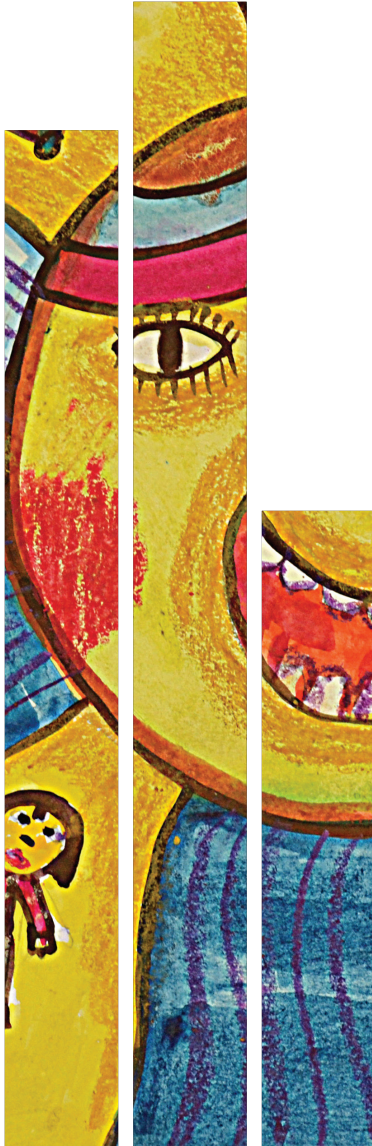


Planet People Profit



# ANNUAL REPORT 2010





ANNUAL  
REPORT  
2010





## Vision, mission and credo

### ■ OUR VISION

XacBank will become a leading financial institution in the country, by providing inclusive and value adding financial services to the citizens and expatriates, institutions and enterprises of Mongolia, while maintaining its leadership in the Global Microfinance Industry.

### ■ OUR MISSION

To contribute to the socio-economic development of the country while creating a fair value for its shareholders. This will be achieved by providing inclusive, value adding, and reliable financial services to all people and entities of Mongolia through establishing a leading financial institution that is equally concerned about Planet, People, and Profit.

The Bank will embrace premium customer service, dedicated and talented employees, corporate social responsibility, efficient usage of ICT and innovation, and effective partnerships at all levels.

### ■ OUR CREDO

- We believe our first responsibility is to our clients – rural and urban residents of Mongolia - micro and small business people, herders and employed people without conventional access to financial services.
- In meeting their needs everything we do must be of high quality.
- We must constantly strive to reduce our costs in order to maintain reasonable prices.
- Client's orders must be serviced promptly and accurately in a friendly fashion.
- Our business partners must have an opportunity to make a fair return.
- We are responsible to our employees, men and women, who work with us throughout Mongolia.
- Everyone must be considered as an individual. We must respect their dignity and recognize their merit.
- They must have a sense of security in their jobs.
- Compensation must be fair and adequate to performance, and working conditions clean, orderly and safe.
- We must be mindful of ways to help our employees fulfill their family and social responsibilities.
- Employees must feel free to make suggestions and complains. There must be equal opportunity for employment, development and advancement adequate to qualification and performance.
- We must provide competent management, and their actions must be just and ethical.
- We are responsible to the communities, in which we live and work.
- We must be good citizens – abide by the laws, support good works and charities, and bear our fair share of taxes.
- We must encourage civic improvements and better health and education.
- We must maintain in good order the property we are privileged to use, protecting the environment and natural resources as our own.
- Our final responsibility is to our shareholders. Business must make a sound profit.
- We must experiment with new ideas. Research must be carried out, innovative programs developed and mistakes paid for. Reserves must be created to provide for adverse times.
- When we operate according to these principles, our clients will benefit from our services, our employees will have a high morale, and shareholders should realize a fair return, which all in the end should lead to development of Mongolia ■

# Board Of Directors Report

Dear Shareholders, Clients, Partners and Co-workers,

It gives me a great honour to present on behalf of the Board of Directors the annual results for the year ended on December 31st, 2010.

The year 2010 was quite challenging with still lingering effects of the global financial crisis of 2008/09, which was also deeply felt on the Mongolian economy, yet with outstanding results for XacBank. However, the organization has further expanded and sustained its institutional growth, reaching a new level of the record results.

Our people, the co-workers of the Bank, were central in accomplishing this success, including through the close efforts executed both management teams and the Boards of Directors, and with the tacit and direct support from our Shareholders. Thus, I am pleased to highlight the key performance areas, as follows:

## ■ EFFECTIVE CAPITAL MANAGEMENT

The Bank is pursuing a triple-bottom-line vision of a full pledged financial services corporation in the country providing equitable access to inclusive financial services to the customers. Our financial results are evidence that, in this pursuit, we are at the competitive edge and winning in the marketplace.

