsic risk that future development may deviate from these estimates. This particularly applies to the following items on the consolidated financial statements: impairment of financial assets, risks to the banking business, employee benefits and the outcome of legal disputes. In some cases, publicly available sources will be used or external experts will be consulted in order to minimise the risk of misjudgements.

Control measures

Control measures are used in ongoing business processes to ensure that potential errors are prevented and that any discrepancies in financial reporting are discovered and rectified. These control measures range from the inspection of the various results for the period under review by management to the specific reconciliation of accounts and items and an analysis of ongoing processes in group accounting. A distinction is made between two types of controls.

Operational controls include manual controls, which are carried out by employees in specific steps, automatic controls, which are carried out with the aid of IT systems, and preventative controls, which have the aim of preventing errors and risks in advance through the separation of functions, the regulation of competencies and access authorisation.

Management controls serve to ensure, on the basis of spot checks, that managers are complying with operational controls. The final scope of the complete control plan for group accounting has already been drawn up and is currently being implemented. The periodicity of checks is determined by the relevant manager (head of division, head of department), in accordance with the level of risk. The spot checks are documented in the control plan in a way that is comprehensible to third parties. The results will be reported at half-yearly intervals as part of management reporting.

At the companies included in the consolidated financial statements, the respective managing board and management staff are responsible for setting up and structuring an internal control and risk management system for the accounting process that meets the requirements of the company in question. They are also responsible for compliance with group-wide guidelines and regulations in connection with this in the final instance.

Information and communication

Guidelines and regulations relating to financial reporting are regularly updated by management and communicated to all employees concerned.

Employees in group accounting are also trained on an ongoing basis with regard to international accounting reforms, so that risks relating to unintentional errors in reporting can be identified at an early stage. Reforms in international accounting are also relayed to employees involved in accounting at the respective subsidiaries.

A management report is produced twice a year. It contains declarations about the completeness, comprehensibility, active implementation and effectiveness of the control system with regard to the accounting process.

Monitoring

Top management receives regular summarised financial reports, such as quarterly reports on the development of the respective segments and the key financial figures. Financial statements that are to be published undergo a final check by management-level employees in accounting, the management of the division and the managing board before they are forwarded to the responsible committees. The respective heads of department and group leaders are also in charge of monitoring the corresponding areas. Controls and plausibility checks are carried out at regular intervals.

The results of monitoring activities with regard to the accounting processes are reported within the management report. The report will contain a risk assessment of the processes on a qualitative basis. The report will also document how many controls are being carried out in relation to control guidelines.

The internal auditing department also performs monitoring and supervisory functions.

DISCLOSURES ON CAPITAL RIGHTS, OWNERSHIP INTERESTS, VOTING RIGHTS AND RIGHTS OF CONTROL AND RELATED OBLIGATIONS

For the composition of the share capital of Volksbank International AG, please refer to the explanations in note 34 Equity in the notes to the consolidated financial statements.

The participations in the share capital of VB International AG are as follows (including the indirect share via VBI Beteiligungs GmbH): Österreichische Volksbanken-AG 51 % (indirect holding), Banques Populaires Participations 24.5 %(indirect holding), DZ Bank AG 16.36 % (indirect holding), WGZ Bank AG 8.14 %(indirect holding).

Consolidated Financial Statements

Volksbank International AG

INCOME STATEMENT
OF VOLKSBANK INTERNATIONAL AG

	Note	1–12 / 2010 EUR thousand	1–12 / 2009 EUR thousand	Changes EUR thousand	%
Net interest income	4	416,557	407,996	8,561	2.10 %
Risk provisions	5	–238,034	–174,580	–63,454	36.35 %
Net fee and commission income	6	81,432	80,212	1,221	1.52 %
Net trading income	7	23,477	4,957	18,521	> 200.00 %
General administrative expenses	8	–258,036	–249,549	–8,487	3.40 %
Other operating result	9	–29,675	–17,903	–11,772	65.75 %
Income from financial investments	10	6,276	–3,669	9,945	< –200.00 %
Result for the period before taxes		**1,997**	**47,464**	**–45,467**	**–95.79 %**
Income taxes	**11**	**–23,766**	**–14,243**	**–9,523**	**66.86 %**
Result for the period after taxes		**–21,770**	**33,221**	**–54,990**	**–165.53 %**
Result attributable to shareholders of the parent company (Consolidated net result)		**–22,374**	**33,255**	**–55,629**	**–167.28 %**
Result attributable to non-controlling interest		604	–34	639	< –200.00 %

COMPREHENSIVE INCOME
OF VOLKSBANK INTERNATIONAL AG

	1–12 / 2010 EUR thousand	1–12 / 2009 EUR thousand	Changes EUR thousand	%
Result for the period after taxes	**–21,770**	**33,221**	**–54,990**	**–165.53 %**
Other comprehensive income				
Currency reserve	–18,399	–32,869	14,470	–44.02 %
Available for sale reserve (including deferred taxes)				
Change in fair value	–8,992	3,239	–12,231	< –200.00 %
Net amount transferred to profit or loss	6,377	952	5,426	> 200.00 %
Hedging reserve (including deferred taxes)				
Change in fair value (effective hedge)	12,219	349	11,870	> 200.00 %
Net amount transferred to profit or loss	–6,608	–646	–5,962	> 200.00 %
Other comprehensive income total	**–15,402**	**–28,974**	**13,573**	**–46.84 %**
Comprehensive income	**–37,171**	**4,246**	**–41,418**	**< –200.00 %**
Comprehensive income attributable to shareholders of the parent company	**–37,044**	**4,783**	**–41,826**	**< –200.00 %**
Comprehensive income attributable to non-controlling interest	–128	–536	409	–76.21 %

STATEMENT OF FINANCIAL POSITION
OF VOLKSBANK INTERNATIONAL AG

	Note	31 Dec 2010 EUR thousand	31 Dec 2009 EUR thousand	Changes EUR thousand	%
ASSETS					
Liquid funds	12	1,838,939	2,216,793	–377,855	–17.05 %
Loans and advances to credit institutions (gross)	13	1,223,545	1,267,927	–44,382	–3.50 %
Loans and advances to customers (gross)	14	9,961,388	9,522,729	438,659	4.61 %
Risk provisions (–)	15	–535,377	–309,769	–225,608	72.83 %
Trading assets	16	7,195	7,016	179	2.54 %
Financial investments	17	873,253	759,392	113,861	14.99 %
Investment property	18	20,407	21,421	–1,014	–4.73 %
Participations	19	14,517	13,830	687	4.97 %
Intangible assets	20	112,541	122,518	–9,977	–8.14 %
Tangible fixed assets	21	113,989	127,114	–13,124	–10.32 %
Tax assets	22	18,630	34,557	–15,927	–46.09 %
Other assets	23	82,463	79,525	2,938	3.69 %
TOTAL ASSETS		**13,731,491**	**13,863,053**	**–131,563**	**–0.95 %**
LIABILITIES AND EQUITY					
Amounts owed to credit institutions	24	7,216,409	7,474,193	–257,784	–3.45 %
Amounts owed to customers	25	4,868,100	4,713,437	154,663	3.28 %
Debts evidenced by certificates	26	252,061	246,972	5,089	2.06 %
Trading liabilities	27	241	32	209	> 200.00 %
Provisions	28, 29	12,072	8,625	3,447	39.97 %
Tax liabilities	30	8,221	9,998	–1,777	–17.77 %
Other liabilities	31	101,212	96,701	4,511	4.66 %
Subordinated liabilities	32	157,876	157,226	650	0.41 %
Equity	34	1,115,300	1,155,870	–40,570	–3.51 %
Shareholders' equity		1,079,821	1,117,110	–37,289	–3.34 %
Non-controlling interest		35,479	38,760	–3,281	–8.46 %
TOTAL LIABILITIES AND EQUITY		**13,731,491**	**13,863,053**	**–131,563**	**–0.95 %**

CHANGES IN THE GROUP'S EQUITY OF VOLKSBANK INTERNATIONAL AG

EUR thousand	Subscribed capital [1]	Capital reserves	Retained earnings	Currency reserve	IAS 39 valuation reserves [2] Available for sale reserve	Hedging reserve	Share-holders' equity	Non-controlling interest	Equity
As at 1 January 2009	**64,385**	**929,600**	**224,702**	**–37,460**	**–2,536**	**–840**	**1,177,851**	**39,293**	**1,217,144**
Comprehensive income *			33,255	–32,203	4,000	–270	4,783	–536	4,246
Release of reserves		–52,500	52,500				0		0
Dividends paid			–65,206				–65,206		–65,206
Change due to reclassifications shown under non-controlling interest and capital increases			–318				–318	4	–314
As at 1 January 2010	**64,385**	**877,100**	**244,933**	**–69,663**	**1,464**	**–1,110**	**1,117,110**	**38,760**	**1,155,870**
Comprehensive income *			–22,374	–17,865	–2,425	5,620	–37,044	–128	–37,171
Release of reserves		–107,316	107,316				0		0
Dividends paid							0	–404	–404
Change due to reclassifications shown under non-controlling interest and capital increases			–245				–245	–2,749	–2,994
As at 31 December 2010	**64,385**	**769,784**	**329,630**	**–87,528**	**–961**	**4,510**	**1,079,821**	**35,479**	**1,115,300**

* COMPREHENSIVE INCOME (INCOME AND CHANGES IN RESERVES)

EUR thousand	1–12/2010 Shareholders' equity	Non-controlling interest	Equity	1–12/2009 Shareholders' equity	Non-controlling interest	Equity
Consolidated net income	–22,374	604	–21,770	33,255	–34	33,221
Currency reserve	–17,865	–534	–18,399	–32,203	–666	–32,869
thereof from application of the average rates of exchange in income statement	96	–4	92	–294	–25	–319
Available for sale reserve (incl. deferred taxes)	–2,425	–189	–2,614	4,000	191	4,191
Hedging reserve (incl. deferred taxes)	5,620	–8	5,612	–270	–27	–296
Comprehensive income	**–37,044**	**–128**	**–37,171**	**4,783**	**–536**	**4,246**

1) Subscribed capital corresponds to the figures reported in the financial statements of Volksbank International AG.
2) As at 31 December 2010 the available for sale reserve included deferred taxes of EUR 337 thousand (31 December 2009: EUR –260 thousand).
The hedging reserve contains deferred taxes in the amount of EUR –1,668 thousand at the balance sheet date (31 December 2009: EUR 260 thousand).

CASH FLOW STATEMENT OF VOLKSBANK INTERNATIONAL AG

EUR thousand	2010	2009
Annual result after taxes	**–21,770**	**33,221**
Non-cash positions in the annual result		
Depreciation, amortisation, impairment and reversal of impairment of fixed assets and financial investments	44,176	36,415
Allocation to and release of provisions, including risk provisions	242,389	175,814
Result from the sale of financial investments and fixed assets	–5	–49
Non-cash changes in taxes	7,285	4,328
Changes in assets and liabilities from operating activities after adjustments for non-cash components		
Loans and advances to credit institutions	44,382	–122,844
Loans and advances to customers	–438,621	365,456
Trading assets	121	10,574
Financial investments	–171,288	–256,523
Assets for operating lease	–438	–20,637
Other assets from operating activities	10,832	–17,278
Amounts owed to credit institutions	–257,784	–606,188
Amounts owed to customers	154,663	–111,233
Debts evidenced by certificates	5,089	23,513
Other liabilities	–19,801	–40,115
Other changes	2,710	–44,021
Cash flow from operating activities	**–398,062**	**–569,566**
Proceeds from the sale or redemption of		
Securities held to maturity	45,227	42,023
Participations	71	450
Fixed assets	2,525	7,752
Payments for the acquisition of		
Securities held to maturity	–6,699	–73,467
Participations	–1,026	–294
Fixed assets	–20,136	–23,851
Cash flow from investing activities	**19,961**	**–47,386**
Dividends paid	0	–65,206
Changes in subordinated liabilities	650	745
Other changes	–404	0
Cash flow from financing activitities	**246**	**–64,461**
Cash and cash equivalents at the end of previous period (liquid funds)	**2,216,793**	**2,898,207**
Cash flow from operating activities	–398,062	–569,566
Cash flow from investing activities	19,961	–47,386
Cash flow from financing activities	246	–64,461
Cash and cash equivalents at the end of period (liquid funds)	**1,838,939**	**2,216,793**
Payments of taxes, interest and dividends		
Income taxes paid	–11,823	–32,995
Interest received	737,362	759,557
Interest paid	–335,916	–372,903
Dividends received	821	393

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF VOLKSBANK INTERNATIONAL AG, VIENNA

1) GENERAL INFORMATION

Volksbank International AG (VBI) which has its registered office at Kolingasse 14–16, 1090 Vienna, is the holding company of subsidiaries located in Central and Eastern Europe, providing retail banking services to private and corporate clients. The consolidated financial statements of VBI for the year ended 31 December 2010 comprise VBI and its subsidiaries (together referred to as the Group).

The majority stake in VBI is held by VBAG Group, which holds 51 % of its issued share capital on the balance sheet date. Volksbank International AG and its subsidiaries belong to the scope of consolidation of Österreichische Volksbanken-AG (VBAG), Vienna. All companies in the Group are fully included in the consolidated financial statements of VBAG, which are therefore the relieving consolidated financial statements in accordance with section 59 of the Austrian Banking Act and section 245 of the Austrian Company Code. Nevertheless VBI does not make use of this easement and voluntarily prepares its own consolidated financial statements.

Preparation of VBI's consolidated financial statements follows the assumption of going concern. VBI's consolidated financial statements are reported in euros, as this is the Group's functional currency. All figures are indicated in thousands of euros unless specified otherwise. The following tables may contain rounding differences.

2) PRESENTATION AND CHANGES IN THE SCOPE OF CONSOLIDATION

In 2010, capital increases were completed in VBI banking subsidiaries, in the course of which VBI partially took over the shares of third-party shareholders. The takeover of these non-controlling interests was recognised directly in equity.

The following list contains detailed information of all fully consolidated companies of VBI.

Company, domicile (country)	Type*	Equity interest 31 Dec 2010	Equity interest 31 Dec 2009	Share in voting rights 31 Dec 2010	Nominal capital in EUR thousand 31 Dec 2010
"VBRO Services"; SRL Bukarest	HD	99.34 %	99.05 %	99.67 %	7
Banka Volksbank d.d.; Ljubljana	KI	95.90 %	95.90 %	95.90 %	43,140
BEVO-Holding GmbH; Wien	SO	100.00 %	100.00 %	100.00 %	35
Magyarországi Volksbank zrt; Budapest	KI	95.43 %	95.43 %	97.49 %	54,204
OJSC Volksbank; Lviv	KI	99.91 %	99.91 %	99.91 %	33,739
Privatinvest d.o.o.; Ljubljana	HD	95.90 %	95.90 %	95.90 %	2,296
Új Garai tér Ingatlanforgalmi Kft.; Budapest	SO	95.43 %	95.43 %	97.49 %	2,518
V-Dat Informatikai Szolgáltató és Kereskedlmi Kft.; Budapest	HD	95.43 %	95.43 %	97.49 %	1,450
Volksbank a.d.; Beograd	KI	96.90 %	96.90 %	96.90 %	55,123
Volksbank a.d. Banja Luka; Banja Luka	KI	99.96 %	99.96 %	99.98 %	12,132
VOLKSBANK BH d.d.; Sarajevo	KI	95.46 %	95.46 %	97.84 %	24,031
Volksbank CZ, a.s.; Praha	KI	98.13 %	98.13 %	98.50 %	80,020
Volksbank d.d.; Zagreb	KI	99.18 %	99.18 %	99.35 %	83,384
Volksbank Ingatlankezelö Kft; Budapest	HD	95.43 %	95.43 %	97.49 %	5,936
Volksbank Romania S.A.; Bukarest	KI	99.34 %	99.05 %	99.67 %	133,659
VOLKSBANK Slovensko, a.s.; Bratislava	KI	93.38 %	91.00 %	97.85 %	33,207
Volksin d.o.o.; Zagreb	HD	100.00 %	100.00 %	100.00 %	924

* Abbreviations
KI ... credit institution
HD ... banking-related auxiliary services
SO ... other enterprises

Three companies in which the group exercises control are not fully consolidated. One company sells goods to members of the Group at usual market conditions which this company purchased from third parties before. The other company is operating as an estate agent and the third one, was founded to purchase real estate collateral of an impaired client. The total assets of these companies amounted to 0.1 % (2009: 0.05 %) of consolidated total assets, while the annual result after taxes corresponds to 1.9 % (2009: 0.12 %) of the Group's annual result after taxes. This calculation was based on the latest available financial statements of the companies and the Group's consolidated financial statements for 2010.

3) ACCOUNTING PRINCIPLES

The accounting principles described below have been consistently applied to all reporting periods covered by these financial statements and have been followed by all consolidated companies without exception.

The VBI Group's consolidated financial statements for 2010 and the comparative figures for 2009 have been prepared in accordance with the International Financial Reporting Standards (IFRS; previously International Accounting Standards, IAS). As these consolidated financial statements are primarily addressed to international readers, they are only prepared in English.

The consolidated financial statements have been prepared in accordance with all IFRS/IAS published by the International Accounting Standards Board (IASB) in force on the balance sheet date as well as all interpretations (IFRIC/SIC) of the International Financial Reporting Interpretations Committee and the Standing Interpretations Committee as endorsed by the European Union.

The consolidated financial statements have been prepared on the basis of cost excluding the following items:

- Derivative financial instruments – measured at fair value
- Financial instruments in the category at fair value through profit or loss and available for sale – measured at fair value
- Investment property assets – measured at fair value
- Financial assets and liabilities which constitute underlying instruments for fair value hedges – amortised cost is adjusted for changes in fair value, which are to be allocated to hedged risks
- Employee benefit provisions – recognised at net present value less unrecognised actuarial gains or losses

The two following chapters present altered and new accounting standards that are of significance to the consolidated financial statements of VBI.

a) Changes to accounting standards

In January 2008, the IASB resolved upon changes to IAS 27 Consolidated and Separate Financial Statements and IFRS 3 Business Combinations. Significant changes to IAS 27 include the accounting treatment of transactions that do not result in a change of control and transactions that do not lead to a loss of control. These are to be recognised as equity transactions. Remaining interests are measured at fair value at the date on which control is lost. Significant changes to IFRS 3 comprise the measurement of non-controlling interests, the recognition of step acquisitions and the treatment of contingent consideration and acquisition-related costs. Non-controlling interests may be measured either at fair value (full goodwill method) or at the fair value of the non-controlling interest's proportionate share of the net identifiable assets of the entity acquired. The full goodwill methode is not used in the VBI Group. In the case of step acquisitions, the revised standards provide for the remeasurement at fair value of the previously recognised assets and liabilities of the acquired entity at the date on which control is obtained. Any change in contingent consideration recognised as a liability at the acquisition date must be recognised in profit or loss in future. Acquisition-related costs must be expensed as incurred. The amended standards must be applied to business combinations in business years commencing on or after 1 July 2009. The application of these amendments to IAS 27 and IFRS 3 does not have a significant impact on future consolidated financial statements.