XacBank's audited total assets hit MNT468.6 billion, exceeding the projected organic growth for 2010, which is attributable to a strong growth in public deposits and shows a growing public confidence in the Bank. Moreover, the Portfolio-at-Risk (PAR) over 1 day was equal to 2.2 percent of Gross Loan Portfolio. The Bank's Return on Equity (RoE) was 20.6 percent while our Net Profit before Tax totaled MNT8.4 billion, thanks to the strong growth in assets, improvement in productivity and treasury management. The Bank's parent company – TenGer Financial Group (TenGer or TFG)'s Book Value per Share reached MNT4,270.37, or up by 18.8 percent on annual basis.

## ■ ENHANCED CORPORATE GOVERNANCE

The Board's governance system has long balanced support for the executive team in the development of the Bank's business strategy with the need to ensure effective monitoring of its implementation. In this context, both the full Board and its committees have tackled the significant events of the year and their impact on the Bank's business and reputation.

There were some major efforts undertaken by the Board of Directors in further enhancing our evolving Shareholders' structure and the Boards' composition, and in particular, redefining the role of the Board of Directors and its powers and responsibilities are being strengthened for enhancing the TenGer and the Bank's good corporate governance practices.

The Bank and its parent company - TenGer is in the process of implementing the Regulations for Nominating, Appointment and Release of Independent Directors, approved by the joint decision of the Central Bank, the Financial Regulatory Commission, Ministry of Finance, based on the new Revised Law on Banking.

The Corporate Governance Assessment was commissioned by the Board of Directors and was carried out by an independent team of experts from the International Finance Corporation (IFC) to determine the present level of corporate governance in TFG and XacBank, identify areas for improvement, and to recommend the necessary changes to corporate governance procedures and policies. This evaluation and related implementation of the Corporate Governance Improvement Plan covers the five areas: (i) Commitment to Corporate Governance Principles; (ii) The Board Structure and Functioning; (iii) Control Environment and Processes; (iv) Transparency and Disclosure; and (v) The Shareholders' Rights and Equal Treatment of Minority Shareholders.

On other hand, Mr. Ch. Ganhuuyag, the Banks' Board Director and CEO of TFG was appointed in December as Vice Minister of Finance by the Government of Mongolia. Accordingly, Mr. Bold Magvan, CEO of XacBank was appointed by the Board of Directors as the new CEO of TFG, and who in turn was succeeded by Mr. Bat-Ochir Dugersuren, then CFO and Chief Investment Officer of the holding company, as a new CEO for the Bank.

## ■ EFFICIENT RISK MANAGEMENT AND OVERSIGHT

The Board of Directors have met in four plenary sessions during 2010 to decide upon the key policy and strategic matters of TenGer and the Bank. The five Board Committees provided the absolutely necessary technical and highly professional inputs between the Board meetings. In addition they provided a regular oversight and monitoring of the management's work performance.

A statutorily required decision was made by the Board of Directors of TenGer to engage one of the four globally leading auditing firms – PricewaterhouseCoopers (PwC), to conduct an external audit on the 2010 financial statements of TenGer, its affiliates and subsidiaries, including XacBank.

## ■ BRIGHT OUTLOOK AND OPPORTUNITIES FOR 2011

The year 2011 is going to be bright in terms of the Mongolian economy, which is promising a record high growth of more than 9 percent over its first quarter, and because of the related unique opportunities evolving around the ever-growing mining boom and their supply-chain businesses. Thus, it is of even more strategic importance for TenGer, its subsidiaries and affiliates, and especially for XacBank. I would like to express our hope and confidence in the full support from our Shareholders in their capital increase for sustaining both our high growth and for good preparation and execution of the Initial Public Offering (IPO) at the international capital markets. On other hand, it will require from the executive management even more effective and efficient use of the Group resources and building our staff capacity, and further streamlining of TenGer and the Bank's internal systems, structures and processes with an even more customer-oriented focus.





#### ■ CONTINUED COMMITMENT TO THE PLANET, PEOPLE AND PROFIT

XacBank achieved considerable progresses in the last year, thanks to the efforts of our over 1,170 co-workers throughout the country. But we have more work ahead. Our goal is to be a more client-driven organization that is more accessible, innovative, and able to strike quickly at the many unique growth opportunities for the Bank and its parent company – TenGer, including its other key business subsidiaries, namely XacLeasing and Tenger Insurance.

Last but not least note, on behalf of the Board of Directors, I would like to reaffirm our commitment to our triple-bottom line mission, as built around our unwavering support for the Planet, People and Profit. We will further pursue our financial inclusion to even more environmentally responsible way. We need to treat microfinance and SME finance as an inherent and integral part of this financial inclusion, not as separate add-ons.