The IASB resolved upon the amendment of IAS 39 in July 2008. This amendment clarifies which risks or portions of cash flows are permitted as hedged items in hedge accounting. Its regulations also include the procedure for handling the inflation portion of financial instruments and option contracts used as a hedging instrument in hedge accounting. The amended standard must be applied to business years commencing on or after 1 July 2009. The effect of these amendments are immaterial for the consolidated financial statements.

b) New accounting standards

IFRS 9 Financial Instruments was published in November 2009, regulating the classification and measurement of financial assets, and is to replace IAS 39 Financial Instruments: Recognition and Measurement in future. There will only be two categories in future – amortised cost and fair value. A financial asset is measured at amortised cost if it is held in the context of a business model with the objective of holding financial assets and collecting the contractual cash flows resulting from these financial assets. The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets that do not satisfy these criteria are to be measured at fair value through profit or loss. For an investment in an equity instrument that is not held for trading, an entity may elect irrevocably at initial recognition to present all fair value changes from the investment directly in equity in other comprehensive income. Sales or impairments are not reclassified to profit or loss. If embedded derivatives are contained in a financial instrument, these are not separated. Instead, the financial instrument is measured in its entirety at fair value through profit or loss.

In addition to measurement of financial instruments, the measurement of financial liabilities in line with IFRS 9 was published in October 2010. The main changes to the former guideline in IAS 39 is the representation of changes in fair value, caused by the requirements of the own credit amounts, for financial liabilities measured at fair value through profit or loss. In future those changes in the fair value should be recognised directly in equity in other comprehensive income, except it would create an accounting mismatch. The rules for measurement at amortised costs and derivatives are unchanged.

This standard is required to be applied for fiscal years beginning on or after 1 January 2013. The standard is not endorsed by the European Union yet. This standard was not adopted prematurely in the VBI Group. The effect of IFRS 9 on the income statement and the balance sheet is currently being evaluated in the VBI Group. Based on the business activities of the Group, this standard will have a considerable impact on the consolidated financial statements.

In November 2009, the IASB resolved upon the amendment of IAS 24 Related Party Disclosures. The amendment includes a simplification of disclosure requirements for companies with close links to governments. Related companies and persons are also clearly defined. The amended standard is required to be applied for financial years beginning on or after 1 January 2011. It will not be adopted prematurely in the VBI Group. As things stand at present, the amendment will not affect VBI's consolidated financial statements.

IFRIC 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, published by the IASB in November 2009, is required to be applied for financial years beginning on or after 1 January 2011. It will not be adopted prematurely in the VBI Group. As things currently stand, the new IFRIC will not affect VBI's consolidated financial statements.

In October 2010, the IASB published amendments to IFRS 7 Financial Instruments: Disclosures. The amendments lead to an extensive standardisation of the corresponding disclosure requirements in accordance with IFRS and the US Generally Accepted Accounting Principles (US-GAAP). Extended disclosure requirements are stipulated for the transfer of financial assets to enable balance sheet addressees to better understand the impact of the remaining risks at the company. These amendments are required to be applied for financial years beginning on or after 1 July 2011. The amendment has not yet been adopted by the EU. It will not be adopted prematurely in the VBI Group. From today's perspective, there will be no major changes to VBI's consolidated financial statements.

In December 2010, the IASB published amendments to IAS 12 Income Taxes. These will also lead to changes in the scope of application of SIC-21 Income Taxes – Recovery of Revalued Non-Depreciable Assets. The amendment includes a partial clarification of the treatment of taxable temporary differences in connection with the application of the fair value model from IAS 40. In the case of real estate held as financial investments, it is often difficult to judge whether existing differences will reverse during continued use or in the course of a sale. The amendment works on the basic assumption that a sale will trigger the reversal. The amendment is to be applied retrospectively for financial years beginning on or after 1 January 2012. The amendment has not yet been adopted by the EU. It will not be adopted prematurely in the VBI Group. From today's perspective, there will be no major changes to VBI's consolidated financial statements.

In October 2009, the IASB published an amendment to IAS 32 Financial Instruments: Presentation. According to this, subscription rights, options and warrants for the acquisition of equity instruments that are in a currency other than the issuer's functional currency and have been issued to the company's existing shareholders are to be classified as equity for issuers. This applies provided that the subscription rights are issued at a defined currency amount. The amended standard is required to be applied for financial years beginning on or after 1 February 2010. Since the VBI Group has not issued any subscription rights, options or warrants of this kind, this amendment does not affect VBI's consolidated financial statements.

In November 2009, IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments was published. This explains how financial reporting is to be performed if a company extinguishes all or part of a financial liability by issuing shares or other equity instruments. According to this, the equity instruments issued for the purpose of repayment are consideration paid for this financial liability and are therefore to be measured at the respective fair value. Any resulting difference between the carrying amount of the financial liability to be extinguished and the initial carrying value of the equity instruments issued must be recognised in profit or loss. This interpretation is required to be applied for financial years beginning on or after 1 July 2010. According to current estimates, the initial application of IFRIC 19 will not affect VBI's consolidated financial statements.

c) Application of estimates and assumptions

All assumptions, estimates and assessments required as part of recognition and measurement in line with IFRS are carried out in accordance with the relevant standard, are re-evaluated on an ongoing basis and are based on historical experience and other factors including expectations with regard to future events that appear reasonable in the particular circumstances. These estimates and assumptions have an influence on the amounts shown for assets and liabilities in the balance sheet and income and expenses in the income statement.

In the case of the following assumptions and estimates, there is the inherent possibility that the development of overall conditions contrary to expectations as at the balance sheet date may lead to considerable adjustments of assets and liabilities in the next business year.

- Alternative investment measurement methods are used to assess the recoverability of financial instruments for which no active market is available. Some of the parameters taken as a basis when determining fair value are based on assumptions concerning the future.
- The assessment of the recoverability of intangible assets, goodwill, investment properties and property, plant and equipment is based on assumptions concerning the future. The calculation of recoverable amounts in the course of the impairment tests is based on assumptions such as future surplus funds and the discount rate. Surplus funds correspond to the values shown in the most recent business plan for the following five years as at the date the financial statements are prepared. The discount rate is based on the industry, corporate risk and the respective market environment and lies between 8 % and 20 %. The underlying development factor is between 1 % and 4 %.
- The recognition of deferred tax assets is based on the assumption that sufficient tax income will be generated in future in order to realise existing tax loss carryforwards.
- Assumptions regarding the interest rate, retirement age, life expectancy and future salary increases are applied when measuring existing long-term employee provisions.
- Provisions are measured on the basis of cost estimates from contractual partners, past experience and investment calculation methods.
- Assessments are regularly carried out for liabilities and impairment not recognised in the balance sheet due to guarantees and contingencies in order to determine whether on-balance sheet recognition in the financial statements is to be carried out.

If estimates were required to a greater extent, the assumptions made are shown with the note on the corresponding item. Actual values may deviate from the assumptions and estimates made if overall conditions develop contrary to expectations as at the balance sheet date. Amendments are recognised in profit or loss and assumptions adjusted accordingly once better information is obtained.

d) Consolidation principles

The consolidated financial statements of VBI are based on the separate financial statements of all fully consolidated companies prepared in accordance with IFRS.

The financial statements of the fully consolidated companies were prepared on the basis of the Group's balance sheet date of 31 December 2010.

All business combinations are accounted for using the purchase method set out in IFRS 3. Accordingly, all identifiable assets, liabilities and contingent liabilities are recognised at their fair values at the acquisition date. If the cost of acquisition exceeds the fair value of the identifiable assets, liabilities and contingent liabilities, goodwill is recognised as an asset. The full goodwill method is not in use. Goodwill is not amortised over the estimated useful life, but instead is tested for impairment annually in accordance with IAS 36. Negative goodwill arising on an acquisition is recognised directly in income in accordance with IFRS 3. Any change in contingent consideration recognised as a liability at the acquisition date is recognised in profit or loss. Transactions, which do not lead to a loss of control are recognised directly in equity.

Subsidiaries under the direct or indirect control of VBI are fully consolidated if these are material for a true and fair view of the net assets, liabilities, financial position and profit or loss of the Group. Proportionate consolidation is not applied in VBI's consolidated financial statements. Investments in subsidiaries with a minor significance and interests in associated companies are not included in the consolidated financial statements. Instead they are shown under financial investments and carried at cost. Investments in other companies are recognised at market value. If a market value is not available or could not be measured reliably they are recognised at amortised cost. The Group does not have any interests in joint ventures.

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions are eliminated in preparing the consolidated financial statements.

e) Currency translation

In accordance with IAS 21, foreign currency monetary assets and debts, non-monetary positions stated at fair value and unsettled spot transactions are translated using the spot exchange mean rate, whereas unsettled forward transactions are translated at the forward exchange mean rate prevailing on the balance sheet date. Non-monetary assets and liabilities carried at amortised cost are recognised at the prevailing rate on the acquisition date.

The individual financial statements of fully consolidated companies prepared in currencies other than the euro are translated using the modified closing rate method set out in IAS 21. Under this method, all assets and liabilities are translated at the spot exchange mean rate effective on the balance sheet date, while the historical rate is applied for the translation of equity. Differences resulting from the translation of the financial statements of foreign subsidiaries are recognised in the currency reserve in equity. Any goodwill, disclosed hidden reserves and liabilities arising from the initial consolidation of foreign subsidiaries prior to 1 January 2005 have been translated at historical rates. Any goodwill, disclosed hidden reserves and liabilities arising from business combinations after 1 January 2005 are translated at the spot exchange mean rate on the Group's balance sheet date.

Income and expense items are translated at the average spot exchange mean rate for the reporting period, calculated on the basis of the end-of-month rates. Exchange differences between the closing rate applied for the translation of balance sheet items and the average rate used for translating income and expense items are recognised in the currency reserve in equity.

f) Net interest income

Interest income and interest expenses are recognised on an accrual basis in the income statement. Current or non-recurring income or expenses similar to interest, such as commitment fees, overdraft commissions or handling fees, are reported in net interest income in accordance with the effective interest method. Premiums and discounts are allocated over the term of the financial instrument using the effective interest method and reported in net interest income.

If it appears more unlikely than likely that a customer will be able to pay the agreed interest, the relevant asset is treated as non-interest-bearing. The unwinding effect resulting from the calculation of the risk provision is therefore shown in interest income.

Net interest income consists of:

- Interest and similar income from credit and money market transactions (including unwinding effect from risk provision)
- Interest and similar income from debt securities
- Income from equities and other variable-yield securities
- Income from affiliated companies and other participations
- Income from operating lease contracts and investment property assets
- Interest and similar expenses for deposits
- Interest and similar expenses for debts evidenced by certificates and subordinated liabilities
- The interest component of derivatives reported in the investment book.

The changes of values of investment property assets which were shown in net interest income last year, were reclassified in the business year 2010 to income from financial investments. The comparative figures have been restated accordingly.

Interest income and expenses from trading assets and liabilities and changes in their fair value are recognised in net trading income.

The result of the valuation and disposal of securities, shares and participations is reported in income from financial investments.

g) Risk provisions

Risk provisions reflect the allocation to and release of provisions for impairments of loans and advances on individual and portfolio basis. Loans and advances directly written off and receipts from loans and advances already written off are also recognised in this item. Furthermore, this item contains additions to and releases of provisions for risks.

h) Net fee and commission income

This item contains all income and expenditure relating to the provision of services in the VBI Group as accrued within the respective reporting period.

i) Net trading income

All realised and unrealised results from securities, foreign currency and derivatives allocated to the trading book (trading assets and trading liabilities) are reported in this item. This includes changes in market value as well as all interest income, dividend payments and refinancing expenses for trading assets.

Results from the daily measurement of foreign currencies are also reported in net trading income.

j) General administrative expenses

General administrative expenses contain all expenditure incurred in connection with the Group's operations.

Staff expenses include wages and salaries, statutory social security contributions and fringe benefits, payments to pension funds as well as all expenses resulting from severance payments.

Administrative expenses include expenses for premises, communications, public relations and marketing, costs for legal advice and other consultancy, as well as training and EDP expenditure.

Amortisation of intangible assets – excluding impairment of goodwill – and depreciation of tangible fixed assets is also reported in this item.

k) Other operating result

In addition to impairment of goodwill this item contains all results from the Group's other operating activities.

l) Income from financial investments

This item contains all realised and unrealised results from financial investments at fair value through profit or loss and all derivatives reported in the investment book.

In addition, the results of disposals of securitised financial investments classified as available for sale (including participations), loans & receivables and held to maturity are included in this item. Remeasurement results attributable to material or lasting impairment are also reported in this item as well as the increase of the fair value, which can be objectively related to an event occurring after the impairment loss was recognised, up to a maximum of amortised cost.

Since the business year 2010 changes in value of investment property assets are reported in this position. The comparative figures have been restated accordingly.

Results from the daily measurement of foreign currencies are reported in net trading income.

m) Financial assets and liabilities

Recognition

A financial asset or a financial liability is initially recognised in the balance sheet when the Group becomes party to a contract on the financial instrument and thus acquires the right to receive or assume a legal obligation to pay liquid funds. A financial instrument is deemed to be added or disposed of at the trade date. The trade date is relevant for the initial recognition of a financial instrument in the balance sheet, its measurement in the income statement and the accounting treatment of its sale.

Derecognition

A financial asset is derecognised on the date on which the contractual rights to its cash flows expire or the transfer criteria set out in IAS 39.18 are met. A financial liability is derecognised once it has been redeemed.

The Group does not conduct transactions in which financial assets are transferred, but the risks or rewards incident to the ownership of the asset remain with the Group.

Offsetting

Financial assets and liabilities are set off and the net amount presented in the balance sheet when, and only when, the Group has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains and losses arising from a group of similar transactions, such as in the Group's trading activities.

Amortised cost

The amortised cost of financial assets and liabilities is defined as the amount consisting of the original purchase price adjusted for account redemptions, the allocation of premiums or discounts over the term of the instrument in accordance with the effective interest method, and value adjustments or depreciation due to impairment or uncollectibility.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

For calculation of fair values, the following hierarchy is used and shows the meaning of the single parameters.

Level 1: Quoted prices in active markets of identical assets or liabilities. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

Level 2: Valuation techniques based on observable data – either directly as prices or indirectly derived from prices. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties, as well as reference to the current fair value of other instruments that are substantially the same. For discounted cash flow analyses and option pricing models all important parameters are derived either directly or indirectly market data. All factors that market participants would consider in setting prices are taken into account, and are consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observables data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

Impairment

There is a monthly procedure for the evaluation of lending under which the organisational units responsible for risk are required to make a proposal for risk provisioning on the basis of current developments. An impairment is recognised if, subsequent to the initial recognition of a financial instrument, there is objective evidence of an event that will have an effect on the future cash flows from the financial instrument and reliable assumptions can be made with regard to the extent of such an effect.

The Group recognises impairments at both individual asset and portfolio level. All significant assets are individually tested for impairment. Financial assets that are not individually significant are grouped together on the basis of similar risk profiles and assessed collectively. In the case of assets for which there is no objective indication of impairment, impairment is recognised in the form of portfolio-based allowances to reflect impairment that has occurred but not yet been detected.

Objective evidence that financial assets are impaired includes, for example, financial difficulties of the debtor; the rescheduling of receivables on terms which would otherwise not be granted; indications that the debtor will enter bankruptcy; the disappearance of securities from an active market and other observable data in connection with a group of financial assets, such as changes in the payment status of borrowers or economic conditions correlating with defaults on the assets in the Group.

In calculating the level of risk provisioning required, all significant assets are individually analysed if there is objective evidence of impairment. All customers with an internal rating of 4C to 4E (watch list loans) and all other customers for which

other indications show a risk of default, i.e. the contractual redemption is at risk, are examined more intensively in accordance with the Group credit risk manual. A corresponding risk provision is recognised for uncollateralised or partly collateralised exposures. For non-performing loans (rating category 5A–5E), the appropriateness of the level of risk provisioning is examined.

The amount of impairment for assets carried at amortised cost is calculated as the difference between the carrying amount and the net present value of the future cash flows, taking any collateral into account, discounted using the effective interest rate of the asset. The impairment amount is reported in the income statement. In the event that the reason for impairment ceases to exist at a later date, the impairment loss is reversed through profit or loss.

Portfolio-based allowances are calculated for homogeneous portfolios. The parameters listed below are used in assessing the amounts of these value adjustments:

- Historical loss experience with non-performing loans
- The estimated period between the occurrence of the loss and its identification (30–180 days)
- Management's experienced judgment as to whether the expected losses in the current period are greater or lower than suggested by historical data.

In the case of available for sale financial assets, impairment corresponds to the difference between amortised cost and fair value and is recognised immediately as a write-down in the income statement. If the reason for impairment ceases to exist, the impairment loss is reversed through profit or loss in the case of debt instruments or recognised directly in equity taking into account deferred taxes in the case of equity instruments.

Financial instruments designated at fair value through profit or loss

The Group makes use of the option to irrevocably designate financial instruments at fair value through profit or loss. Allocation to this category is performed if one of the three following criteria is met:

- Groups of financial assets and financial liabilities are managed on a fair value basis in accordance with a documented risk management and investment strategy.
- Fair value measurement can be demonstrated to prevent inconsistencies in the valuation of financial assets and liabilities.
- A financial instrument contains an embedded derivative that is generally required to be reported separately from the host agreement at fair value.

Financial liabilities which are measured at fair value through profit or loss, are customer deposits which are tied to the performance of the underlying. For calculation of fair value of these financial liabilities, the performance of the underlying is considered, therefore it does not contain any changes in value due to the own credit risk.

In note 35) Financial assets and liabilities, the amounts allocated to the at fair value through profit or loss category are indicated

for each class of financial asset and liability. The reasons for the designation are described in the notes on the individual financial assets and liabilities.

Derivatives

Derivatives are always recognised in income at their fair value.

Changes in the fair value of derivatives used in fair value hedges are recognised in income immediately under income from financial investments. Changes in the market value of the underlying instruments are also reported in income from financial investments, irrespective of their allocation to the individual IAS 39 categories. The Group uses fair value hedges with a view to hedging fixed-interest financial assets.

In the case of cash flow hedges, the change in the fair value of the derivative is recognised in the hedging reserve in equity, taking into account deferred taxes. The measurement of the host instrument is performed on the basis of its allocation to one of the individual IAS 39 categories. The Group uses cash flow hedges with a view to hedging the variable interest rate risk on issued mortgage bonds and amounts owed to credit institutions.

If a derivative is used as a hedge of a net investment in a foreign operation, the effective portion of the hedge is recognised directly in the currency reserve in equity, while the ineffective portion is recognised immediately in income. The amount contained in the currency reserve is transferred to income at the disposal date of the foreign operation.

Embedded derivatives are reported and measured separately, irrespective of the financial instrument in which they are embedded, unless the structured investment has been designated and allocated to the at fair value through profit or loss category.

Own equity and debt instruments

Own equity instruments are carried at cost and deducted from equity on the liabilities side of the balance sheet. Own issues are deducted from issues at their redemption amounts on the liabilities side of the balance sheet, with the difference between the redemption amount and cost reported in net interest income.

n) Loans and advances to credit institutions and customers

Loans and advances represent non-derivative financial assets with fixed or determinable redemption amounts which are not traded on an active market and are not securitised.