I would like also to express our special gratitude to the management team and all our staff, because our institutional success rests and depends on these people. My deep appreciation goes to all our Shareholders and Partners, whose continued support to TenGer and XacBank will be the key to our future institutional growth as well as for the outstanding business performance during 2011. Thus, only through our joint efforts and team work, we would be able to contribute to more maximizing our Shareholders' fair value and fostering more inclusive finance in Mongolia in the coming years. May the good deeds always develop further ■

Ch. Ganbold, *Chairman of the Board of Directors*

# The Board Committees Composition

As of March 31, 2011

## ■ THE BOARD RISK MANAGEMENT COMMITTEE

The Risk Management Committee was established to approve, monitor and evaluate a comprehensive risk management policy for the Bank as well as to monitor new and ongoing financial risks across each of the Bank's business departments. Additionally it ensures that the appropriate risk limits are maintained and that adequate systems and standards for measuring such financial risk and performance are in place. The Risk Management Committee meets bi-monthly, and the members of the Risk Management Committee are as follows:

- Michael Madden, Chair
- Bold Magvan
- Richard Ranken
- Bat-Ochir Dugersuren
- Amartuvshin Hanibal (Managing Director, TFG)
- Secretary: Delgerjargal Bayanjargal (Chief Financial Officer, XacBank)

## ■ THE BOARD CREDIT COMMITTEE

The Credit Committee was established to monitor and evaluate the credit risk of the Bank and to oversee the Management Credit Committee and the Sub-Credit Committees as well as assess any loans which are too large for the Management Credit Committee to assess. Additionally, it reviews and maintains the guidelines for determining the type and value of collateral to be obtained in respect of its loan products, and the members of the Credit Committee are as follows:

- Arvid Tuerkner, Chair
- Sarah Djari
- Bat-Ochir Dugersuren
- Jim Anderson
- Arno de Vette
- Oyungerel Byambajav (Head of Mortgage Banking, XacBank)
- Secretary: Gerelmaa Yunden (Chief Credit Officer, XacBank)

## ■ THE BOARD AUDIT COMMITTEE

The Audit Committee was established for the primary purpose of ensuring that the risk management processes throughout the Bank are audited on an annual basis by the internal audit function. It examines both the adequacy of the procedures and the Bank's compliance with the procedures that have been implemented. The Audit Committee includes representatives from a number of the TenGer Financial Group LLC's shareholders, and the members of the Audit Committee are as follows:

- Sarah Djari, Chair
- Jim Anderson
- Arvid Tuerkner
- Erdenejargal Perenlei
- Arno de Vette
- Secretary: Saynsanaa Yamaaranz (Chief Auditor)

## ■ THE BOARD GOVERNANCE, NOMINATIONS AND COMPENSATION COMMITTEE

The Governance, Nominations and Compensation (GNC) Committee was established to review and implement among other things, compensation and corporate governance across the Bank, and the members of the GNC Committee are as follows:

- Ganbold Chuluun, Chair
- Richard Ranken
- Erdenejargal Perenlei
- Michael Madden
- Bold Magvan
- Secretary: Tur-Od Lkhagvajav (Corporate Secretary, XacBank) ■

# Executive Management Report

## Message from outgoing CEO Bold Magvan

*Our records and achievements until 2010*

XacBank has become one of Mongolia's leading commercial banks and the pre-eminent provider of microfinance and community lending services. Since our founding in 1998 and obtaining a banking license in 2001, we have built a strong reputation based on our product and service quality and long community service history in Mongolia. We have been, and continue to be, focused on the Planet, People and Profit – as our continued commitment to community and environmental issues while operating based on sound commercial principles. We strive to enhance our position in the market through prudent risk management, robust corporate governance and our commitment to transparency. In recent years, we have leveraged our extensive microfinance experience to broaden our presence in the SME business sector, in line with economic development in the country. Through an extensive national branch network, we provide services to all levels of Mongolian society, from SME and corporate customers to more remote communities. We recognize the importance of maintaining a strong financial position to achieve our mission and we are committed to maintaining a conservative capital adequacy ratio.

XacBank believes its position as the leading microfinance lender in Mongolia derives from our long-standing position as the primary provider of banking services to the lower-income segment of the Mongolian population, including customers engaged in micro and agricultural businesses. Our microfinance business segment includes lending activities for small loans to entrepreneurs and family businesses primarily engaged in trade and production as well as services. In recent years, as the Mongolian economy has expanded, we have made significant progress towards achieving our founding microfinance objectives, and we have begun developing our SME business by leveraging our expertise in credit enhancement and disciplined lending guidelines gained from our extensive microfinance experience.

XacBank offers a broad range of loan products, including micro-business loans, consumer loans, SME loans, agricultural loans (including crop loans and herder loans), mortgage loans, apartment loans, deposit-backed loans, salary loans and student loans as well as deposit accounts, overdraft facilities, credit cards, ATM services, bill payment, international and domestic money transfers and remittance services. While consolidating our microfinance business and SME business market share in rural areas, we have continued to increase our market share in Ulaanbaatar and other key urban centers in Mongolia, including Erdenet and Darkhan. As of December 31, 2010, we had 84 branches and units, of which 33 branches and units and four business service business centers were located in Ulaanbaatar city, six branches and units were located in Erdenet and Darkhan towns, and the remaining branches and units were located in rural areas nation-wide.

As XacBank expands its role as the leading microfinance lender into the SME sector, we remain firmly committed to playing a positive role in the community and to assisting in the development of a financially inclusive society. Our development of 'branchless' solutions for remote areas of Mongolia, including 'AMAR' mobile phone-based banking service, as well as our Savings and Credit Cooperatives (SCC) franchise have enabled us to assist low-income and financially marginalized citizens in remote rural areas. We believe our education programs, such as 'Aflatoun' and 'Aspire', created to encourage primary and secondary school students between the ages of eight and 18 years to make savings, have deepened our reputation in the community and have engendered loyalty in potential future customers and clients. XacBank continues to expand its deposit base through our specialized children's products such as the nationwide 'Future Millionaire' product. Additionally, by establishing partnerships with non-profit organizations such as Kiva and Vittana, we have made significant contributions to local communities across in the country.

Furthermore, XacBank has become leading eco-banking in Mongolia through its global alliance with Micro Energy Credits, which enables us to develop clean energy product lines and to provide eco-loans to low-income customers in Mongolia. We believe these initiatives are not only part of our corporate environmental responsibility, but also represent good business consistent with our microfinance heritage.

Not last but not least, XacBank is now wholly-owned by TenGer Financial Group (TenGer or TFG), and through TFG, we are the only Mongolian financial institution that is majority-owned by a broad base of globally recognised international investors. This diverse yet committed to a common mission international investor base, which in aggregate owns approximately 69.0 percent of TenGer's shares, provides us with significant support and assistance in our future growth and development. Each of our institutional investors contributes to the Bank's growth and development by providing financing options and investment advice as well as communication with investors, education, market research, technical assistance in corporate governance and risk management. We believe TenGer's current shareholders provide us with a foundation of international expertise that enhances our ability to take advantage of growth and expansion opportunities not only in Mongolia, but also across the region.

**With best wishes to all our stakeholders for reaching new heights in 2011 ■**



**Bold Magvan**, CEO of TenGer Financial Group

# Profile Of The Board Of Directors

As of March 31, 2011



## ■ GANBOLD CHULUUN *Chairman*

Ch. Ganbold was appointed as the Chairman of the Board of Directors of XacBank in November 2004 and has served as a Board Director since August 2003. Ganbold was the founding member of the X.A.C. (Golden Fund for Development), the first NBFi in Mongolia. Currently, he is the CEO of EDN LLC, and President of several NGOs as well as founder of the Rotary movement in Mongolia. He was the Director General of the World Mongolian Federation from 1993 to 1995. He has also served as an advisor to the Prime Minister of Mongolia on public relations and media from 1999 to 2000. Since 2010, he is also serving as the Board Director of Oyu Tolgoi LLC. Ganbold graduated from the Moscow University of Foreign Languages, Russia in 1976.



## ■ BAT-UCHIR DUGERSUREN

D.Bat-Ochir was appointed as the Chief Executive Officer (CEO) of the Bank in January 2011. He has held managerial positions with the Bank and TenGer Financial Group LLC for 13 years. He was appointed as the financial director of X.A.C. Finance Company (the predecessor of the Bank) in 2000. Between 2001 and 2006, Bat-Ochir was appointed as the Vice-President of Finance and Accounting Division and he served as the First Deputy Chief Executive Officer of the Bank during 2009 and 2010. He has also served as the Chief Investment Officer at TenGer Financial Group LLC between 2009 and 2010, before returning to the Bank. Bat-Ochir holds a MBA in International Finance from the International Business School, Brandeis University, Boston, the United States.



## ■ JAMES ANDERSON

Jim was appointed as a Director of the Bank in 2003. He is the senior regional advisor for Microfinance, Mercy Corps, in Ulaanbaatar. He has been contracted by Mercy Corps as a Senior Technical Advisor to the Bank. He has also served as the Country Manager in Vietnam for the Mekong Project Development Facility, and as the regional investment officer with the International Finance Corporation between 1999 and 2002 for the Central Asia region. Between 1996 and 1999 he served as the Vice-President and Country Manager for USAID's sponsored venture capital fund providing financing alternatives to SMEs in five Central Asian Republics. Mr. Anderson graduated from the Fairfield University in 1979, and holds a Master's degree in Finance from Pace University, New York in 1984.