Loans and advances to credit institutions and customers are recognised at their gross amounts before deductions for impairment losses, including deferred interest. The total amount of risk provisions for balance sheet receivables is recognised as

a reduction on the asset side of the balance sheet under loans and advances to credit institutions and loans and advances to customers. Risk provisions for off-balance sheet transactions are included in provisions.

Receivables are initially measured at fair value plus incremental direct transaction costs. Subsequent measurement is performed at amortised cost using the effective interest method unless the receivables are designated to the at fair value through profit or loss category.

o) Risk provisions

Provisions for individual and portfolio-based impairment are recognised in order to cover the specific risks inherent to banking. Provisions are also recognised for potential losses from investments in high-risk countries; these are based on the standard international valuations for such types of investments. For further details, see section m) Financial assets and liabilities.

p) Trading assets and liabilities

Trading assets include all financial assets acquired with a view to short-term sale or forming part of a portfolio which is intended to yield short-term profits. Trading liabilities consist of all negative fair values of derivative financial instruments used for trading purposes. In this position there are no financial assets and liabilities reported which are designated to the at fair value through profit and loss category.

Both initial recognition and subsequent measurement are performed at fair value. Transaction costs are expensed as incurred. All changes in fair value as well as all interest and dividend payments and refinancing allocable to the trading portfolio are reported in net trading income.

q) Financial investments

Financial investments comprise all securitised debt and equity instruments not classified as participations. Financial investments are initially recognised at fair values plus incremental direct transaction cost. Subsequent measurement depends on whether the financial assets are allocated to the at fair value through profit or loss, available for sale, loans & receivables or held to maturity categories.

At fair value through profit or loss

The Group allocates some securities to this category and records changes in the fair value of such securities directly in the income statement as described in section m) Financial assets and liabilities.

Available for sale

This category comprises all financial instruments which are not allocated to the at fair value through profit or loss, loans & receivables or held to maturity categories. It also includes all equity instruments with no maturity date, provided that they have not been classified as at fair value through profit or loss. Shares which are not traded on a stock exchange and whose fair value cannot be reliably determined are carried at cost less any impairment losses. All other available for sale assets are measured at fair value. Changes in fair value are taken directly to equity until these financial investments are sold or impaired and the remeasurement result is transferred from equity to the income statement. With regard to debt securities, the difference between cost including transaction cost and the redemption amount is amortised in accordance with the effective interest method and recognised in income. Accordingly, only the difference between amortised cost and fair value is recognised in the available for sale reserve, taking into account deferred taxes.

Loans & receivables

All securitised financial investments with fixed or determinable payments that are not quoted in an active market and which the Group does not intend to sell immediately or in the near term are classified as loans & receivables. These financial instruments are recognised at amortised cost in accordance with the effective interest method.

Held to maturity

The Group allocates financial instruments to this category if it has the positive intention and ability to hold them to maturity and they have fixed or determinable payments and a fixed maturity.

These financial instruments are recognised at amortised cost in accordance with the effective interest method. Any sale or reallocation of a substantial part of these financial instruments which does not occur on a date that is close to the redemption date or is attributable to a non-recurring isolated event that is beyond the Group's control and that could not have been reasonably anticipated, results in the reallocation of all held to maturity financial investments to the available for sale category for the two subsequent fiscal years. In 2010 and 2009, no such reallocations took place.

r) Investment property

All land and buildings that meet the definition of investment property set out in IAS 40 are reported at fair value. The calculations are net income calculations, which are prepared on the basis of current rental interest lists subject to assumptions concerning market developments and interest rates. Colliers International is mandated to act as independent expert for assessing the value of foreign investment properties. The fee basis for external appraisers is a fixed amount and independent of the appraised value.

Rental income is recognised on a straight-line basis in accordance with the term of the respective lease and rental contracts and

reported in interest and similar income. Starting 2010, changes in value of investment property assets are reported in position income from financial statements. The comparative figures have been restated accordingly.

s) Participations

The Group establishes subsidiaries and acquires participations for strategic reasons and as financial investments. Strategic participations relate to companies operating in the Group's lines of business or companies supporting the Group's business activities.

All participations are recognised at their respective fair values. Participations whose fair value cannot be determined without an unreasonable amount of effort are carried at cost. Write-downs have been recognised for impairment. If the reason for impairment ceases to exist, the impairment loss is reversed and recognised directly in equity taking into account deferred taxes.

t) Intangible and tangible fixed assets

Intangible assets are carried at cost less straight-line amortisation and impairment. This item primarily comprises acquired goodwill and software.

Goodwill is not depreciated on a straight-line basis, but instead is tested for impairment at least once a year in accordance with IAS 36, or more frequently if events or changes in circumstances indicate that impairment may have occurred. The value in use for the cash-generating units (CGUs) to which goodwill is allocated, is assessed in a two phase discounted cash flow model. In the first phase the expected cash flows are calculated on the basis of the forecast result of the respective CGU for the following five years, discounted using a risk-adjusted interest rate which is between 8 % and 20 %. This corresponds to a long-term, risk-free interest rate which is increased by an equity premium, multiplied by a branch beta and adjusted for any country risk premiums. In phase two future cash flows are determined based on the return on equity adjusted by future capital requirements. The discount rate used for calculation of the perpetuity value is based on those of phase one and adjusted by a development factor. The underlying development factor lies between 1 % and 4 %.

The proportionate enterprise value (value in use) determined according to the principles listed above is offset against the proportionate equity of the CGU plus any goodwill. If the proportionate enterprise value is lower than the sum of the proportionate equity and any goodwill, an impairment loss is recognised in the amount of the difference.

Due to impairment tests which were done on 31 December 2010 the goodwill of one VBI credit institutions was partly impaired. On balance sheet date, all other impairment tests which took place, did not lead to further impairment requirements.

A sensitivity analysis for all CGUs to which goodwill is allocated was performed. Therefore the percentage points were assessed by which the cost of equity in phase two can increase in order for the proportionate enterprise value of a CGU to be equal to its proportional equity plus any goodwill. The possible increase in the cost of equity in phase two is stated in the table below:

Subsidiary	Increase in percentage points
Volksbank, Slovakia	6.86
Volksbank, Czech Republic	6.31
Volksbank, Hungary	3.07
Volksbank, Slovenia	1.47
Volksbank, Croatia	0.89
Volksbank, Romania	0.91
Volksbank, Bosnia-Herzegovina	8.48
Volksbank, Banja Luka	5.12
Volksbank, Serbia	0.25
Volksbank, Ukraine	0.00

Tangible fixed assets are carried at cost and depreciated on a straight-line basis over their estimated life in the case of depreciable assets.

Write-downs are recognised for permanent impairment. If the circumstances resulting in the recognition of a write-down cease to exist, the write-down is reversed up to a maximum of amortised cost.

The useful life is the period of time during which an asset is expected to be used by the Group and is calculated as follows:

Office furniture and equipment	up to 10 years
EDP hardware (including calculators, etc.)	up to 5 years
EDP software	up to 4 years
Vehicles	up to 5 years
Strongrooms and safes	up to 20 years
Buildings, reconstructed buildings, rental rights	up to 50 years

u) Tax assets and liabilities

This item is used to report current and deferred tax assets and liabilities. According to the balance sheet liability method set out in IAS 12, deferred taxes are derived from all temporary differences between the tax base of an asset or liability and its carrying amount in the balance sheet prepared in accordance with IFRS. Deferred taxes are calculated for subsidiaries on the basis of the tax rates that apply or have been announced in the individual countries on the balance sheet date. Deferred tax assets are offset against deferred tax liabilities for each individual subsidiary.

Deferred tax assets in respect of unutilised tax loss carryforwards are recognised to the extent that it is probable that future taxable profit will be available at the same company against which the unused tax losses can be utilised or if sufficient taxable temporary differences exist. The appraisal period is up to 5 years. Deferred tax assets from tax loss carryforwards are impaired, if it is unlikely that the tax benefit can be realised. Deferred taxes are not discounted.

v) Other assets

Deferred items are used for accruing income and expenses and are shown in this item together with other assets. Value adjustments are recognised for impairment. This item also includes all positive fair values of derivatives that are reported in the investment book and carried at fair value. With the exception of derivatives used in cash flow hedges and hedges of a net investment, which are taken directly to equity, changes in fair value are reported in income from financial investments.

w) Liabilities

The initial recognition of amounts owed to credit institutions and customers as well as debts evidenced by certificates is performed at fair value plus directly attributable transaction cost. Subsequent measurement is performed at amortised cost in accordance with the effective interest method, unless these liabilities were designated as liabilities at fair value through profit or loss.

x) Employee benefits

Payments to defined contribution plans are expensed as incurred. Irregular payments are allocated to the respective reporting period.

In accordance with the projected unit credit method, provisions for severance payments are calculated on the basis of generally recognised actuarial principles for determining the present value of the overall entitlement and additional claims acquired in the reporting period. For severance payments, this procedure takes into account retirement due to attainment of pensionable age, occupational incapacity, disability or death, as well as the vested rights of surviving dependents.

Actuarial gains and losses are treated in accordance with the so-called corridor method, meaning that contributions are recognised in income when the cumulative unrecognised actuarial gains or losses exceed 10 % of the present value of the defined benefit obligation for severance payments. In 2010 and 2009, actuarial gains and losses exceeding the corridor were recognised in income in full.

PRINCIPAL ACTUARIAL ASSUMPTIONS

	2010	2009	2008	2007	2006
Discount rate	4.25 %	5.25 %	5.75 %	5.00 %	4.50 %
Future salary increase	3.50 %	3.50 %	3.50 %	3.50 %	3.50 %
Fluctuation rate	none	none	none	none	none

The fundamental biometric actuarial assumptions of the latest Austrian scheme by Pagler and Pagler for calculating pension insurance for salaried employees are applied as the basis of calculation (AVÖ 2008 P- Rechnungsgrundlagen für die Pensionsversicherung – Pagler&Pagler, Angestelltenbestand).

The current retirement age limits are generally taken into account in these calculations. It is assumed that, as a rule, men will retire at the age of 65 years and women at the age of 60 years. Any transitional arrangements are disregarded. For staff not employed in Austria, the standard retirement age stipulated in the respective country is applied.

y) Other provisions

Other provisions are recognised if a past event has given rise to a present obligation and it is likely that meeting such an obligation will result in an outflow of resources. They are built to the amount of the most probable future claims, taking into account cost estimates of contractual partners, experienced data and financial mathematical methods. A contingent liability is reported if an eventual obligation exists and an outflow of resources does not appear probable or no reliable estimate of the amount of the obligation can be made.

z) Other liabilities

Deferred items are used for accruing income and expenses and are shown in this item together with other liabilities. This item also includes all negative market values of derivatives that are reported in the investment book and carried at fair value. With the exception of derivatives used in cash flow hedges and hedges of a net investment, which are taken directly to equity, changes in fair value are reported in income from financial investments.

aa) Subordinated Liabilities

Initial recognition of subordinated liabilities is carried out at fair value plus directly attributable transaction cost. Subsequent measurement is performed at amortised cost in accordance with the effective interest method, unless these liabilities were designated as liabilities at fair value through profit or loss.

In case of bankruptcy or the winding up of the enterprise, all amounts accounted for as subordinated liabilities may be satisfied after having met the demands of all other non-subordinated creditors. Securitised and non-securitised liabilities of VBI Group are classified as subordinated liabilities if the rank order described above is applicable.

Additionally to subordination, terms of contract of supplementary capital imply a performance-related interest payment. Payment of interest only will take place, as far as this payment is covered by the result before changes in reserves of the company issuing the supplementary capital.

bb) Equity

Financial instruments issued by the VBI Group which do not involve a contractual obligation to transfer cash or another financial asset to another entity or to exchange financial assets or liabilities with another entity under conditions that are potentially unfavourable to the issuer are reported in equity.

Capital management in VBI Group is done on the basis of the supervisory capital. VBI Group is part of the VBAG Group and therefore is subject to external provisions governing its equity requirements based on the EU directives 2006/48/EC and 2006/49/EC which have been implemented in national law. VBI Group is not a group of credit institutions itself.

VBAG Group uses the rules regarding capital ratios specified here as the central management variable for VBI Group. These ratios reflect the relationship between regulatory own funds and credit, market and operational risk. Accordingly, the risk/return management of VBI is based on the capital allocated to one business or, ultimately, one organisational unit and the income to be generated from this, taking into account the corresponding risk considerations.

Credit risk is determined by multiplying on-balance sheet and off-balance sheet exposures on the basis of their relative risks by the risk weighting to be allocated to a counterparty. The procedure for determining risk-relevant parameters (exposure, risk weighting) is based on percentages specified by regulatory requirements (standard approach). The capital requirements for operational risk are calculated by multiplying the revenues by the respective percentages for the divisions.

Regulatory own funds can be broken down into three elements:

- Core capital or tier I capital
- Supplementary capital or tier II capital
- Short-term subordinated liabilities or tier III capital.

Core capital or tier I capital consists of subscribed capital, capital reserves and retained earnings as well as hybrid capital components less intangible assets.

Supplementary capital or tier II capital consists of non-current subordinated liabilities, unrealised profits from listed securities and provisions for risks inherent in lending operations.

Tier III capital consists of current subordinated liabilities.

The minimum equity ratio (based on the total of tier I, tier II and tier III capital) corresponds to 8 %, and the minimum core capital ratio 4 %, of total risk exposure. The total tier II capital is limited to 100 % of tier I capital. Depending on the configuration of tier II capital, subordinated liabilities may be included only up to a maximum of 50 % of tier I capital. Tier III capital may only be used to cover market risks.

cc) Capital reserves

In accordance with IAS 32, the transaction costs of an equity transaction are accounted for as a deduction from equity, taking into account deferred taxes, to the extent that they constitute incremental costs that are directly attributable to the equity transaction.

dd) Retained earnings

All legal and statutory reserves as well as other reserves, provisions against a specific liability as defined by section 23 (6) of the Austrian Banking Act, untaxed reserves and all other undistributed profits are reported in retained earnings.

ee) Contingent liabilities

Possible obligations for which an outflow of resources does not appear probable or no reliable estimate of the amount of the obligation can be made are reported under contingent liabilities.

Provisions are recognised for acceptances and endorsements as part of provisions for risks if there are likely to be future claims.

Obligations arising from financial guarantees are recognised as soon as the VBI Group becomes a contracting party, i.e. when the guarantee offer is accepted. Initial measurement is performed at fair value. Considered in its entirety, the fair value of a financial guarantee at the time of contract conclusion is nil because, for standard market contracts, the value of the premium agreed generally corresponds to the value of the guarantee obligation.

A follow-up check is regularly performed in order to determine whether on-balance sheet recognition in the consolidated financial statements is necessary.

ff) Cash flow statement

The cash flow statement is calculated in accordance with the indirect method. Here, the net cash flow from operating activities is calculated based on the annual result after taxes and before non-controlling interests, whereby non-cash expenses and income during the business year are included and deducted respectively first of all. Moreover, all expenses and income which did serve as cash, but were not allocated to operating activities, are eliminated. These payments are recognised under the cash flow from investing activities or financing activities. The interest, dividend and tax payments, which are stated separately, are solely from operating activities.

Cash flows from non-current assets such as held to maturity securities, participations and fixed assets are assigned to the cash flow from investing activities. The cash flow from financing activities includes all cash flows of the owners as well as changes to subordinated liabilities and non-controlling interests. Liquid funds have been defined as cash and cash equivalents and comprise balances with central banks as well as cash in hand. These balances are composed of the minimum reserve to be held according to statutory provisions and current investments with various central banks.

As the business activity of the VBI Group mainly comprises financing activities, the informative value of the cash flow statement is rather limited.

4) NET INTEREST INCOME

EUR thousand	2010	2009
Interest and similar income	**689,528**	**788,957**
Interest and similar income from	687,904	787,743
liquid funds	16,781	43,161
credit and money market transactions with credit institutions	19,498	39,439
credit and money market transactions with customers	569,791	606,820
debt securities	45,870	49,776
derivatives – investment book	35,964	48,547
Current income from	824	949
equities and other variable-yield securities	3	2
other affiliates	821	947
Income from investment property and operating lease	800	265
rental income investment property	640	76
rental income from operating lease contracts	160	189
Interest and similar expenses of	**–272,971**	**–380,960**
deposits from credit institutions (including central banks)	–128,447	–199,283
deposits from customers	–114,804	–153,869
debts evidenced by certificates	–8,550	–8,637
subordinated liabilities	–2,630	–4,164
derivatives – investment book	–18,540	–15,008
Net interest income	**416,557**	**407,996**

Starting 2010, changes in value of investment property assets are reported in position financial investments. The comparative figures have been restated accordingly.

NET INTEREST INCOME ACCORDING TO IAS 39 CATEGORIES

EUR thousand	2010	2009
Interest receivable and similar income	**689,528**	**788,957**
Interest receivable and similar income from	687,904	787,743
financial investments at fair value through profit or loss	618	302
derivatives – investment book	35,964	48,547
financial investments not at fair value through profit or loss	651,322	738,894
financial investments available for sale	31,353	26,032
financial investments at amortised cost	609,455	693,283
of which unwinding	9,583	5,105
financial investments held to maturity	10,514	19,578
Current income from	824	949
financial investments available for sale	824	949
Income from investment property and operating lease	800	265
Interest and similar expenses of	**–272,971**	**–380,960**
financial investments at fair value through profit or loss	–1,145	–369
derivatives – investment book	–18,540	–15,008
financial investments at amortised cost	–253,286	–365,583
Net interest income	**416,557**	**407,996**

5) RISK PROVISIONS

EUR thousand	2010	2009
Allocation to risk provisions	–322,920	–236,391
Release of risk provisions	84,801	62,166
Allocation to provisions for risks	–1,565	–2,106
Release of provisions for risks	1,301	1,256
Direct write-offs of loans and advances	–3,221	–1,675
Income from loans and advances previously written off	3,569	2,171
Risk provisions	**–238,034**	**–174,580**

For more details to risk provisions and provisions for risks we refer to chapter 15) Risk provisions and chapter 28) Provisions.

6) NET FEE AND COMMISSION INCOME

EUR thousand	2010	2009
Fee and commission income from	**111,108**	**104,897**
lending operations	16,705	16,027
securities businesses	1,537	2,213
payment transactions	52,105	52,166
foreign exchange, foreign notes and coins transactions	29,607	25,233
other banking services	11,153	9,258
Fee and commission expenses from	**–29,676**	**–24,686**
lending operations	–5,418	–5,727
securities businesses	–500	–596
payment transactions	–6,142	–6,464
foreign exchange, foreign notes and coins transactions	–13,605	–7,525
other banking services	–4,011	–4,373
Net fee and commission income	**81,432**	**80,212**

Net fee and commission income does not include any income or expenses from financial investments designated at fair value through profit or loss.