## ■ RICHARD RANKEN

Dick was appointed as a Board Director of the Bank in 2009. He is a senior advisor to the International Finance Corporation, in the East Asia and Pacific Region and serves as a director on the boards of several banks and private equity funds in Asia. He has been with IFC for almost 30 years and has spent a majority of his professional life working in the Former Soviet Union, Africa and more recently in East Asia. Dick has degrees in Agricultural Economics and Business Administration



## ■ SARAH DJARI

Sarah was appointed as a Board Director of the Bank in 2009. She was the investment manager at BlueOrchard Investments Management, the private equity investment arm of BlueOrchard Finance SA. In 2005 Sarah founded and headed the strategy team of the Centre for Microfinance in Chennai, India to help fast-growing Indian microfinance institutions and support them in the development and implementation of their growth strategy. She also contributed in setting up Grameen Capital India to promote securitisation and bond issuance on the mainstream capital markets and in setting up a microfinance incubator whose objective is to create 200 new microfinance institutions by 2010. She started her career at Bain & Company in 2000. Sarah graduated from MSc in Theoretical Physics: Paris XI University (France) and Imperial College (London, UK) with a Bachelor of Arts in 1996 and obtained her Master's degree in from MSc in Engineering, Ecole Centrale Paris, France's premier engineering school in 1998.



## ■ BOLD MAGVAN

M.Bold has been a Board Director of the Bank since 2009. He was appointed as the Chief Executive Officer of TenGer Financial Group LLC in January 2011, after serving as the Chief Executive Officer of XacBank since 2009 and as the President of the Bank between 2005 and 2009. Bold was the Deputy Governor of the Bank of Mongolia (Central Bank) from 1996 to 2000. As a member of the MicroStart Advisory Committee of UNDP in 1998, he co-initiated and promoted X.A.C., the first NBFi in Mongolia. Prior to joining XacBank, Bold worked for the World Bank in Washington, DC from 2001 to 2005 and for IMF in Kabul, Afghanistan from 2002 to 2003. He has also served as the honorary consul of the Republic of Iceland in Mongolia since 2008. Bold is the Board Chairman of the Development Solutions NGO in Mongolia. He is currently the Vice-President of the Mongolian Bankers Association, a position he has held since 2007, and Chairman of the Board of the Credit Information Bureau LLC. He obtained a Master's degree in International Affairs from Columbia University, New York in 2001 as well as a B.Sc. from Budapest University of Economic Sciences, Hungary, in 1986.



## ■ MICHAEL MADDEN

Michael was appointed as a Board Director of the Bank in 2009. He is currently the Managing Director of Ronoc International. Prior to joining Ronoc, Michael was the founding Chief Executive Officer of Renaissance Credit (Russia). Prior to building Renaissance Credit, he held positions with American Express from 1988 to 1996. Michael graduated from College of Management Studies, Limerick, Ireland, in 1987.



## ■ ERDENEJARGAL PERENLEI

P.Erdenejargal was appointed as a Director of the Bank in 2005. Since 2004 Ms. Erdenejargal has been the executive director of the Open Society Forum (OSF). She has served as the executive director of the Mongolian Development Foundation, as well as a researcher at the Government Centre for Public Policy and Social Studies, and as a lecturer at the Academy of Management. Erdenejargal was trained as a psychologist at the Rostov-on-Don State University, Russia, and started her career at the Mongolian Ministry of Labor and Welfare in 1982. She has also worked as a part-time lecturer with the National University of Mongolia from 1984 to 1991.



## ■ ARNO DE VETTE

Arno was appointed as a Board Director of the Bank in March 2011. He is currently a Senior Investment Officer at Triodos Bank in the Netherlands. He has been with Stichting Triodos-Doen for 3 years and has spent a majority of his professional life working in ABN-group since 1989 and more recently as the Senior Investment Officer at Dutch Development Bank (FMO) between 2002-2009. Arno graduated from Economics, Erasmus University Rotterdam, with a Bachelor of Arts in 1985 and all Dutch banking courses in 1990.



## ■ ARVID TUERKNER

Arvid was appointed as a Board Director of the Bank in 2009. He also serves as a senior banker with the financial institutions team of the European Bank for Reconstruction and Development (EBRD) in Moscow. Between 2001 and 2002 and between 2004 and 2008 he was the senior investment manager for Deutsche Investitions und Entwicklungsgesellschaft, responsible for debt and equity investments in Russia, the Commonwealth of Independent States and Latin America. Prior to 2004 he was UNDP's donor relations advisor, responsible for cooperation with its major donor countries and institutions on resource mobilisation. Arvid graduated in 2000 from the Free University of Berlin, Germany, with a special focus on banking and finance, enterprise valuation, financial sector reform, microfinance, political economy of countries in transition, privatisation, and social security systems.