7) NET TRADING INCOME

EUR thousand	2010	2009
Equity related transactions	–34	192
Exchange rate related transactions	22,730	4,992
Interest rate related transactions	781	–227
Net trading income	**23,477**	**4,957**

8) GENERAL ADMINISTRATIVE EXPENSES

EUR thousand	2010	2009
Staff expenses	**–121,803**	**–120,505**
Wages and salaries	–88,641	–87,965
Expenses for statutory social security	–27,149	–26,578
Fringe benefits	–4,766	–4,748
Expenses for retirement benefits	–265	–240
Allocation to provision for severance payments	–983	–975
Other administrative expenses	**–108,014**	**–102,132**
Depreciation of fixed tangible and intangible assets	**–28,219**	**–26,911**
Scheduled depreciation	–25,627	–26,600
Impairment	–2,592	–312
General administrative expenses	**–258,036**	**–249,549**

Staff expenses include payments for defined contribution plans totalling EUR 294 thousand (2009: EUR 540 thousand).

INFORMATION ON COMPENSATION FOR BOARD MEMBERS

EUR thousand	2010	2009
Expenses for severance payments and pensions		
Managing board	15	14
Total compensation		
Managing board	1,111	1,207

The figures for the managing board include employees of the parent company. At the VBI Group, the board members of the parent company are classified as management members in key positions.

The VBI Group employed 5,362 staff members (2009: 5,483) at year-end 2010. At average the VBI Group employed 5,400 staff members (2009: 5,617).

For the business year, expenses for the auditor KPMG Austria GmbH amounted to EUR 482 thousand (2009: EUR 141 thousand). Thereof EUR 142 thousand (2009: EUR 116 thousand) fall upon the audit of the consolidated financial statement and EUR 340 thousand (2009: EUR 25 thousand) upon other audit services.

9) OTHER OPERATING RESULT

EUR thousand	2010	2009
Other operating income	8,006	6,804
Other operating expenses	–22,830	–16,408
Impairment of goodwill	–14,851	–8,299
Other operating result	**–29,675**	**–17,903**

Details of impairment of goodwill can be found in chapter 20) Intangible assets.

Hire purchase transactions as well as operating expenses and insurance contributions which are passed on to customers are netted and recognised in other operating income to the amount of EUR 3,886 thousand (2009: EUR 772 thousand), as this procedure presents a fairer view of the economic nature of these transactions.

10) INCOME FROM FINANCIAL INVESTMENTS

EUR thousand	2010	2009
Result from financial investments at fair value through profit or loss / macro hedges	**–4**	**–1**
Result from financial investments at fair value through profit or loss and from underlying instruments for macro hedges	–267	299
Debt securities	313	–62
Equities and other variable-yield securities	0	–322
Amounts owed to customers	–580	684
Result from revaluation of derivatives	263	–300
Result from fair value hedges	**0**	**0**
Loans and advances to customers – underlying instrument	38	13
Result from revaluation of derivatives	–38	–13
Result from valuation of other derivatives in the investment book	**3,608**	**–3,231**
Equity related transactions	799	0
Exchange rate related transactions	2,525	–2,867
Interest rate related transactions	257	–39
Other transactions	27	–325
Result from available for sale financial investments (including participations)	**3,778**	**–259**
Realised gains / losses	6,383	1,001
Income from revaluation	156	144
Impairments	–2,761	–1,404
Result from assets for operating lease and investment property as well as other financial investments	**–1,106**	**–177**
Income from revaluation	5	0
Impairments	–1,111	–177
Income from financial investments	**6,276**	**–3,669**

Since the business year 2010, changes in value of investment property assets are reported in this position. The results of participations are part of available for sale financial investments beginning with this business year. The comparative figures have been restated accordingly.

In 2010, an amount of EUR 6,377 thousand (2009: EUR 952 thousand) previously recognised in the available for sale reserve was reclassified and shown in the income statement.

EUR thousand	2010	2009
Result from financial investments, which are measured at fair value through profit and loss	**2,498**	**–3,409**
Financial instruments at fair value through profit or loss	–267	299
Fair value hedges	0	0
Other derivatives in investment book	3,871	–3,531
Investment property assets	–1,106	–177
Result from financial investments, which are not measured at fair value through profit and loss	**3,778**	**–259**
Realised gains / losses	6,383	1,001
Available for sale financial investments	6,383	1,001
Income from revaluation	156	144
Available for sale financial investments	156	144
Impairments	–2,761	–1,404
Available for sale financial investments	–2,761	–1,404
Income from financial investments	**6,276**	**–3,669**

11) INCOME TAXES

EUR thousand	2010	2009
Current income taxes	–8,557	–6,885
Deferred income taxes	–7,285	–4,328
Income taxes for the current fiscal year	–15,841	–11,212
Income taxes from previous periods	–7,925	–3,031
Income taxes	**–23,766**	**–14,243**

The reconciliation below shows the relationship between the imputed and reported tax expenditure.

EUR thousand	2010	2009
Annual result before taxes	1,997	47,464
Computed tax expenses 25 %	499	11,866
Tax relief resulting from		
tax-exempt investment income	–2,083	–198
investment allowances	–41	–467
other tax-exempt earnings	–597	0
non-tax deductible impairment of goodwill	3,713	2,075
different foreign tax rates	–2,230	–8,317
changes in tax rates	423	0
adjustment of deferred taxes	8,750	0
non-inclusion of deferred taxes	2,057	9,837
other differences	5,351	–3,584
Reported income taxes	**15,841**	**11,212**
Effective tax rate	**793.41 %**	**23.62 %**

2010, the informative value of the effective tax rate is restricted due to high allowances and non-inclusion of deferred tax assets as well as permanent differences from non-tax deductible allocations to risk provisions included in other differences.

Deferred taxes totalling EUR 3,710 thousand (2009: EUR 2,533 thousand) were taken directly to equity. In 2010, tax loss carry-forwards and deferred tax assets to the amount of EUR 35,000 thousand (2009: none) were impaired. Furthermore, for the current year no deferred taxes were recognised for taxable loss carryforwards and for deferred tax assets to the amount of EUR 8,229 thousand (2009: 39,348) as, in the opinion of the management, the realisation of these tax loss carryforwards and deferred tax assets does not appear to be probable over an adequate period of time (up to 5 years). Therefore no deferred taxes were recognised for tax loss carryforwards to the amount of EUR 71,578 thousand (2009: EUR 39,348 thousand). Of these taxable loss carryforwards EUR 70,664 thousand (2009: EUR 39,317 thousand) are without limitation.

NOTES TO THE CONSOLIDATED BALANCE SHEET

12) LIQUID FUNDS

EUR thousand	31 Dec 2010	31 Dec 2009
Cash in hand	102,830	107,743
Balances with central banks	1,736,108	2,109,050
Liquid funds	**1,838,939**	**2,216,793**

13) LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Loans and advances to credit institutions are all measured at amortised cost.

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
on demand	291,941	416,068
up to 3 months	764,276	705,061
up to 1 year	6,469	61
up to 5 years	36,615	55,111
more than 5 years	124,244	91,627
Loans and advances to credit institutions	**1,223,545**	**1,267,927**

14) LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers are all measured at amortised cost.

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
on demand	965,530	588,110
up to 3 months	540,914	631,536
up to 1 year	1,135,157	1,218,993
up to 5 years	2,466,292	1,867,745
more than 5 years	4,853,495	5,216,346
Loans and advances to customers	**9,961,388**	**9,522,729**

15) RISK PROVISIONS

EUR thousand	Individual impairment customers	Portfolio based allowance	Total
As at 1 Jan 2009	**133,960**	**27,262**	**161,222**
Currency translation	532	–469	63
Reclassification	5,878	–3,212	2,666
Unwinding	–5,105	0	–5,105
Utilisation	–23,301	0	–23,301
Release	–41,509	–20,657	–62,166
Addition	217,400	18,991	236,391
As at 31 Dec 2009	**287,855**	**21,915**	**309,769**
Currency translation	20,421	276	20,697
Reclassification	3,276	–3,444	–168
Unwinding	–9,583	0	–9,583
Utilisation	–23,457	0	–23,457
Release	–75,592	–9,209	–84,801
Addition	312,042	10,878	322,920
As at 31 Dec 2010	**514,961**	**20,416**	**535,377**

The addition includes an amount of EUR 13,661 thousand (2009: EUR 17,800 thousand), which is caused by allocation due to interest past-due. Loans and advances to customers include non-interest-bearing receivables amounting to EUR 303,129 thousand (2009: EUR 148,819 thousand). The reclassification item reflects the regrouping within risk provisions and to other balance sheet positions.

16) TRADING ASSETS

EUR thousand	31 Dec 2010	31 Dec 2009
Debt securities	5,919	5,988
Equity and other variable-yield securities	977	994
Positive fair value from derivatives	299	34
exchange rate related transactions	299	34
Trading assets	**7,195**	**7,016**

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
up to 3 months	51	680
up to 1 year	498	554
up to 5 years	3,349	1,411
more than 5 years	2,022	3,343
Debt securities	**5,919**	**5,988**

17) FINANCIAL INVESTMENTS

EUR thousand	31 Dec 2010	31 Dec 2009
Financial investments at fair value through profit or loss	12,190	11,459
Debt securities	12,190	2,254
Equity and other variable-yield securities	0	9,206
Financial investments available for sale	625,603	483,548
Debt securities	624,873	483,149
Equity and other variable-yield securities	730	399
Financial investments loans & receivables	124,044	101,436
Financial investments held to maturity	111,415	162,948
Financial investments	**873,253**	**759,392**

Financial investments held to maturity also include deferred interest of EUR 4,248 thousand (2009: EUR 3,897 thousand).

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
up to 3 months	78,637	133,300
up to 1 year	309,991	216,320
up to 5 years	310,501	256,555
more than 5 years	173,395	143,611
Debt securities	**872,523**	**749,787**

Financial investments measured at fair value through profit or loss

Financial investments have been designated at fair value through profit or loss as the Group manages these investments on a fair value basis in accordance with its investment strategy. Internal reporting and performance measurement for these investments are conducted on a fair value basis.

18) INVESTMENT PROPERTY

EUR thousand	Investment properties
Cost as at 1 Jan 2009	1,046
Additions, including transfers	20,637
Cost as at 31 Dec 2009	21,683
Currency translation	–354
Additions, including transfers	578
Disposals, including transfers	–140
Cost as at 31 Dec 2010	**21,767**

EUR thousand	Investment properties
2009	
Cost as at 31 Dec 2009	21,683
Cumulative impairments and revaluation	–262
Carrying amount as at 31 Dec 2009	**21,421**
Impairments in fiscal year	–177
Carrying amount as at 1 Jan 2009	961
2010	
Cost as at 31 Dec 2010	21,767
Cumulative impairments and revaluation	–1,360
Carrying amount as at 31 Dec 2010	**20,407**
Impairments in fiscal year	–1,106

In 2010, carrying amount of investment property assets to the amount of EUR 140 thousand (2009: none) was disposed of.

Investment properties contain 2 completed properties (2009: 2 properties). There are no other obligations to purchase, construct, develop or maintain investment property assets.

19) PARTICIPATIONS

EUR thousand	31 Dec 2010	31 Dec 2009
Investments in unconsolidated affiliates	1,292	1,285
Participating interests	4,807	5,026
Investments in other companies	8,417	7,518
Participations	**14,517**	**13,830**

In 2010, participations with a carrying amount of EUR 119 thousand were disposed of (2009: EUR 1,153 thousand). The proceeds from these divestments amounted to EUR 5 thousand (2009: EUR 49 thousand) and are reported in income from financial investments.

All investments and participations are measured at acquisition costs, as their fair value cannot be determined without an ureasonable amount of effort. None of the Group’s participations are listed on a stock exchange. The Group is not planning to sell significant participations.

20) INTANGIBLE ASSETS

EUR thousand	Software	Goodwill	Other	Total
Cost as at 1 Jan 2009	**56,623**	**118,576**	**3,531**	**178,729**
Currency translation	–451	–2,050	10	–2,491
Additions, including transfers	9,327	0	155	9,482
Disposals, including transfers	–1,404	0	–9	–1,412
Cost as at 31 Dec 2009	**64,095**	**116,525**	**3,688**	**184,308**
Currency translation	–96	2,080	–53	1,931
Additions, including transfers	11,103	0	54	11,157
Disposals, including transfers	–304	0	–48	–352
Cost as at 31 Dec 2010	**74,798**	**118,606**	**3,641**	**197,045**

EUR thousand	Software	Goodwill	Other	Total
2009				
Cost as at 31 Dec 2009	64,095	116,525	3,688	184,308
Cumulative write-downs and reversals	–39,326	–19,734	–2,730	–61,790
Carrying amount as at 31 Dec 2009	**24,769**	**96,791**	**958**	**122,518**
of which unlimited useful live	0	96,791	0	96,791
of which limited useful live	24,769	0	958	25,727
Amortisation in fiscal year	–7,171	0	–539	–7,710
Impairments in fiscal year	–24	–8,299	0	–8,323
Carrying amount as at 1 Jan 2009	22,987	107,141	1,339	131,467
2010				
Cost as at 31 Dec 2010	74,798	118,606	3,641	197,045
Cumulative write-downs and reversals	–46,796	–34,585	–3,123	–84,504
Carrying amount as at 31 Dec 2010	**28,002**	**84,021**	**518**	**112,541**
of which unlimited useful live	0	84,021	0	84,021
of which limited useful live	28,002	0	518	28,520
Amortisation in fiscal year	–7,645	0	–487	–8,132
Impairments in fiscal year	–109	–14,851	0	–14,960

In position software is no internally developed software included.

Impairment of goodwill in 2010 was made for VBI subsidiary in Ukraine. The other changes in the carrying amount of goodwill are due to currency translations.

COMPOSITION OF GOODWILL

EUR thousand Subsidiary	31 Dec 2010 Carrying amount	31 Dec 2009 Carrying amount
Volksbank, Slovakia	13,746	13,746
Volksbank, Czech Republic	14,574	14,330
Volksbank, Hungary	7,386	7,475
Volksbank, Slovenia	2,770	2,770
Volksbank, Croatia	7,016	7,054
Volksbank, Romania	6,974	6,975
Volksbank, Bosnia-Herzegovina	511	511
Volksbank, Banja Luka	20,799	20,799
Volksbank, Serbia	966	1,071
Volksbank, Ukraine	9,280	22,061
Total	**84,021**	**96,791**

21) TANGIBLE FIXED ASSETS

EUR thousand	Land and buildings	EDP equipment	Office furniture and equipment	Other	Total
Cost as at 1 Jan 2009	**116,091**	**52,040**	**60,264**	**21,590**	**249,985**
Currency translation	–1,818	–825	–842	–502	–3,987
Additions, including transfers	8,987	2,779	2,451	1,247	15,464
Disposals, including transfers	–6,249	–3,522	–5,292	–2,374	–17,437
Cost as at 31 Dec 2009	**117,012**	**50,471**	**56,581**	**19,961**	**244,025**
Currency translation	492	–211	–284	85	82
Additions, including transfers	4,156	2,947	2,506	930	10,539
Disposals, including transfers	–1,449	–5,813	–2,987	–2,018	–12,267
Cost as at 31 Dec 2010	**120,210**	**47,394**	**55,816**	**18,959**	**242,379**

EUR thousand	Land and buildings	EDP equipment	Office furniture and equipment	Other	Total
2009					
Cost as at 31 Dec 2009	117,012	50,471	56,581	19,961	244,025
Cumulative write-downs and reversals	–30,339	–38,965	–38,011	–9,596	–116,911
Carrying amount as at 31 Dec 2009	**86,673**	**11,506**	**18,569**	**10,366**	**127,114**
Depreciation in fiscal year	–5,229	–6,408	–5,081	–2,172	–18,890
Impairments in fiscal year	–164	–63	–51	–10	–288
Carrying amount as at 1 Jan 2009	90,932	16,249	24,180	11,337	142,698
2010					
Cost as at 31 Dec 2010	120,210	47,394	55,816	18,959	242,379
Cumulative write-downs and reversals	–38,095	–39,461	–40,501	–10,333	–128,390
Carrying amount as at 31 Dec 2010	**82,116**	**7,933**	**15,315**	**8,625**	**113,989**
Depreciation in fiscal year	–5,497	–5,545	–4,450	–2,003	–17,496
Impairments in fiscal year	–2,280	–84	–119	0	–2,482

22) TAX ASSETS

EUR thousand	31 Dec 2010	31 Dec 2009
Current tax assets	12,866	17,818
Deferred tax assets	5,765	16,740
Tax assets	**18,630**	**34,557**

The table below shows the differences resulting from the balance sheet figures reported in accordance with tax legislation and IFRS giving rise to deferred tax assets.

EUR thousand	31 Dec 2010	31 Dec 2009
Loans and advances to customers, including risk provisions	4,098	6,754
Trading assets	197	198
Financial investments	373	83
Assets for operating lease	0	3
Participations	367	357
Intangible and tangible fixed assets	190	252
Trading liabilities	48	135
Provisions for severance payments and other provisions	1,318	689
Other assets and liabilities	2,291	2,156
Tax loss carryforwards	30,673	23,448
Deferred taxes before netting	**39,557**	**34,077**
Offset against liabilities-side deferred taxes	–33,792	–17,337
Reported deferred tax assets	**5,765**	**16,740**

Deferred tax assets and deferred tax liabilities can only be offset to the extent that they relate to the same company.

For verification of the usability of tax loss carryforwards a period of 5 years was taken as a basis according to the Group's tax planning.

23) OTHER ASSETS

EUR thousand	31 Dec 2010	31 Dec 2009
Deferred items	13,210	9,983
Other receivables and assets	44,278	53,384
Positive fair value from derivatives – investment book	24,975	16,158
Other assets	**82,463**	**79,525**

In 2010 derivatives with a positive fair value amounting to EUR 10,485 thousand (2009: none) were used for cash flow hedges.

24) AMOUNTS OWED TO CREDIT INSTITUTIONS

EUR thousand	31 Dec 2010	31 Dec 2009
Central banks	6	33,004
Other credit institutions	7,216,403	7,441,189
Amounts owed to credit institutions	**7,216,409**	**7,474,193**

Amounts owed to credit institutions are all measured at amortised cost.

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
on demand	121,312	85,421
up to 3 months	413,538	603,042
up to 1 year	48,751	392,023
up to 5 years	3,488,547	3,297,489
more than 5 years	3,144,261	3,096,217
Amounts owed to credit institutions	**7,216,409**	**7,474,193**

25) AMOUNTS OWED TO CUSTOMERS

EUR thousand	31 Dec 2010	31 Dec 2009
Measured at fair value through profit or loss	21,934	20,419
Measured at amortised cost	4,846,166	4,693,018
Savings deposits	125,522	136,167
Other deposits	4,720,644	4,556,852
Amounts owed to customers	**4,868,100**	**4,713,437**

Amounts owed to customers have been designated at fair value through profit or loss as the Group manages these financial liabilities on a fair value basis in accordance with its investment strategy. Internal reporting and performance measurement for these liabilities are conducted on a fair value basis.

The carrying amount of the amounts owed to customers designated at fair value through profit or loss exceeded the redemption amount at maturity by EUR 84 thousand (2009: the carrying amount fall short the redemption amount with EUR 486 thousand). As the amount of fair value is geared to the performance of the underlying, there were no fair value changes in 2010 and 2009 that can be traced back to a change of the own credit risk.

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
on demand	2,333,395	2,084,182
up to 3 months	1,452,519	1,760,436
up to 1 year	813,782	690,976
up to 5 years	262,911	172,736
more than 5 years	5,493	5,107
Amounts owed to customers	**4,868,100**	**4,713,437**

26) DEBTS EVIDENCED BY CERTIFICATES

Debts evidenced by certificates are all measured at amortised cost.

EUR thousand	31 Dec 2010	31 Dec 2009
Mortgage and local authority bonds	233,244	233,308
Bonds	18,818	13,664
Debts evidenced by certificates	**252,061**	**246,972**

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
up to 3 months	229	162
up to 1 year	76,521	51,789
up to 5 years	123,008	149,478
more than 5 years	52,304	45,544
Debts evidenced by certificates	**252,061**	**246,972**

27) TRADING LIABILITIES

EUR thousand	31 Dec 2010	31 Dec 2009
Negative fair value from derivatives		
Exchange rate related transactions	241	32
Trading liabilities	**241**	**32**

28) PROVISIONS

EUR thousand	Provisions for risks	Other provisions	Total
As at 1 Jan 2009	**2,902**	**1,420**	**4,322**
Currency translation	–91	3	–87
Utilisation	–19	–179	–197
Release	–1,256	–614	–1,869
Addition	2,106	620	2,726
As at 31 Dec 2009	**3,643**	**1,251**	**4,894**
Currency translation	139	18	157
Utilisation	–118	–644	–762
Release	–1,301	–322	–1,623
Addition	1,565	3,644	5,210
As at 31 Dec 2010	**3,928**	**3,948**	**7,875**

Other provisions consist of provisions recognised for obligations that are likely to lead to an outflow of resources in the future. These provisions are recognised among other things, for pending legal proceedings.

29) LONG-TERM EMPLOYEE PROVISIONS

EUR thousand	Provisions for severance payments	Provisions for anniversary bonuses	Total
Long-term employee provisions as at 1 Jan 2009	**2,819**	**488**	**3,307**
Current service costs	290	81	370
Interest costs	164	33	197
Payments	–255	–55	–310
Actuarial gains or losses	196	166	362
Net present value as at 31 Dec 2009	**3,214**	**712**	**3,927**
Unrecognised actuarial gains or losses	–196	0	–196
Long-term employee provisions as at 31 Dec 2009	**3,018**	**712**	**3,730**
Current service costs	450	126	576
Interest costs	192	44	237
Payments	–212	–6	–218
Actuarial gains or losses	693	–408	286
Net present value as at 31 Dec 2010	**4,142**	**468**	**4,610**
Unrecognised actuarial gains or losses	–414	0	–414
Long-term employee provisions as at 31 Dec 2010	**3,727**	**468**	**4,196**

HISTORICAL INFORMATION

EUR thousand	2010	2009	2008	2007	2006
Net present value	4,610	3,927	3,051	2,805	2,492

30) TAX LIABILITIES

EUR thousand	31 Dec 2010	31 Dec 2009
Current tax liabilities	2,315	1,248
Deferred tax liabilities	5,906	8,750
Tax liabilities	**8,221**	**9,998**

The table below shows the differences resulting from the balance sheet figures reported in accordance with tax legislation and IFRS giving rise to deferred tax liabilities.

EUR thousand	31 Dec 2010	31 Dec 2009
Loans and advances to customers, including risk provisions	33,647	21,749
Financial investments	211	489
Assets for operating lease and investment properties	11	0
Participations	327	344
Intangible and tangible fixed assets	2,511	2,988
Amounts owed to customers	0	167
Debts evidenced by certificates	79	0
Provisions for severance payments and other provisions	211	160
Other assets and liabilities	2,701	190
Deferred taxes before netting	**39,698**	**26,086**
Offset against asset-side deferred taxes	–33,792	–17,337
Reported deferred tax liabilities	**5,906**	**8,750**

31) OTHER LIABILITIES

EUR thousand	31 Dec 2010	31 Dec 2009
Deferred items	8,861	6,194
Other liabilities	68,124	66,154
Negative fair value from derivatives – investment book	24,227	24,352
Other liabilities	**101,212**	**96,701**

In 2010 derivatives with a negative fair value amounting to EUR 5,593 thousand (2009: EUR 2,247 thousand) were used for cash flow hedges and derivatives with a negative fair value amounting to EUR 43 thousand (2009: EUR 94 thousand) were used for fair value hedges.

32) SUBORDINATED LIABILITIES

The subordinated liabilities are all measured at amortised cost.

EUR thousand	31 Dec 2010	31 Dec 2009
Subordinated liabilities	157,873	157,218
Supplementary capital	3	8
Subordinated liabilities	**157,876**	**157,226**

BREAKDOWN BY RESIDUAL TERM

EUR thousand	31 Dec 2010	31 Dec 2009
up to 3 months	65	58
up to 1 year	25,231	10,097
up to 5 years	83,493	97,683
more than 5 years	49,086	49,388
Subordinated liabilities	**157,876**	**157,226**

33) CASH FLOWS ON THE LIABILITY SIDE

The table below presents the future cash flows on the liability side classified according to their maturity.

EUR thousand	Amounts owed to credit institutions	Amounts owed to customers	Debts evidenced by certificates	Subordinated liabilities	Derivatives investment book/ trading book
31 Dec 2010					
Carrying amount	7,216,409	4,868,100	252,061	157,876	24,468
Undiscounted cash flows	**7,791,756**	**4,914,796**	**278,095**	**215,026**	**22,588**
up to 3 months	547,528	3,799,358	335	2,281	11,233
up to 1 year	145,608	829,066	84,002	33,567	1,042
up to 5 years	3,839,743	279,604	126,621	128,156	3,366
more than 5 years	3,258,878	6,768	67,136	51,023	6,947
31 Dec 2009					
Carrying amount	7,474,193	4,713,437	246,972	157,226	24,384
Undiscounted cash flows	**8,198,145**	**4,769,277**	**281,213**	**170,581**	**84,111**
up to 3 months	737,508	3,857,386	214	267	75,971
up to 1 year	478,188	709,745	59,466	11,532	3,445
up to 5 years	3,710,555	196,076	165,679	107,053	–11,306
more than 5 years	3,271,895	6,070	55,855	51,730	16,002

Cash flows for contingent liabilities are displayed in chapter 40) Contingent liabilities and credit risks.

34) EQUITY

As at 31 December 2010, the subscribed capital of VBI amounted to EUR 64,385 thousand. It consists of individual no-par value shares as follows.

		EUR thousand
466,729	bearer shares	46,673
177,121	non-voting preferred bearer shares	17,712
		64,385

In return for waiving their voting rights, holders of preferred bearer shares receive a surplus dividend of 1 % on the proportionate calculated par value of shares.

DIVIDEND PAYMENT

EUR thousand	2010	2009
Dividend voting capital	0	47,140
Dividend non-voting capital	0	18,066
Total	**0**	**65,206**

The VBI Group is a member of the VBAG Group of credit institutions as defined in the Austrian Banking Act. The own funds of the VBI Group calculated in accordance with the Austrian Banking Act can be broken down as follows.

EUR thousand	31 Dec 2010	31 Dec 2009
Core capital (tier I capital) before deductions	984,179	987,887
Deductions from core capital (50 % deduction pursuant to section 23 (13) Austrian Banking Act)	–510	0
Core capital (tier I capital) after deductions	**983,669**	**987,887**
Supplementary capital (tier II capital) before deductions	94,833	125,288
Deductions from supplementary capital (50 % deduction pursuant to section 23 (13) Austrian Banking Act)	–510	0
Supplementary capital (tier II capital) after deductions	94,323	125,288
Deductions from own funds pursuant to section 103e no. 13 Austrian Banking Act)	–3,068	0
Eligible qualifying capital	**1,074,924**	**1,113,175**

35) FINANCIAL ASSETS AND LIABILITIES

The table below shows financial assets and liabilities in accordance with their individual categories and their fair values.

EUR thousand	Note	Held for trading	At fair value through profit or loss	Held to maturity	Available for sale	Amortised cost	Carrying amount – Total	Fair value
31 Dec 2010								
Liquid funds	12	0	0	0	0	1,838,939	1,838,939	1,838,939
Loans and advances to credit institutions	13	0	0	0	0	1,223,545	1,223,545	1,223,544
Loans and advances to customers	14	0	0	0	0	9,961,388	9,961,388	9,282,797
Trading assets	16	7,195	0	0	0	0	7,195	7,195
Financial investments	17	0	12,190	111,415	625,603	124,044	873,253	873,298
Participations	19	0	0	0	14,517	0	14,517	14,517
Derivatives – investment book	23	24,975	0	0	0	0	24,975	24,975
Financial assets – Total		**32,170**	**12,190**	**111,415**	**640,120**	**13,147,916**	**13,943,812**	**13,265,264**
Amounts owed to credit institutions	24	0	0	0	0	7,216,409	7,216,409	7,212,046
Amounts owed to customers	25	0	21,934	0	0	4,846,166	4,868,100	4,866,474
Debts evidenced by certificates	26	0	0	0	0	252,061	252,061	254,536
Trading liabilities	27	241	0	0	0	0	241	241
Derivatives – investment book	31	24,227	0	0	0	0	24,227	24,227
Subordinated liabilities	32	0	0	0	0	157,876	157,876	156,985
Financial liabilities – Total		**24,468**	**21,934**	**0**	**0**	**12,472,512**	**12,518,914**	**12,514,508**

EUR thousand	Note	Held for trading	At fair value through profit or loss	Held to maturity	Available for sale	Amortised cost	Carrying amount – Total	Fair value
31 Dec 2009								
Liquid funds	12	0	0	0	0	2,216,793	2,216,793	2,216,793
Loans and advances to credit institutions	13	0	0	0	0	1,267,927	1,267,927	1,267,925
Loans and advances to customers	14	0	0	0	0	9,522,729	9,522,729	9,117,345
Trading assets	16	7,016	0	0	0	0	7,016	7,016
Financial investments	17	0	11,459	162,948	483,548	101,436	759,392	759,457
Participations	19	0	0	0	13,830	0	13,830	13,830
Derivatives – investment book	23	16,158	0	0	0	0	16,158	16,158
Financial assets – Total		**23,174**	**11,459**	**162,948**	**497,378**	**13,108,886**	**13,803,845**	**13,398,525**
Amounts owed to credit institutions	24	0	0	0	0	7,474,193	7,474,193	7,466,801
Amounts owed to customers	25	0	20,419	0	0	4,693,018	4,713,437	4,711,162
Debts evidenced by certificates	26	0	0	0	0	246,972	246,972	248,172
Trading liabilities	27	32	0	0	0	0	32	32
Derivatives – investment book	31	24,352	0	0	0	0	24,352	24,352
Subordinated liabilities	32	0	0	0	0	157,226	157,226	155,934
Financial liabilities – Total		**24,384**	**20,419**	**0**	**0**	**12,571,410**	**12,616,213**	**12,606,453**

Some financial investments are assigned to categories in which they are not carried at fair value through profit or loss. However such financial investments are underlying instruments for fair value hedges of interest rate risk, meaning that these instruments are measured at fair value with respect to the hedged interest rate risk. Loans and advances to customers with a carrying amount of EUR 2,555 thousand (2009: EUR 2,305 thousand) measured at amortised cost are underlyings to fair value hedges.

The table below shows all assets and liabilities which are measured at fair value classified according to their fair value hierarchy.

EUR thousand	Level 1	Level 2	Total
31 Dec 2010			
Trading assets	4,032	3,163	7,195
Financial investments	274,948	362,845	637,793
at fair value through profit or loss	0	12,190	12,190
available for sale	274,948	350,655	625,603
Derivatives – investment book	0	24,975	24,975
Total	**278,979**	**390,984**	**669,964**
Amounts owed to customers	0	21,934	21,934
Trading liabilities	0	241	241
Derivatives – investment book	0	24,227	24,227
Total	**0**	**46,402**	**46,402**
31 Dec 2009			
Trading assets	4,603	2,413	7,016
Financial investments	370,621	124,387	495,007
at fair value through profit or loss	10,172	1,287	11,459
available for sale	360,449	123,099	483,548
Derivatives – investment book	0	16,158	16,158
Total	**375,224**	**142,958**	**518,181**
Amounts owed to customers	0	20,419	20,419
Trading liabilities	0	32	32
Derivatives – investment book	0	24,352	24,352
Total	**0**	**44,803**	**44,803**

In 2010 and 2009, there have not been any reclassifications between the levels.

VBI only uses market data which are from observable markets. If the system delivers prices for inactive traded positions, these prices are checked with prices based on secondary available market data, like creditspreads or transactions which are done on active markets in similar products. If necessary, the prices of the system are adopted.

36) CASH FLOW HEDGES

In cash flow hedge accounting, interest rate swaps are used with a view to hedging the interest rate risk of mortgage bonds and amounts owed to credit institutions carrying variable interest rates.

PERIODS IN WHICH CASH FLOWS CAN BE EXPECTED TO OCCUR

EUR thousand	Interest rate related transactions
31 Dec 2010	
up to 3 months	2,609
up to 1 year	8,352
up to 5 year	46,262
more than 5 years	13,967
Total	**71,190**
31 Dec 2009	
up to 3 months	–155
up to 1 year	–317
up to 5 year	–1,464
Total	**–1,936**

PERIODS IN WHICH CASH FLOWS ARE EXPECTED TO AFFECT THE CONSOLIDATED INCOME STATEMENT

EUR thousand	Interest rate related transactions
31 Dec 2010	
up to 3 months	3,117
up to 1 year	9,073
up to 5 year	47,165
more than 5 years	11,610
Total	**70,965**
31 Dec 2009	
up to 3 months	–104
up to 1 year	–470
up to 5 year	–1,252
Total	**–1,826**

Changes in value in the hedging reserve in the amount of EUR –6,608 thousand (2009: EUR –646 thousand) were recognised in income during the reporting period. No significant inefficiencies have been realised in cash flow hedge.

37) DERIVATIVES

DERIVATIVE FINANCIAL INSTRUMENTS

EUR thousand	Nominal value up to 1 year	1 to 5 years	more than 5 years	Total	Fair value 31 Dec 2010	31 Dec 2009
Interest related transactions	**4,593**	**690,952**	**690,692**	**1,386,236**	**4,850**	**–2,859**
Caps&Floors	0	6,068	1,845	7,913	76	33
Interest rate swaps	4,593	682,399	688,847	1,375,839	4,723	–2,891
Swaptions	0	2,485	0	2,485	51	0
Currency related transactions	**1,548,503**	**43,530**	**41,585**	**1,633,618**	**–4,414**	**–5,768**
Cross currency swaps	13,151	10,029	40,606	63,786	4,474	–5,744
Foreign exchange options	59,711	27,123	979	87,813	1	2
FX-Swaps	1,393,018	1,948	0	1,394,967	–9,408	–288
Forward exchange transactions	82,622	4,430	0	87,052	519	262
Others transactions	**400**	**2,238**	**399**	**3,037**	**371**	**434**
Options	400	2,238	399	3,037	371	434
Total	**1,553,496**	**736,720**	**732,676**	**3,022,891**	**806**	**–8,193**

All derivative financial instruments are OTC products.

38) HEDGE OF A NET INVESTMENT IN A FOREIGN OPERATION

In the business years 2010 and 2009 there was no hedge of a net investment in a foreign operation.

39) ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES

On the balance sheet date, assets denominated in foreign currencies (non-MUM currencies) totalled EUR 5,901,978 thousand (2009: EUR 6,374,680 thousand), whereas liabilities denominated in foreign currencies stood at EUR 6,313,731 thousand (2009: EUR 6,505,223 thousand). Differences between the amounts of foreign currency assets and liabilities are covered by derivative transactions.

40) CONTINGENT LIABILITIES AND CREDIT RISKS

EUR thousand	31 Dec 2010	31 Dec 2009
Contingent liabilities		
Acceptances and endorsements	8,021	15,301
Liabilities arising from guarantees	333,713	345,432
Liabilities arising from assets pledged as collateral	52,891	83,141
Others (amount guaranteed)	2,135	0
Commitments		
Unutilised loan commitments	848,278	949,092

The table below presents future cash flows of contingent liabilities classified according to their contracted maturity, concerning guarantees also according to their expected maturity.

EUR thousand	Loan commitments	Guarantees as contracted	Guarantees expected
31 Dec 2010			
Carrying amount	848,278	333,713	
Undiscounted cash flows	**848,278**	**333,713**	**1,021**
up to 3 months	743,923	333,713	189
up to 1 year	40,619	0	423
up to 5 years	37,161	0	193
over 5 years	26,575	0	215
31 Dec 2009			
Carrying amount	949,092	345,432	
Undiscounted cash flows	**949,092**	**345,432**	**17,796**
up to 3 months	627,253	345,432	3,226
up to 1 year	106,459	0	9,246
up to 5 years	70,660	0	5,109
over 5 years	144,721	0	217

Loan commitments are reported according to the end of their contracted maturity. Contracted guarantees are reported when the utilisation is first possible, while column guarantees expected shows management estimates of the expected utilisation over the period.

If the management estimates a cash out flow for financial guarantees, a provision was built for off-balance risks to the amount of the probable cash out flow under consideration of possible available collaterals. Therefore the provision amounts to EUR 570 thousand (2009: EUR 817 thousand).

41) RELATED PARTY DISCLOSURES

EUR thousand	Companies in which the Group has a participating interest	Companies which have a controlling influence on the parent company	Companies which, through their holdings, exercise a significant influence on the parent company
31 Dec 2010			
Loans and advances to credit institutions	0	245,184	0
Loans and advances to customers	2,404	0	0
Debt securities	0	16,122	0
Amounts owed to credit institutions	0	3,327,424	1,541,321
Amounts owed to customers	22,566	0	0
Subordinated liabilities	0	79,160	0
31 Dec 2009			
Loans and advances to credit institutions	0	352,146	0
Loans and advances to customers	6,562	0	0
Debt securities	0	6,419	0
Equities and other variable-yield securities	0	8,671	0
Amounts owed to credit institutions	0	3,679,961	1,585,218
Amounts owed to customers	65,511	0	0
Subordinated liabilities	0	77,708	0

Settlement prices between the VBI Group and its associated companies are consistent with standard market practices.

The shareholder Österreichische Volksbanken-AG (VBAG) exercises a controlling influence and Banque Federale des Banques Populaires exercises a significant influence on VBI Group.

VBI Group has concluded service level agreements with VBAG for the following areas:

- Legal affairs
- Compliance officer
- Organisation and IT
- Human resources
- Group asset liability management and liquidity management
- Group credit risk management
- Research
- International Markets
- Payment transactions
- Group controlling, Group regulatory reporting and Group accounting
- Investment management

For the business year, expenses for these service level agreements amounted to EUR 2,618 thousand (2009: EUR 3,100 thousand).

At the VBI Group, the board members of the parent company are classified as management members in key positions. No contracts were closed with members in key positions.

42) DISCLOSURES ON MORTGAGE BANKING IN ACCORDANCE WITH THE AUSTRIAN MORTGAGE BANK ACT

EUR thousand	Covering loans	Debts evidenced by certificates	Surplus cover
31 Dec 2010			
Mortgage bonds	535,282	233,244	302,367
31 Dec 2009			
Mortgage bonds	683,386	233,308	450,577

The required coverage for debts evidenced by certificates includes surplus cover of 2 % calculated on the basis of the face value of all outstanding mortgage bonds.