# Executive Management Report

## Message from incoming CEO Bat-Ochir Dugersuren

*Our corporate strategy for 2011 and beyond*

XacBank's overall corporate strategy for 2011 and beyond continues to be the fostering the access to inclusive finance in Mongolia.

The Bank's core corporate strategy as built around its triple-bottom line vision and mission - the Planet, People and Profit - is to ultimately contribute to the social and economic development of Mongolia through solidifying and expanding its current position as a leading Mongolian financial institution by increasing our SME business segment while maintaining our leadership in microfinance, particularly in Ulaanbaatar and other growing urban areas of Mongolia. The key components of this strategy to achieve these objectives include:

We aim to maintain and consolidate our leading position in the microfinance and SME business sectors by continuing to improve our customer service and the range and quality of our products and services. We seek to expand the banking services we offer outside our core lending activities, including the development of cash management, depository services and custodian services. We continue to develop our microfinance business products and SME products in line with the development of our customers, the mining services industry and the expansion of the Mongolian economy. Further, we continue to focus on increasing our retail customer base through the introduction of the 'Aspire' and 'Aflatoun' programs as a result of which we have seen an increase in the number of younger accountholders.

As an emerging economy, the country has numerous SME customers requiring specialised commercial banking products and services that differ from traditional corporate banking services. We plan to expand our business to provide services to SME customers through advancing the bank's capacity to identify and serve SME customers' demands as well as establishing lending teams and branches to focus on SME lending. We have opened four specialised business services centres in Ulaanbaatar to provide services to SME customers in the mining sector and other growing industries. Additionally, we have collaborated with the Business Advisory Service, a programme funded by the European Bank of Reconstruction and Development, to support and nurture the emerging SME market.

We continually strive to enhance our service quality through a range of product and service initiatives. By enhancing the "branchless" solutions we offer our customers, including Internet, mobile phone and SMS banking product offerings as well as our telephone customer service operations and ATM network, our customers can access our products and services through multiple channels at their convenience from locations across both urban and remote areas of Mongolia.

We strive to manage our competitive cost of funding, increase our operating margins and maintain our ability to leverage our asset base. To this end, we expect to continue to enlarge our deposit base by competing with other Mongolian banks to obtain attractively priced deposits denominated in MNT and USD in the domestic market. We intend to continue to develop our products and services to attract younger and more diverse Mongolian customers as well as international corporate customers located in Ulaanbaatar city, Erdenet and Darkhan towns that are entering the Mongolian market to take advantage of the mining sector expansion. We will also strive to expand into strategic locations as they arise such as in Umnugovi and Hovd aymags where increased mining activity is developing. As the Mongolian economy relies heavily on USD pricing for certain goods, many SME and microfinance business customers operating in the country maintain both MNT-denominated and USD-denominated deposits as a hedging strategy against inflationary pressures.

We are committed to corporate social responsibility and stewardship of the local environment and communities. In February 2010, our commitment to social responsibility was recognised by the Mongolian Management Association, who awarded us with the 'Social Responsibility Leader of 2009' award and by the World Bank-led Consultative Group to Assist the Poorest (CGAP) who awarded us with the silver 'Social Performance Reporting Award' in 2010. Additionally, we were one of the first banks in Mongolia to embrace a greener approach to business and to incorporate commercial banking programmes consistent with our social vision. Since past two years, the Bank entered into a strategic partnership with Micro Energy Credits to provide loans for the purchase of energy-saving and pollution-reducing consumer products to customers in Mongolia and we have since increased our eco-banking exposure by working with international financial institutions, including the Asian Development Bank (ADB), to provide financial solutions for energy efficient housing.

We sincerely believe that the sustainable development of Mongolia will enhance the equitable growth of the economy and thereby increase our fair business for all ■



**Bat-Ochir Dugersuren, CEO of XacBank**

*XacBank and Golden Fund for Development, an NGO, piloted Aflatoun, a social and financial education program, which saw more than 350 children across 10 general education schools participating.*





People

# The Executive Management Team

*As of March 31, 2011*





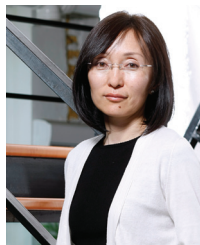
# Profiles of The Executive Management Team