43) BRANCHES

	31 Dec 2010	31 Dec 2009
Foreign	547	582
Total number of branches	**547**	**582**

44) EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

As set out in VBAG's "Strategy 2015", VBAG will focus on its defined core business in future. This encompasses its role as the central institution of the Volksbank sector, corporate customer business and real estate business. The core regions for these activities are Austria and the neighbouring countries. Options are currently being examined for activities and participations outside the core business. In this context, a process has been initiated that evaluates the possibility of disposing of Volksbank International AG and VB-Leasing International Holding GmbH. Exploratory steps are to take place over the coming months – supported by the mandated consultants – and may lead to the sale of these two participations. The data rooms were opened at the start of February for this purpose.

With effect of 17 February 2011 Mr. Ralf Weingartner left his appointment as managing board member of VBI.

No events with a significant impact on the Group's financial statements as at 31 December 2010 occurred between the balance sheet date and the approval of the Group's financial statements by the managing board. The managing board released the Group's financial statements and handed it on to the supervisory board on 2 May 2011. The supervisory board has the function of verifying and declaring if it approves the Group's financial statements.

45) SEGMENT REPORTING

Segment reporting serves to provide an overview of the nature and financial effects of our business activities in which we engage and the economic environment in which we operate. The Group's internal management is based on the different geographical areas in which the Group operates. The location of respective companies' head offices of the individual subsidiaries is used as a basis for segmentation. The segment Austria shows all activities of VBI headquarters. The column consolidation reports all intragroup transactions and amounts posted on Group level which cannot be allocated to separat regions.

The figures of every segment is reported at least quarterly to the managing board and the management level. The results represented are the results of the individual legal entities. The intragroup settlement prices for investments, refinancing or services rendered correspond to standard market conditions.

The segment reporting is based on the same accounting and measurement principles as the consolidated financial statements. The segments are managed according to the income statement items given in segment reporting as well as the carrying amounts given. As management is carried out on the basis of factors including net interest income, interest income and interest expenses are not given separately.

In addition to the amounts of intragroup transactions the following items are shown in the column consolidation. Net interest income includes in 2010 the consolidation of dividends of fully consolidated companies amounting to EUR 30,321 thousand. The allocation for additional portfolio allowances for the group is shown in risk provisions in 2009. Whereas in 2010, the release of portfolio allowances on group level is reported there. General administrative expenses include the amount of the actuarial gains and losses of long-term employee provisions recognised in income in the amount of EUR –279 thousand (2009: EUR 510 thousand).

A) SEGMENT REPORTING BY GEOGRAPHICAL MARKETS

EUR thousand	Slovakia	Czech Republic	Hungary	Slovenia	Croatia	Bosnia-Herzegovina	Romania	Serbia	Ukraine	Austria	Consolidation	Total
Net interest income												
2010	36,228	48,434	51,932	19,452	37,655	25,336	141,552	36,661	19,975	30,886	–31,555	**416,557**
2009	33,537	42,977	48,515	15,720	35,907	22,532	155,404	36,157	19,274	–1,673	–353	**407,996**
Risk provisions												
2010	–10,936	–12,538	–14,812	–6,021	–17,642	–7,039	–153,434	–12,790	–7,975	1,153	4,000	**–238,034**
2009	–10,440	–13,602	–24,436	–4,326	–11,216	–4,830	–69,816	–12,166	–19,749	0	–4,000	**–174,580**
Net fee and commission income												
2010	10,309	14,559	18,811	1,999	7,140	6,341	12,819	5,697	2,775	7,550	–6,568	**81,432**
2009	9,317	13,182	20,693	2,006	6,835	6,117	14,017	5,221	2,737	6,396	–6,309	**80,212**
Net trading income												
2010	204	89	1,958	–30	1,726	367	19,426	518	327	–1,108	2	**23,477**
2009	–92	59	696	136	2,476	346	1,175	622	–445	–19	1	**4,957**
General administrative expenses												
2010	–36,290	–34,858	–43,863	–12,393	–22,207	–19,751	–53,878	–18,600	–8,318	–15,429	7,550	**–258,036**
2009	–37,446	–32,933	–42,649	–11,971	–22,346	–20,061	–47,612	–18,574	–7,885	–14,868	6,797	**–249,549**
Other operating result												
2010	244	–1,915	–16,117	–7	42	–192	–1,983	–373	–15,035	5,693	–30	**–29,675**
2009	–1,019	–12	–8,581	60	–27	–6,548	–196	–336	–1,662	48	369	**–17,903**
of which impairment of goodwills												
2010	0	0	0	0	0	0	0	0	–14,851	0	0	**–14,851**
2009	0	0	0	0	0	–6,697	0	0	–1,602	0	0	**–8,299**
Income from financial investments												
2010	3,070	–184	2,281	971	320	339	–519	–2	0	0	0	**6,276**
2009	53	900	–3,147	115	–373	151	–1,187	–4	–176	0	0	**–3,669**
Annual result before taxes												
2010	**2,829**	**13,586**	**190**	**3,971**	**7,034**	**5,399**	**–36,017**	**11,111**	**–8,251**	**28,744**	**–26,600**	**1,997**
2009	**–6,088**	**10,571**	**–8,909**	**1,739**	**11,256**	**–2,292**	**51,784**	**10,921**	**–7,907**	**–10,115**	**–3,495**	**47,464**
Income taxes												
2010	–1,182	–2,939	–2,123	–717	–2,138	–602	4,602	–1,241	–2,311	–14,185	–930	**–23,766**
2009	–1,055	–3,440	–1,478	–342	–2,359	–413	–8,349	–988	1,144	2,163	872	**–14,243**
Annual result after taxes												
2010	**1,648**	**10,647**	**–1,932**	**3,254**	**4,896**	**4,797**	**–31,415**	**9,869**	**–10,562**	**14,559**	**–27,531**	**–21,770**
2009	**–7,143**	**7,131**	**–10,387**	**1,396**	**8,897**	**–2,705**	**43,436**	**9,933**	**–6,762**	**–7,952**	**–2,623**	**33,221**
Total assets												
2010	1,329,847	1,968,298	1,827,888	939,135	1,067,140	638,624	4,817,204	794,020	273,265	5,340,044	–5,263,974	**13,731,491**
2009	1,411,776	1,797,873	1,750,233	907,676	1,068,323	610,483	5,247,566	733,514	249,804	5,678,484	–5,592,678	**13,863,053**
Loans and advances to customers												
2010	1,051,452	1,606,144	1,360,473	827,657	748,905	454,156	3,193,618	500,546	196,022	22,539	–125	**9,961,388**
2009	1,019,349	1,472,192	1,320,731	762,400	736,309	443,354	3,106,689	436,651	198,807	26,248	0	**9,522,729**
Amounts owed to customers												
2010	1,013,668	1,273,284	804,172	273,367	497,544	279,049	580,054	105,185	40,982	795	0	**4,868,100**
2009	1,001,157	1,029,118	816,257	300,724	492,885	264,840	689,843	83,066	34,709	838	0	**4,713,437**
Debts evidenced by certificates												
2010	118,770	114,474	18,818	0	0	0	0	0	0	0	0	**252,061**
2009	122,771	110,537	13,664	0	0	0	0	0	0	0	0	**246,972**
Subordinated liabilities												
2010	0	10,075	14,445	28,362	9,538	7,500	131,707	40,286	14,923	0	–98,961	**157,876**
2009	0	10,097	14,423	28,358	9,592	7,500	130,755	40,588	13,683	0	–97,770	**157,226**

46) RISK REPORT

General

Assuming and professionally managing the risks connected with business activities is a core function of every bank. VBI AG performs the key tasks of implementing and supporting processes and methods for identifying, managing, measuring and monitoring all risks related to banking operations at VBI Group level. As VBI is part of VBAG Group it is also integrated in the risk measurement systems of VBAG.

To this end, the following various risks are addressed in the context of the risk strategy specified annually by the managing board on the basis of risk policy principles in force across the Group:

- Credit risk (counterparty risk)
- Market risk (interest rate risk, foreign exchange risk, option risk, commodity risk, risks relating to assets and credit spread risk)
- Operational risk
- Liquidity risk
- Other risks

Current developments

The sustaining economic and financial crisis moulded the tasks of risk management of VBI in the elapsed year. Apart from optimising risk reporting by shortening the frequency of data providing to have a more accurate real time view, VBI focuses its attention of the soft and hard collection processes within the entire Group.

In a first step the current prevailing situation in every VBI affiliate has been evaluated by taking the advantage of external advisory support. Together with local debt collection experts from VBI banks a gap analysis was conducted and a milestone plan created to cover concerning issues in order to achieve a suitable debt collection approach for each single VBI bank along their market environment. During 2011 all VBI banks should have efficient collection infrastructure in place. The implementation is also accompanied by a centralised monitoring in order to bench mark the efficiency of the procedures with operative network.

In 2010, efforts were taken to connect VB UA to the central data pool. During the preliminary stages a strong focus was given enhancing the data quality, only after several delivery tests showing a low deficiency ratio green light was given for accessibility to the data warehouse.

a) Risk management structure and basic principles of risk policy

Risk management structure

VBI put in place the necessary organisational infrastructure in order to meet the requirements of state of the art risk management. A clear distinction is made between the banking business and the evaluation, measurement and monitoring of risks. With a view to grant maximum security and to avoid conflicts of interest, these tasks have been assigned to different organisational units.

Basic principles of risk policy

A risk strategy is in place for the VBI Group, which follows the principles of the VBAG Group risk strategy. This VBI risk strategy lays down the basic principles how to deal with all kinds of risks, which VBI Group is exposed to. It also outlines the limits of the VBI Group's risk-appetite, and certain principles of credit procedures. Furthermore, this binding policy clearly defines the different responsibilities at the various levels of management, starting with the managing board of VBI AG and down to the risk responsible managing board member in the respective VBI bank.

Clear organisational structures: Particular attention is paid to the separation of risk-taking on the one hand and calculating risk and specifying risk standards on the other (risk controlling/risk management). Clear separation of functions within the VBI Group ensures that conflicts of interest are avoided.

Systems and methods: Uniform risk management methods assure comparability and risk aggregation in the VBI Group. In addition, these systems and methods represent a core element in VBI´s internal efforts to develop efficient limit structures and to calculate the degree of limit utilisation. Attention is also strongly focused on uniform risk management systems with a view to achieve cost efficiency and lean use of available resources. Contingency planning assures the required availability of all systems.

Limit system: In principle, all quantifiable risks are subject to a group-wide limit structure, which is constantly monitored. VBI Group adheres to the principle that no risk is assumed without setting a limit. VBI banks only take risks which can sufficiently be measured by accurate methods and tools.

Risk reporting: In the VBI Group, prompt, regular and comprehensive risk reporting is implemented in various forms, including a Group risk report. This is an important element for identifying, measuring, managing and monitoring risks within the Group. It is produced on a quarterly basis and covers all significant types of risk (market, interest rate, liquidity, credit spread, credit, real estate and operational risk). The group risk report periodically informs the managing board of the Group of the development of risk-bearing ability and the risk situation of the Group and focuses on a quantitative presentation of management-related information on the risk categories addressed, which is supplemented by brief assessments of the situation and further qualitative information where appropriate. During preparation of the report, particular emphasis is placed on data quality in order to ensure the findings are meaningful.

Processes: Functioning processes form the basis of risk management. Developing these processes and integrating them into day-to-day business procedures is thus a key risk management task in the VBI Group.

Backtesting: As parameter estimations relating to the variable probability of default (PD), loss given default (LGD), exposure at default (EAD) and credit conversion factor (CCF) are based on past values, they are always validated by way of backtesting. In the VBI Group, backtesting reports are prepared for credit and market risk in all cases. Although the frequency of reporting depends on the type of risk, the reports are produced at least once a year. The managing board is promptly informed of the findings. Any findings giving cause for concern (e.g. the number of outliers is too high from a statistical perspective) lead to an immediate analysis of the calculation methods or the models.

Stress testing: For credit risk a stress test was conducted in the middle of 2010 based upon amended parameters as of 2009 in order to see the implications on risk bearing capacity in case of a further downturn of prevailing market situation. Those scenarios are designed to simulate highly improbable but not completely out of the range events. The results of such stress tests are taken into account when devising the Group's risk strategy and capital management policies in order to maintain the going concern of individual business lines. Further development of stress testing on a regular basis is planned by observing deterioration of the economic environment of markets where VBI is operating. Our stress-scenarios focus on the implication from devaluation of local currencies and simultaneously on significant deteriorations in the real estate markets as the collateral position is group-wide dominated by real estate property.

b) Regulatory requirements

Regulatory requirements are split into three pillars within VBI in accordance with Basel II. Pillar 1, minimum capital requirements, regulates the calculation of the minimum capital requirements for credit risks, market risks and operational risks. Pillar 2, supervisory review, defines minimum requirements of banks' risk management systems as part of ICAAP (internal capital adequacy assessment process – see also Point c)). Pillar 3, disclosure, regulates disclosure for market participants.

Pillar 1 minimum capital requirements in the VBI Group

In accordance with managing board resolutions, the implementation of pillar 1 in the VBI Group not only fulfills the minimum requirements but, while taking cost efficiency into account, also provides for implementation of internal models in order to improve the risk management systems for all types of risk on an ongoing basis. Thus, at present, the following methods are used to calculate the minimum capital requirements for each type of risk:

- Market risk: internal VaR (value at risk) model since 1 January 2005
- Operational risk: standard approach (in exceptional cases and for a limited period the basic indicator approach) since 1 January 2008
- Credit risk: Comprehensive standardised approach

A project has been set up across the Group in consultation with the supervisory authorities which is intended to ensure that banks using the standard approach are gradually changed over to the IRB approach (IRB roll-out project).

Pillar 2 internal capital adequacy assessment process

The internal capital adequacy assessment process (ICAAP) requires banks to take all necessary measures to guarantee at all times that there are sufficient capital resources for current business activities and those planned for the future as well as the associated risks. Internal methods and procedures developed by the banks may be used for this purpose. The size and complexity of the business activities plays a key role in the design of the strategies, methods and systems required for implementing the ICAAP (proportionality principle). The implementation of the ICAAP at VBI is explained in more detail in chapter c) Risk strategy and internal capital adequacy assessment process.

Pillar 3 disclosure in the VBI Group

As VBI Group is part of the group of credit institutions of VBAG, VBI has not to fulfill the disclosure requirements on its own. The requirements of pillar 3 of VBAG are met through publication of the qualitative and quantitative disclosure requirements defined under the Austrian Financial Market Supervisory Authority (FMA) regulation on implementation of the Austrian Banking Act as it relates to the disclosure obligations of banks, on the Bank's website under Group/Investor Relations/Risk Management as well as in the annual report.

c) Risk strategy and internal capital adequacy assessment process

The group-wide risk strategy is reassessed and determined by the managing board on an annual basis – taking into account results from the internal capital adequacy assessment process (ICAAP) – and forms the basis for a uniform approach to dealing with risks throughout the entire Group. The risk strategy sets out and documents the general framework and principles for risk management to be applied consistently across the Group and the design of appropriate processes and organisational structures in a clear and comprehensible manner. Enhancements of the methods applied for measuring and managing risks are integrated into the risk strategy via the annual update process.

VBI has established the ICAAP as a revolving management circuit in accordance with international best practice. This starts with defining a risk strategy, then goes through the process of identifying, quantifying and aggregating risks, and finishes by

determining risk-bearing ability, allocating capital and establishing limits, leading to ongoing risk monitoring. The individual elements of the circuit are performed with varying regularity (daily for measurement of trading book market risk, quarterly for creation of the risk sustainability account and annually for risk assessment and risk strategy). All the activities described in the circuit are examined at least once a year to ensure that they are up to date and adequate and are adjusted to current underlying conditions if necessary.

In line with this principle and based on risk assessments conducted across the Group as a whole, the VBI Group regularly ascertains which risks are present in ongoing banking operations within the Group as well as their significance and the danger they potentially pose for the Group. This process involves both a quantitative assessment of individual types of risk and an assessment of the existing methods and systems for monitoring and managing risks (qualitative assessment). The risk assessment concept is based on a scoring procedure, thus providing a comprehensive overview of the risk situation in the VBI Group.

The results of the risk assessments are compiled in a risk map in which the individual types of risk are allocated to the subsidiaries according to their significance. The results of the risk assessments also flow into the risk strategy.

ICAAP implementation took place in 2008 by establishing a functional committee which deals with the entire risk profile, capital capacity monitoring and core issues of all risk aspects of VBI. This risk committee is chaired by VBI's CRO and is responsible for management and steering of all risk types across VBI Group.

The basis for the quantitative implementation of the ICAAP in the VBI Group is the risk sustainability account, which demonstrates that adequate risk-covering capital is in place at all times to provide sufficient cover for risks that have been entered into and which also ensures such cover is available for the future. For this purpose, firstly all relevant individual risks are aggregated into a total bank risk on both an economic and regulatory basis. The existing previously defined risk-covering capital is then compared with this total bank risk.

In the course of the risk monitoring process, the risk-bearing ability is calculated, compliance with the overall bank risk limit as decided by the managing board of VBI is monitored on a quarterly basis and the Group risk report is produced.

Within VBI, the predominant risk is credit risk and accordingly, the overall regulatory capital requirement is mainly driven by the charge for credit risk.

In 2010, economic risk measurement was promoted in addition to regulatory observations. It is the intention to implement value at risk methods for the economic risk measurement procedure. The term economic capital describes the minimum economic capital necessary from an economic perspective based on the result of a risk measurement. Combining risk measurement and the income statement make risk-adjusted income management possible. Standard performance measurement methods such as return on equity (ROE) are supplemented by the meaningful return on economic capital (ROEC) measurement, which takes adequate account of risks and facilitates comparison of segment performance, thus laying the foundation for value-oriented bank management. First ROEC test calculations were carried out considering all significant risks for the individual control portfolios (business segments and profit centers) in the 4th quarter 2010 in cooperation with the controlling unit.

d) Credit risk

Definition

Credit risk is defined as possible losses due to default or deterioration in creditworthiness on the part of our business partners.

It is the main task of the responsible risk management department to limit these risks appropriately taking into account the needs of the customer as far as possible. These risks are limited on a case by case basis and in terms of the portfolio as a whole. In all of our operating VBI bank subsidiaries consistent standards are applied for executing the credit decision process.

The measurement and management of credit risk is undertaken using a sophisticated range of methods and system's which both supports the decision making process in respect of individual loans and allows an appropriate analysis of the total lending portfolio.

Organisation and risk strategy

Strict separation of sales and risk management units is in place in all VBI Group units that generate credit risk. All case-by-case decisions are made under strict observance of the principle of dual control, which led to stipulation of clear processes for the collaboration between the risk management units in the subsidiaries and risk management at Group level. For large-volume transactions, processes have been created to ensure the involvement of VBI credit risk management and the group managing board in risk analyses and credit decisions. Limit systems that combine the decision-making competences of the individual corporate units in a single framework play a key role in this process.

Controlling the credit risk also necessitates the development of sophisticated models and systems and processes tailored to the bank's own portfolio. The aim is firstly to structure and improve credit decision making and secondly to use such instruments and their findings as a basis for portfolio management. When implementing these systems, the VBI Group paid particular attention to ensuring that all rating systems used with the Group show a comparable probability of default (PD) and are connected with the VB master scale, which comprises a total of 25 rating categories. The PD band used enables both comparison of internal ratings with the classifications of external rating agencies and, most importantly, comparison of credit ratings across countries and customer segments.

The process in the area of corporate lending initiated last year, which served to identify early risk features of borrowers, will be extended this year by a reporting element that is currently being designed within a project.

GROUP CREDIT RISK MANUAL

The group credit risk manual (GCRM) regulates credit risk management throughout the VBAG Group in a binding fashion. It encompasses the existing processes and methods for managing, measuring and monitoring credit risks within the Group.

Based upon the credit risk framework VBI created a credit risk manual which caters in a more detailed way for VBI Group needs. A strong focus was given in the document to watch list process, restructuring procedure and workout activities.

The aim of the GCRM is to stipulate and document the general framework and principles for measuring and managing credit risks to be applied consistently across the Group and the design of appropriate processes and organisational structures in a clear and comprehensible manner. The manual lays the foundation for implementing the risk strategy in operations as regards credit risk components, setting the basic risk targets and limits that are to guide business decisions in line with the main areas of business focus.

On level of operating units VBI banks have to implement their own CRM on basis of the standards stipulated in CRM of VBI.

The GCRM is a living document that is regularly expanded and adapted to current developments and changes within the VBAG Group.

LOAN PORTFOLIO

The use of credit risk instruments and consistency in the methods applied enabled the creation of a suitable basis for determinating expected losses. Particular importance is placed on recording data which covers longer periods of time.

Early recognition of risk is however one the most important credit risk methods and instruments and aims to avoid losses. Since the systems, by their very nature, primarily only support the persons involved in these procedures, training, qualification and experience of staff are extremely important. Thus the successful use of the systems does not simply depend on the quality of the methods.

At VBI clear lending authority limits have been developed in terms of decisions related to lending, and implemented in all VBI banks. Above a determined level VBI banks also send lending applications for loans to VBI headquarters in Vienna for approval, although the lending limits granted to the VBI banks were set at levels aiming to enable the VBI banks to locally decide upon the majority of transactions. As a result VBI in Vienna is primarily responsible for those tasks which are typically assumed by holding companies such as establishing agreements on targets and monitoring whether these are fulfilled. In terms of credit risk management this means that for both the so-called dynamic risk – implemented above all via the established rating structure – as well as for static risk – this in turn is monitored using appropriate standards for collaterals – principles and guidelines are specified and their implementation is regularly monitored. The procedures and reviews within the local banks are also monitored by VBI AG in order to ensure a safe and slim credit process.

Risk management and controlling

LIMITS

Limits exist within VBI Group aimed at monitoring, controlling and restricting the risk of individual exposures and risk clusters:

- Credit limits for individual customers
- Credit limits for groups of affiliated customers
- Portfolio limits

When limits are defined, with regard to individual customers and groups of affiliated customers a distinction is made between governments, banks and others, with the latter category subsuming both corporate and retail customers.

At present, when setting limits for portfolios, the VBI Group primarily uses country risk limits with the aim of limiting the transfer risk.

CONCENTRATION RISKS

Concentration risks are quantified and assessed quarterly on a group-wide basis during creation of the group risk report. This includes, for example, concentrations at individual counterparty, industries, ratings and sub-portfolio segments.

RATING SYSTEMS

Standardised models are applied across the Group to determine credit ratings (the VB rating family) and to determine the loss amount in the event of default. The expected likelihood of each customer defaulting is estimated across the VB rating family and expressed via the VB master scale. The concept behind the VB master scale allows for the comparison of borrower credit ratings across regions and customer groups.

The rating classes in rating category 5 cover the reasons for defaulting on a loan applied across the Group and are also used for reporting non-performing loans (NPL). An in-depth description of rating methods can be found in the disclosure in accordance with section 16 of the FMA Disclosure Regulation on the homepage of Österreichische Volksbanken-AG.

Risk reporting

Central, regular and comprehensive risk reporting in the form of quarterly and monthly risk reports has been implemented in the VBI Group. These risk reports constitute a vital element for identifying, measuring, controlling and monitoring risks within the VBI Group. Such risk reports focus on the credit risks, by far being the most important risk category for the VBI Group. These reports secure a permanent monitoring of the credit portfolio of all VBI banks. Thus unwanted developments or any other significant change can immediately be responded at group level.

The following analyses form part of the report:

- Foreign currency lending development
- NPL development
- Credit risk concentrations
- Rating distribution
- RWA ratios
- Portfolio loans at risk
- Overdue structure
- Segment distribution
- Granularity structure
- Maturity structure

These analyses are presented according to different sizes and ratios: unsecured exposure, total exposure, expected loss, existing and planned risk provisions and average risk costs.

The key ratios used to describe credit risks for the various business segments as at the balance sheet date are shown in the following tables and are excerpts taken from the Group risk report.

Presentation of loans and advances to credit institutions and customers according to credit quality and allocation to the individual risk categories.

EUR thousand	Loans and receivables to credit institutions and customers 31 Dec 2010	31 Dec 2009
Gross carrying amount	11,184,934	10,790,656
Risk provision	535,377	309,769
Carrying amount	**10,649,557**	**10,480,887**
Receivables impaired		
Risk category 1 (1A–1E)	52,856	46,820
Risk category 2 (2A–2E)	95,374	143,553
Risk category 3 (3A–3E)	1,566,557	1,743,337
Risk category 4 (4A–4E)	682,268	511,118
Risk category 5 (5A–5E)	1,411,025	752,671
Risk category 6 (NR)	1,840	3,330
Gross carrying amount	**3,809,921**	**3,200,827**
Risk provision	514,961	287,855
Net carrying amount	**3,294,960**	**2,912,972**
Receivables not impaired but past due 90 days		
Risk category 2 (2A–2E)	16	4,688
Risk category 3 (3A–3E)	16,999	10,081
Risk category 4 (4A–4E)	25,164	13,114
Risk category 5 (5A–5E)	190,444	66,513
Risk category 6 (NR)	213	50
Gross carrying amount	**232,835**	**94,447**
Receivables neither impaired nor past due		
Risk category 1 (1A–1E)	302,927	151,587
Risk category 2 (2A–2E)	550,731	1,002,980
Risk category 3 (3A–3E)	4,402,735	4,796,329
Risk category 4 (4A–4E)	1,514,660	1,125,215
Risk category 5 (5A–5E)	235,983	169,256
Risk category 6 (NR)	135,142	250,016
Gross carrying amount	**7,142,178**	**7,495,383**
Portfolio based allowance	20,416	21,915
Total net carrying amount	**10,649,557**	**10,480,887**

Classification to the individual risk categories is carried out according to internal rating categories at VBI. Receivables in risk category 1 have the highest rating (lowest expected default rate), while receivables in risk category 4 have the lowest rating and receivables in risk category 5 constitute group-internal receivables in default. The distribution of risk provisions is also clarified accordingly. Receivables in risk category 6[1)] are receivables for which there is no external rating and for which there is no regulatory requirement to produce an internal rating. The restructured loan portfolio amounted to EUR 777,617 thousand as at the balance sheet date (2009: EUR 404,091 thousand). If within 6 month after restructuring no trigger event occurs the loan is reclassified to a better risk category.

The following table shows gross and net carrying amounts of receivables according to their respective risk categories.

EUR thousand	Loans and receivables to credit institutions and customers 31 Dec 2010 Gross	Net	31 Dec 2009 Gross	Net
Risk category 1 (1A–1E)	355,783	355,767	198,406	198,379
Risk category 2 (2A–2E)	646,121	645,565	1,151,221	1,150,374
Risk category 3 (3A–3E)	5,986,290	6,119,733	6,549,746	6,395,949
Risk category 4 (4A–4E)	2,222,092	2,180,817	1,649,446	1,616,821
Risk category 5 (5A–5E)	1,837,452	1,211,212	988,440	866,985
Risk category 6 (NR)	137,195	136,463	253,396	252,379
Total	**11,184,934**	**10,649,556**	**10,790,656**	**10,480,887**

Individual impairments outside default category 5 take place only in a very small number of cases. If the rating of a defaulted customer improves, the customer is assigned to a better (=performing) rating category and the impairment is reduced accordingly. Individual impairment in risk category 5 generally does not cover the entire gross value of outstanding receivables, as collateral is taken into account but other provisions (portfolio provisions) are not, and this does not always need to result in complete impairment of the defaulted receivable in cases of restructuring (going concern consideration when recognising risk provisions).

1) This also concerns ratings that have not been prepared in a very small number of cases.

The following table shows the share represented by defaulted and non-defaulted receivables in total receivables.

EUR thousand	Loans and receivables to credit institutions and customers 31 Dec 2010	31 Dec 2009
Receivables total		
Exposure	11,184,934	10,790,656
Unsecured	4,741,727	4,199,634
Receivables in loss		
Unsecured	830,324	435,067
Risk provision	626,240	363,502
Receivables alive		
Unsecured	3,911,403	3,764,567
Expected Loss	66,514	42,216

Across the Group, default follows the definition given by the Austrian Solvency Regulation for banks which employ an approach based on internal ratings when calculating own funds. Defaulted receivables are compared with the amount of individual impairments recognised and performing receivables are compared with the loss expected for the following year. The expected loss is based on internal credit ratings, the economic collateral situation and the loss amount expected in the event of default derived from this. Defaulted receivables generally result in risk provisions which are less than the unsecured exposure, as in addition to provisions based on individual impairments, there are also lump sum impairments and portfolio provisions that are not included in the above table.

The following table shows the value of collateral assigned to the individual receivables.

EUR thousand	Loans and receivables to credit institutions and customers 31 Dec 2010	31 Dec 2009
Collaterals for individual impaired loans and receivables	**1,945,534**	**1,788,865**
Liquid funds	31,617	36,836
Securities	10,646	33,081
Mortgages	1,877,315	1,649,754
Guarantees	12,592	27,474
Movable goods	12,661	13,933
Others	702	27,788
Collaterals for loans and receivables not impaired but past due 90 days	**200,855**	**77,020**
Liquid funds	33,712	1,482
Mortgages	162,610	72,634
Guarantees	2,177	666
Movable goods	1,101	0
Others	1,256	2,238
Collaterals for loans and receivables which are neither impaired nor past due	**4,296,818**	**4,725,136**
Liquid funds	197,448	249,292
Securities	8,484	36,756
Mortgages	3,790,489	4,004,675
Guarantees	112,467	149,210
Movable goods	132,768	101,810
Others	55,163	183,393
Total value of collaterals	**6,443,207**	**6,591,022**

The key form of collateral in the lending business is mortgages. Movable property collateral mainly constitutes vehicles for private use.

The following table shows the exposure allocated to the regions where the customers are situated.

EUR thousand	Loans and receivables to credit institutions and customers 31 Dec 2010	31 Dec 2009
Austria	68,714	17,818
EEA incl. Switzerland	387,896	309,975
EU Central- and Eastern Europe	8,635,466	8,464,687
None EU Europe	2,070,855	1,806,615
USA and Canada	18,922	5,637
Others	3,081	185,924
Total	**11,184,934**	**10,790,656**

The distribution of the receivables portfolio across the main regions which are used within the Group for controlling purposes shows a focus on countries in the CEE region which are members of the EU.

The table below shows the exposure sub-divided by customer segment.

EUR thousand	Loans and receivables to credit institutions and customers 31 Dec 2010	31 Dec 2009
Public sector	195,790	217,492
Banks	1,223,545	1,267,927
Corporates	2,665,126	2,253,141
Retail SME	1,046,142	1,170,424
Retail Private	4,858,033	4,628,832
Special finance	1,196,298	1,252,840
Total	**11,184,934**	**10,790,656**

The break-down according to customer segment conforms to the customer groups as defined by the Austrian Banking Act.

Risk Mitigation

RATIONALE

The use of collateral and its management are seen as a core component of VBI group credit risk management. Accompanied to the borrower's financial standing collateral constitutes the decisive factor for identifying the credit risk of an exposure. The primary significance of collateral is the provision against future risk and to limit potential LLP in case of default or restructuring.

APPROPRIATE COLLATERAL SELECTION

VBI just considers prime collateral types which can be realised easily in the assessment of binding transactions accompanied by a liquid market environment and eligible legal enforceability. Weak physical collateral which does not fulfill all relevant requirements is partially also taken into consideration because of possible revenues from recovery and to improve debtor's loyalty.

For risk mitigation effects personal given collateral is also taken into consideration next to physical collateral. Additionally to the mentioned relevant requirements for physical collateral, the major attention for the eligibility of personal given collateral is set on the clients rating.

PRINCIPLES GOVERNING COLLATERAL MANAGEMENT

Based on the market covered by operational units of VBI Group, regulations have been elaborated in terms of collateral management, appraisal and realisation. For each member of VBI Group a catalogue per underlying collateral assets has been implemented and will be revised along with changes in local legislation and market circumstances.

Generally, valuation is based upon the following basic values:

Collateral	Basic value
Financial collateral	Market value/nominal value
Real estate	Market value
Other physical collateral	Market value
Accounts receivables	Nominal value
Life insurance	Surrender value
Guarantees	Nominal value
Credit derivatives	Nominal value

The initial valuation method used for loan collateral is appropriately documented together with the valuation results for ongoing examination.

THE MOST IMPORTANT TYPES OF COLLATERAL

Loan collateral should correspond with the type of loan to be secured. As such, capital investment loans should be secured by the assets to be financed, provided these are sound and the guarantor disposes of them for the term of the loan. During selection of loan collateral, the cost/benefit ratio is taken into consideration so that sound loan collateral that requires low levels of processing and costs as well as loan collateral that is actually realisable can be selected first. For this reason, tangible collateral, such as real estate collateral, and financial collateral, such as cash or securities collateral, are given priority.

Whether or not personal collateral is recognised depends largely on the quality of the guarantor and its close association with the borrower.

e) Market Risk

Definition

Market risk is the risk that the value of an asset item will change as a result of changes to the price of value-determinant market risk factors. VBI draws a distinction between the following market risk sub-groups:

- Interest rate risk
- Foreign currency risk
- Commodity risk
- Equity risk
- Option risk
- General credit spread risk
- Liquidity risk

GENERAL STATEMENT

From the operative side local treasury departments comply with the guidelines set by VBI Board to exclusively serve as support units for sales, refinancing and asset liability management activities. The support for sales means providing mainly hedging products for clients, partially also more complex products. In this sense VBI Group's Board decided as group risk strategy to exclude any kind of speculative trading activities. VBI AG's treasury coordination is the centralised treasury department within the VBI Group and assumes exclusively a coordinative function. Furthermore treasury coordination is consolidating the demands and needs of local treasury units and is also responsible for achieving the Group's treasury strategy.

REGULATORY ASPECTS

In terms of market risk arising from treasury activities, the whole group bank network of VBI is restricted to the also referred to as small trading book ("kleines Handelsbuch") according to and governed by section 22q of the Austrian Banking Act.

However, compliance with stipulated regulation is monitored on a daily basis. In terms of short term liquidity directly connected to Austrian Banking Act section 25a, minimum liquidity is monitored on a weekly basis.

OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT

Generally speaking market risk is in charge of assessing, evaluating and monitoring adverse market movements resulting mainly from interest, foreign exchange, equity and commodity fluctuations. Subject of controlling and steering are financial instruments revaluated on a daily basis allocated depending on their trading intention either to the trading or investment book.

Limit strategy and structure of the Group is adopted centrally through management board decision of VBI AG with respect on the one hand to the recommendation done by the risk committee and on the other hand taking into account the defined bank's risk profile in terms of capital assessment and budget. The whole limit regulation process guarantees that risks arising from market activities are an integral part of the limit system. The monitoring of limits is done for efficiency purposes as a cooperation of local and central structured processes.

Key elements for assessing limit utilisations on a Group level as well as locally are performed through value at risk and profit and loss calculation. The ongoing and well suited reporting process ensures a consistent flow of information within the Group and, moreover, enables where necessary through a predefined escalation process to induce rapid deployment of required measures. The process of monitoring potential losses and limit breaches that could result from unfavourable market developments is carried out on a daily basis. The value at risk calculations are carried out based on VBAG's internal model – approved by the Austrian authorities in 2004 – using the historical simulation method on the basis of the internationally recognised KvaR+ software. A confidence level of 99 % and a holding period of one day are used for the daily risk evaluation. Furthermore the provided infrastructure ensures a group-wide standardised method of position revaluation and methodology, which is also enforced by expertise of both VBAG and VBI AG risk departments. Additionally activities within the VBI banks are locally revised by their internal controlling or market risk departments as part of the multistage approach already mentioned above. VBI group market risk department is providing a global market risk manual which is adapted in accordance with market idiosyncrasies.

Organisation and risk strategy

Within VBI network, group market risk controlling is responsible for all matters related to market risk. Due to the already mentioned multistage approach and depending on the subject, tasks are performed by local, VBAG or VBI AG market risk departments. The market risk departments fulfill the following requirements:

- Calculation and monitoring of value at risk and profit and loss figures
- Providing analysis and reports on a daily basis and upon request
- Servicing and improving system infrastructure and methodology
- Implementation and support of internal and external reporting
- Coordination and preparation of risk committee
- Delivering support and expertise in all issues related to market risk

MARKET RISK IN THE SMALL TRADING BOOKS

Market risks in trading in the VBI Group are managed and monitored by independent market risk departments on a local as well as on a group level. Besides producing a risk and income presentation on a daily basis and specifying the limit structure based on the economic capital made available by the managing board, the department's main tasks include administration of front-office systems, collateral management, enhancement of risk measurement systems and monitoring the market risk and counterparty limits.

INTEREST RATE RISKS IN THE BANKING BOOK

Entering into interest rate risks is a completely normal part of banking business and is a key source of income. However, excessive interest rate risks represent a significant threat to the earnings and capital situation. Accordingly, an effective risk management system that monitors and limits the interest rate risk in line with the scope of business is vital for maintaining the bank's ability to bear risk.

Functional separation of the units that enter into interest rate risks and those that monitor such risks is in place.

The asset liability committee (ALCO) is the coordination body for managing the asset liabiltity management (ALM) processes and is convened bimonthly in line with the rules of procedure or at short notice if required.

ALM is responsible for ensuring the ALM organisation is adequate, chairs the meetings of the ALCO and devises the bases and analyses relevant for decision-making.

The VBI AG market risk management department is responsible for specifying risk measurement methods and enhancing them on an ongoing basis. Preparing evaluations and analyses, setting parameters and monitoring limits also fall within its remit. The reports it produces serve as a decision-making tool for the ALCO in performance of its management tasks.

The declared aim of interest rate risk management is to identify all material interest rate risks from assets, liabilities and off-balance positions in the investment book. This requires analysis of both the income effect and the present value effect of interest rate changes using simulation scenarios in the form of statistical and dynamic reports that also incorporate new business.

Risk management and controlling

MARKET RISK IN THE SMALL TRADING BOOKS

The key task in risk monitoring is estimating possible loss that could arise from unfavourable market developments on a daily basis. These value at risk calculations are performed using the internationally recognised software program KVaR+ using the method of historical simulation and essentially include the following calculation steps: following identification and definition of

the market risk factors to be included in the modelling process, historical changes are identified from the time series of the market risk factors. The historic simulation method is based on the assumption that future changes can be forecasted from these historically observed changes.