As of March 31, 2011



## ■ BAT-UCHIR DUGERSUREN

Bat-Ochir was appointed as the Chief Executive Officer (CEO) of XacBank in January 2011. He has held managerial positions with XacBank and TenGer Financial Group for 13 years and has an extensive banking experience in corporate investment, microfinance, management and business development. Bat-Ochir started his career at XacBank when he first joined MicroStart Project, UNDP as a Financial Advisor in 1998 and later quickly promoted to the role of the Financial Director of X.A.C. Finance Company (predecessor of XacBank) in 2000. Between 2001 and 2006, Bat-Ochir was appointed as the Director of Finance and Accounting Division, and from 2009 and onwards he worked as the First Deputy CEO of XacBank. He also served as the Chief Investment Officer at TenGer Financial Group between 2009 and 2010, before returning to XacBank for the top position. Bat-Ochir holds a Master's degree in International Finance from the International Business School, Brandeis University, Boston in the United States.



## ■ DELGERJARGAL BAYANJARGAL

Delgerjargal was appointed as the Vice President for Retail Banking since February 2011, and was serving as the Chief Financial Officer (CFO) of the Bank from September 2009, after serving as its Chief Operating Officer (COO) since August 2007. Delgerjargal has served as a Credit Officer/Office Manager at the UNDP supported MicroStart project, in August 1998, then as a Finance Manager, Chief Accountant, Research and Development Officer and as the Head of Policy Coordination Department with X.A.C. Finance Company (predecessor of XacBank), from 1998 to 2002. Since 2002 Delgerjargal has served as the Head of the Microcredit Division, the Chief Credit Officer and the Director of the Credit Management Division, and the Director of the Finance and Accounting Division of the Bank. She started as officer in the Listing and Research Department of the Mongolian Stock Exchange from 1992 to 1998. Delgerjargal graduated with a Business Administration degree in Banking and Finance from the Institute of Finance and Economics, Ulaanbaatar and has further studied microfinance, banking development and financial management.



## ■ TUUL BALJIR

Tuul was appointed as the Chief Accountant and Director of the Finance and Accounting Division XacBank in January 2008. She joined the Bank in 2002 and has held various positions in the Accounting and Controlling Department, the Planning and Budgeting Department and the Financial Controlling Department. She is responsible for the Bank's financial policy and control functions, including management information, budget planning and accounting procedures. She started her professional banking career in July 1998 with the Savings Bank as a Supervisor. Tuul graduated with a Business Administration degree in Finance and Economics from the Institute of Finance and Economics, Ulaanbaatar and has continued her studies in financial risk management, commercial bank accounting and internal control, as well as completed a preparatory course for the certified public accountants.



## ■ TUR-OD LKHAGVAJAV

Tur-Od was appointed as the Deputy CEO (currently as Executive Vice President and Chief Operating Officer) of XacBank in February 2009. He was appointed as the Corporate Secretary and the General Counsel to the Board of Directors in November 2010. Previously he served as the Director of the Legal and Compliance Division in the Bank. Prior to this position, he was working as the Advisor since October 2005 and then as the Director of Administration Division. Tur-Od started his professional career at the Ministry of Justice (1997-1999) as the Legislative Drafting Officer in banking and foreign investment laws, followed by assignment as the Senior Officer in charge of international institutions and legal sector aid, projects and loans. From 1999 to 2005 he worked in UNDP Country Office, as a human rights and governance specialist, and later as a first-time Governance Practice Manager. Tur-Od after his initial legal studies at the National University of Mongolia, graduated from the National Law School of India University with BA., LL.B. (Honors) degree. He received his Master of Laws in Law and Development degree with Merit from the University of London (SOAS), United Kingdom.



## ■ SAYNSANAA YAMAARANZ

Saynsanaa was appointed as the Director of the Internal Audit Division of XacBank in September 2010. Previously he has worked at the Bank of Mongolia (Central Bank) as an Auditor. Saynsanaa graduated from Mongolian National University with a Bachelor of Finance in 1998 and obtained his Master's degree in Finance from the University of Melbourne, Australia, in 2010.



## ■ MUNKHBOLD SUHBAATAR

Munkhbald has been working as the Director Retail Banking Division of XacBank, as of February, 2010. He started his long-standing career at the Bank in 2002 and has since filled the position of Loan Officer, Product Development Manager, progressing right through to become Director of Rural Loan Department and Director of Microfinance Department. He began his work career at an NFB named NetMon in 2001, before joining XacBank.



#### ■ GERELMAA YUNDEN

Gerelmaa was appointed as the Chief Credit Officer (CCO) and the Director of Credit Risk Management Division of XacBank in January 2006. She is responsible for managing the Bank's credit review and monitoring functions, including special assets management. Gerelmaa has also served as an Accountant in the International Settlements Department from 1986 to 1990 in the Bank of Mongolia (Central Bank). She has served as a Director in the International Banking Department, as the Deputy Director of the Credit Department, as the Director of the Debt Workout Unit, and as the Manager of Financial Institutions in the Corporate Banking Department of the Trade and Development Bank of Mongolia LLC, until 2006. Gerelmaa graduated with a degree in Economics from the Institute for Economy in Berlin, Germany. She also attended the management programme on market economy from 1992 to 1994 in the Institute for Economy in Kiel, Germany.