To identify the future (hypothetical) development of market risk factors required for the VaR calculation, in each case the historically observed changes are added as an alternative to the current development of a risk factor, thus producing a hypothetical distribution for the future development of individual market risk factors. In the next step, hypothetical portfolio values are defined for the scenarios generated in this way that are then used to calculate the profit and loss distribution by mapping the differences between the hypothetical future and currently observed portfolio value. The VaR is obtained by applying the relevant quantile to the empirically calculated profit and loss distribution. The time series length used at VBI corresponds with the minimum legal requirement of one year.

The amount of VaR is ascertained from the 1 % quantile of the hypothetical profit and loss distribution, thus meeting the legal requirement of assuming a one-sided forecast interval with a probability level of 99 % in the VaR calculation. VBI calculates the VaR for a holding period of one day, which is then multiplied by the root of ten for the purpose of extrapolating a ten-day VaR. The capital requirements of products that are not integrated into the internal VaR model are covered in the standard procedure.

BACKTESTING

The process of backtesting is intended to compare the realised and observed market value changes and the calculated changes out of historical method by means of KvaR on a daily basis. The outcoming is then used to assess the overall "predictive" quality of the internal model and when necessary adapted to comply with supervisory requirements.

The plausibility and reliability of the risk ratios is reviewed daily by way of backtesting. In this process, the potential risk amounts calculated by the model on a daily basis are compared ex post with the trading results, whereas the Austrian supervisory authorities favour the use of hypothetical trading results. An exception (outlier) is deemed to exist if a negative trading result exceeds the potential risk amount calculated by the model.

Backtesting at VBI is based on hypothetical trading results for which the portfolio can be assumed to remain constant. On the following day, the portfolio on which the VaR calculation is based is reassessed using the current prices/results of the calculation model.

If backtesting identifies cases where the VaR calculated on an ex ante basis is exceeded, a corresponding analysis of the causes is conducted and immediately forwarded to the Austrian Financial Market Supervisory Authority and the Austrian National Bank.

A hierarchical limit system approved by the managing board is a key element of market risk management. The desired higher degree of diversification in the portfolios and the trading strategy are key factors in the development of this limit structure.

In addition to VaR, a further series of risk ratios is calculated up to department level. These chiefly include interest rate sensitivities and option risk ratios (delta, gamma, vega, rho).

Volume limits for all currencies and product groups limit the liquidity risk. Management action triggers and stop loss limits are also in place. Besides the KVaR+ risk engine, the front office systems Kondor+ and Bloomberg TS are available for daily risk controlling. The external pricing software UnRisk is also used to support the valuation of structured products. Comprehensive position data management and daily market data checks ensure optimal data quality.

STRESS TESTING

As the effects of extreme situations on earnings cannot be covered by VaR, stress tests using around 80 historical and portfolio-specific worst case scenarios are performed monthly or as required. These crisis tests are mandatory under section 22p Austrian Banking Act for banks that use an internal model for calculating the regulatory capital requirements for market risk in the trading book.

The crisis tests are of both a quantitative and a qualitative nature. The quantitative criteria determine plausible crisis scenarios with which the banks could be confronted. Qualitative criteria ensure that two important objectives of the crisis tests are brought to the fore: assessing whether the bank's own funds can absorb potential major losses and identifying measures with which the bank can reduce its risk and retain its equity.

Quantitative standards, which VBI meets by conducting crisis tests, concern the plausibility of the selected scenarios. Plausible scenarios to which the bank may be exposed in the course of critical market events are determined. For selecting scenarios, VBI has chosen to apply four methods which are in turn divided into two categories, namely non-portfolio-specific and portfolio-specific methods:

Non-portfolio-specific methods:

- Historical crises
- Standardised scenarios
- Historical simulation

Portfolio-specific methods:

- Scenario building by expert committees

HISTORICAL CRISES

Here, crises that have occurred in the past, as for example 11 September 2001, are implemented as scenarios and applied to the current portfolio, with the largest one-day return implemented as a crisis over the observed time interval.

STANDARDISED SCENARIOS

When implementing these scenarios, VBI mostly uses the scenario suggestions of the Austrian National Bank in Volume 5 of the guide series on conducting crisis tests. The following standard scenarios are among those implemented:

- Parallel shifts in interest rate curves
- Tilts in interest rate curves
- Changes in exchange rates
- Significant changes in share indexes
- Changes in volatilities

The scope of the changes made is also based on the suggestions of the Austrian National Bank guide series.

HISTORICAL SIMULATION

With this method, the portfolio is valued using the VaR approach of historical simulation. The simulated changes in value are sorted in ascending order and the largest loss incurred is used as the stress test result. To investigate extremely negative scenarios, the largest losses incurred are added at sub-portfolio level independently of the days on which they occurred, thus deliberately negating portfolio effects.

SCENARIO BUILDING BY EXPERT COMMITTEES (WORST CASE SCENARIOS)

These scenarios stress all relevant risk types and attempt to find the most unfavourable possible impact for the VBI treasury portfolio. At VBI, such scenarios are sought subjectively and empirically. VBI has established an expert committee comprising representatives from trading and market risk management that constructs and discusses various scenarios that would have a decisive influence which, although generally unlikely, are still possible.

Extreme developments on the market are discussed and analysed in detail in the expert committee of VBI with a view to identifying any potential need to adjust the expert scenarios.

VALUATIONS

In accordance with section 198 Austrian Solvency Regulation, banks must value each position allocated to the trading book pursuant to section 22n Austrian Banking Act at market prices at least once a day. The positions must be valued based on close-out prices obtained from independent sources. If a direct valuation at market prices is not possible, in accordance with section 199 Austrian Solvency Regulation banks are permitted to perform a valuation using model prices.

VBI has mapped all trading positions, within regulatory framework of section 22q Austrian Banking Act, in a Kondor+ front office and risk management system that is directly linked to various price information systems. This means that the market prices for different products are updated in real time. Products that are not referenced to any direct price are valued with valuation models using market data (market risk factors) in this standard software.

The systems described above ensure a daily, independent valuation of trading book positions.

Well-organised, efficient processes and procedures are an important component of risk management. The process for launching new treasury products, which falls under the remit of the group market risk management department, also plays an important role in this context.

All the rules and organisational processes connected with measuring and monitoring market risks are compiled in the VBI market risk manual. The manual also stipulates the limit structure and escalation procedures in the event of limits being exceeded.

INTEREST RATE RISKS IN THE INVESTMENT BOOK

The risk measurement system records all the main forms of interest rate risk, such as basis and option risks. All Group positions sensitive to interest rate movements are included. Risk reporting takes place on a monthly or an ad hoc basis whenever necessary. The objective of risk management is to keep the bank's interest rate risks within specific parameters defined by the bank itself.

Positions with no specific lock-in period, which are primarily core deposit products such as savings deposits, current account deposits and loans with no fixed maturity are incorporated in the risk measurement using fictions. The assumptions were made based on statistical analyses or experience values or using expert opinions. The assumptions made were documented, are adhered to at all times and regularly reviewed with regard to their validity. Any deviations are also documented and displayed, provided that they are justified by facts. No assumptions are made with regard to early repayment of loans. To approximate the basis risk within the gap process report, products (interest rate swaps, bonds, loans) whose lock-in period is not equal to the interest rate adjustment and is greater than or equal to one year are placed in maturity bands by replicating fixed-interest portfolios. This relates to those positions for which interest rates are fixed in line with secondary market rates of return (SMR) or a constant maturity swap (CMS).

Risk reports

Regarding reporting activities, market risk department provides and monitors the following:

- For internal disposition
  - On a daily basis
    - Measuring value at risk for treasury activities, thereby delivering corresponding reports to subsidiaries
    - Evaluating and controlling a set of relevant sensitivities
    - Monitoring of utilisation of counterparty limits
  - On a monthly or quarterly basis
    - Different risk report comprising trading and investment book on an aggregate level
    - Limit utilisation development of different risk and asset classes
- For external disposition
  - Quarterly report to Austrian supervisory institution (FMA)
  - Ad hoc for supervisory authorities

A building block of reporting is the gap report, which also forms the basis for interest rate risk statistics in line with the gap analysis method. To determine the gaps, products sensitive to interest rate movements are allocated to the appropriate maturity band according to their remaining maturity or the points at which interest rates are to be fixed. Initial risk ratios are obtained from calculating the net positions and weighting them using the associated weighting factors. A further risk ratio is obtained by then correlating the present value risk calculated in this way with the own funds.

As an additional step, a gap report is produced that approximates the basis risk, e.g. of positions that are linked to secondary market rates of return, by replicating fixed-interest portfolios.

Additional present value reports are produced to obtain further ratios. Besides parallel shifts, tilts in interest rate curves are used. These scenarios and stress tests are regularly examined as to their validity and may be added to or replaced.

Currently, the following scenarios are implemented:

- Parallel shift by +1 bp, +10 bp, +25 bp and +50 bp
- Parallel shift by –1 bp, –10 bp, –25 bp and –50 bp

Stress testing refers to the development of scenarios for extreme market conditions. Interest rate shocks that can lead to extraordinary losses for the bank are a fixed component of stress tests in risk management.

Currently, the following stress tests are performed:

- Parallel shift by +100 bp and +200 bp
- Parallel shift by –100 bp and –200 bp
- Tilt/money market +100 bp, capital market –100 bp
- Risk stress tests are conducted half-yearly as part of the ICAAP. The scenarios used (mild and severe recession) are determined and examined in advance.

Apart from the maximum limit defined by the Supervisory Authority of 20 % of eligible qualifying capital with a standardised interest rate curve shift of 200 bp based on interest rate risk statistics, limits are defined and monitored for the purpose of limiting internal risk across the Group.

ECONOMIC AND CAPITAL REGULATION REQUIREMENTS

As a standard VBI AG and VBAG risk management provides open currency position, interest rate stress testing and liquidity reports for the local risk management on a weekly or monthly basis. In terms of open currency position in percentage of own funds VBI Group showed the following open foreign currency exposure.

EUR thousand	2010		2009	
Currency	FX risk	In % of allowable own funds	FX risk	In % of allowable own funds
USD	–41,427	3.89 %	–17,135	1.60 %
CHF	5,506	0.52 %	4,549	0.43 %
RSD	5,261	0.49 %	16,640	1.55 %
HRK	–3,146	0.30 %	–7,385	0.69 %
HUF	805	0.08 %	–2,248	0.21 %
CZK	–507	0.05 %	10,878	1.02 %

It seems to be worth mentioning that the depicted relatively high percentage of foreign currency exposure in USD is exclusively stemming from VB Ukraine, where local national bank backed by regulation in force prohibits financial institutions to hold an amount of USD stock exceeding 20 % of own funds, thus being symptomatically short USD with an already reached level of 20 % and putting the banks in a position not to be able to close their open USD currency position. New regulations are expected to come into force in order to alleviate this distortion.

Also part of regulatory reporting in terms of interest rate risk is the 200 bp shift used for purposes of stress testing. Due to an internal defensive approach to interest risk the board decided to limit overall interest risk to 15 % of own funds in contrast to

the regulatory proposition of 20 %. However, local banks are in accordance with their own ALM Committee decisions and strategies invited for instance for liquidity increasing activities to act within prescribed limits set by VBI AG.

The figures are representing the interest rate risk per currency in terms of own funds.

EUR thousand	2010		2009	
Currency	Interest rate risk	In % of allowable own funds	Interest rate risk	In % of allowable own funds
CHF	32,958	3.09 %	318	0.03 %
RON	12,329	1.16 %	3,285	0.31 %
HUF	5,151	0.48 %	4,578	0.43 %
RSD	4,363	0.41 %	2,183	0.20 %
USD	4,128	0.39 %	5,173	0.48 %
EUR	3,252	0.30 %	6,640	0.62 %
CZK	2,119	0.20 %	6,876	0.64 %
UAH	1,485	0.14 %	551	0.05 %
BAM	1,467	0.14 %	975	0.09 %
Other	431	0.04 %	950	0.09 %

As a result of VBI Group's interest rate risk strategy and supported by the chart depicted above, the overall interest rate risk is thought to range at a low level.

f) Operational risk

Definition

The Basel Committee defines operational risk as "the risk of losses incurred owing to the inappropriateness or failure of internal procedures (processes), individuals, systems or external events." The definition applied at VBI Group extends the concept of operational risk further than that defined in the Austrian Banking Act by including legal risk and reputation risks due to business disruptions.

Organisation and risk strategy

The management of operational risk in the VBI Group contains the elements of risk identification, risk measurement/evaluation, reporting and monitoring, risk control and mitigation at the overall portfolio and single transaction levels. Both quantitative and qualitative methods are applied within the operational risk management process.

The responsibility for managing operational risk is with the line management supported by the local and group operational risk management functions. Furthermore VBI AG managing board actively addresses operational risks in the VBI Group. The objective of this active management approach is to minimise the loss potential of prevailing operational risks.

Risk management and controlling

The standard approach to the management of operational risks within the meaning of Basel II was employed and took effect in VBI Group. This approach is based on gross earnings in each business segment. Up to and including 2010, the standard approach was applied on group-wide level with two exceptions: The operational risk basic indicator approach was applied at Volksbank Banja Luka and Volksbank Ukraine for a defined transition period. Starting with January 2011 the whole VBI Group is calculating the minimum capital requirements for operational risks based on the standard approach.

The standard OpRisk platform BART is rolled-out throughout the whole VBI Group. It contains modules for event data capturing, risk & control self assessments, measures/actions tracking, key risk indicators and reporting. This enables a holistic management of operational risks throughout the Group.

Operational risk reporting is established in all VBI banks addressing business responsibles/risk owners, managing board and supervisory board. Based on this transparency numerous measures and actions were defined on individual bank level as well as on group level to optimise processes and reduce operational risks. Major activities in 2010 were focusing on the definition of anti-fraud management standards and further improvement of fraud mitigation measures/controls and tools. In this respect the VBI Group fraud policy defines the processes and responsibilities for managing fraud risks. Furthermore activities to increase awareness among employees for fraud, operational and security risks were executed throughout the Group. Further projects to improve the identification and prevention of fraud are started.

VBI group-wide internal control system standards were defined and rolled-out. The existing internal control system is documented, reviewed and continuously enhanced.

Furthermore the business continuity and disaster recovery set-up and plans were improved and tested.

Group-wide security standards were updated and a risk function for major IT projects was established.

Based on identified operational risks and events, one main focus was the exchange of know-how within the Group (best practice/lessons-learnt approach). This is ensured via a defined continuous information flow and workshops within the Group. Based on these identified risks, additional standard risk assessment scenarios were defined and executed.

Furthermore the reporting and the early warning system (key risk indicators) were further improved to ensure an adequate monitoring of dedicated operational risks.

g) Liquidity risk

Definition

Liquidity risk is defined as the risk of not being able to meet payment obligations on their due date or not being able to raise the liquidity required at the conditions expected as and when necessary. Liquidity risk is controlled and quantified by means of monitoring gaps from the allocation of cash flows of all asset and liability items to defined maturity bands, by key rate and other target-oriented indicators.

Organisation and strategy

LIQUIDITY RISK MANAGEMENT

Due to economical and regulatory requirements, liquidity risk management has been broken down into two main categories: operational (short time horizon up to one year) and structural (medium to long term horizon) liquidity management.

The more day-by-day focused operational liquidity steering and monitoring is managed by VBAG treasury coordination in close co-operation with local risk and treasury departments. In terms of structural liquidity, risk management on a local and group level within VBI AG newly developed liquidity risk framework provides needed figures, analyses etc., allowing thus ALM committee to make overall and strategic decisions. Moreover the mentioned liquidity framework is providing group-wide reliable cash flow modelling, key rate indicators, stress tests and limit structure. The methods used for the approach are derived and adjusted in accordance with released papers and publication made by BIS and CEBS within so called Basel III framework.

The long term refinancing is fulfilled by means of capital, deposits, refinancing facilities provided by the shareholders (BPCE, DZ Bank, WGZ Bank and VBAG) and supranational entities.

h) Other risks

In terms of other risks, the VBI Group is confronted with strategic risk, reputational risk, equity risk and business risk. Although other risks are not of key significance to the VBI Group, they are intrinsic to its operations.

As measurement of all sub-groups of other risk is not possible, mainly organisational measures are implemented for the management of those risk categories.

A capital buffer is therefore defined in order to protect against other risks and the risk arising from market value changes of investment valuations.

47) GOVERNING BODIES

SUPERVISORY BOARD:

Chairman
Wolfgang PERDICH

First Deputy Chairman
Hans HOFINGER

Second Deputy Chairman
Frank WESTHOFF

Members
Thomas BOCK
Alain DAVID (until 27 May 2010)
Bruno DELETRE (from 27 May 2010)
Martin FUCHSBAUER (from 9 September 2010)
Josiane LANCELLE
Fausto MARITAN
Michael MENDEL
Dieter TSCHACH (until 22 June 2010)
Klaus WELLNER

MANAGING BOARD:

Chairman of the Board
Friedhelm BOSCHERT

Members
Christophe DESCOS (from 1 December 2010)
Armin HUBER (from 1 September 2010)
Michel IVANOVSKY (until 30 November 2010)
Udo SZEKULICS (until 4 May 2010)
Ralf WEINGARTNER (until 17 February 2011)

INDEPENDENT AUDITOR'S REPORT

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying **consolidated financial statements** of

Volksbank International AG,
Vienna, Austria,

for the **year from 1 January 2010 to 31 December 2010**. These consolidated financial statements comprise the consolidated balance sheet as of 31 December 2010, the consolidated income statement, the consolidated cash flow statement and the consolidated statement of changes in equity for the year ended 31 December 2010 and a summary of significant accounting policies and other explanatory notes. Our liability as auditors toward the Company and third parties is guided under Section 275 UGB (Austrian Commercial Code).

Management's Responsibility for the Consolidated Financial Statements and for the Accounting System

The Company's management is responsible for the group accounting system and for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility and Description of Type and Scope of the Statutory Audit

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with laws and regulations applicable in Austria and Austrian Standards on Auditing. Those standards require that we comply with professional guidelines and that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

Our audit did not give rise to any objections. In our opinion, which is based on the results of our audit, the consolidated financial statements comply with legal requirements and give a true and fair view of the financial position of the Group as of 31 December 2010 and of its financial performance and its cash flows for the year from 1 January to 31 December 2010 in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

REPORT ON THE MANAGEMENT REPORT FOR THE GROUP

Pursuant to statutory provisions, the management report for the Group is to be audited as to whether it is consistent with the consolidated financial statements and as to whether the other disclosures are not misleading with respect to the Company's position. The auditor's report also has to contain a statement as to whether the management report for the Group is consistent with the consolidated financial statements.

In our opinion, the management report for the Group is consistent with the consolidated financial statements.

Vienna, 2 May 2011

KPMG Austria GmbH
Wirtschaftsprüfungs- und Steuerberatungsgesellschaft

signed by:

Bernhard Mechtler — Wirtschaftsprüfer
Thomas Smrekar — Wirtschaftsprüfer
(Austrian Chartered Accountants)

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