#### ■ TIMOTHY O'NEILL

Tim was appointed as the Vice-President for Business and Corporate Banking of the Bank at the beginning of 2011. Prior to joining XacBank, he served as the Deputy Project Director and Senior Financial Markets Advisor of the USAID Mongolia Economic Policy Reform and Competitiveness Project between 2005 and 2010, providing support to the Mongolian financial services industry to increase access to finance for SME and lower and middle income families. Moreover, as part of his advisory role, Tim led the project's assistance to the establishment and organisation of the Mongolia Mortgage Corporation, the Mongolia Corporate Governance Development Centre and most recently the Credit Information Bureau LLC. He brings extensive experience to the Bank having previously been a member of the board of directors, steering committees and/or credit committees of banks, alternative credit facilities and SME private equity funds in Bulgaria, FYR Macedonia, Kosovo and Greece. Tim started his banking career with Citibank in London, England in 1981 and has held senior bank management positions in England, Canada, Russia and Bulgaria where he was a Senior Banker and the Head of Office for the European Bank for Reconstruction and Development. He qualified as a Chartered Accountant in Ontario, Canada in 1972.



#### ■ OYUNGEREL BYAMBAJAV

Oyungerel was appointed as the Director of the Mortgage Banking Division of XacBank in October 2010. She is responsible for the Bank's mortgage banking services, including development of mortgage products policies and procedures. Oyungerel joined the Bank in 2003 and has served as the Director of the Rural Lending Department, Loan Service Department and was in charge of the Bank's rural loan policy and franchise service. She has served as the Financial Manager and also as the Executive Director of NETMON LLC, which was a part of the XAC-GE group (predecessor TenGer Financial Group). Oyungerel graduated from the Mongolian University of Science and Technology, Ulaanbaatar with specialisation in Information Technology Management, and received a Master's degree from the Technical University of Colorado, Denver, the United States.



#### ■ ERDENECHIMEG DORJGOTOV

Erdenechimeg was appointed as the Director of Operations Management Division of the Bank in July 2009. She is responsible for the overall back-office management of the Bank, including payments processing, procurement and general services. Erdenechimeg has also served as the Director of Internal Audit Division of the Bank responsible for on-site inspection of all branches and headquarters unit. She joined XacBank in March 2000 as a Marketing Specialist, then served as an Internal Auditor from 2000 to 2002 and as a Senior Auditor from 2002 to 2004. Erdenechimeg started her career as an Auditor with Itgelt Audit LLC. She graduated with a degree in Business Economics and Administration from the Mongol Business School, Ulaanbaatar. Erdenechimeg holds a Master's degree of Economics in banking and finance from the National University of Mongolia. She has participated in various international and domestic training workshops on external and internal audit and controls, risk and credit analysis, enterprise risk management framework, and fraud prevention.



#### ■ MUNKHBAYAR BATKHUY

Munkhbayar was appointed as the Director of Information Technology Management Division of the Bank in January 2010. He heads up and manages two IT departments relating to the network-hardware and the core banking system. He also served as the CEO of one of the largest software development companies in Mongolia, USI Inc. from 2005 to 2010, as the Marketing Manager and Systems Administrator at MobiCom Corporation from 2000 to 2005, and as the founding member of T&C Computer Systems Company from 1996 to 2000. Munkhbayar holds a Business Administration degree in Business Management from the Institute of Finance and Economics, Ulaanbaatar and a Master's degree in Computer Science, Software Engineering from the Mongolian University of Science and Technology, Ulaanbaatar and has also completed a technical training course in the field of Software Project Management in Tokyo.



#### ■ BOLOR-ERDENE DAMDIN

Bolor-Erdene was appointed as the Director of Integrated Risk Management Division of XacBank in August 2010. Previously he has served as a Senior Risk Officer at the Bank. Bolor-Erdene graduated from Institute of Commerce and Business with a Bachelor of Arts in Econometrics.

# Corporate Governance Statement Of The Bank

## ■ GOOD CORPORATE GOVERNANCE PRINCIPLES

XacBank is committed to implementing a corporate governance system that puts in place additional transparent structures that add to the long-term sustainability of the bank and aid in aligning the interests of a wide range of stakeholders, including shareholders, investors, management and co-workers. This enhancement of corporate governance contributes to the sustainable economic development of the bank by transparently showing the Bank's corporate performance and further increasing its access to external sources of required capital, as well as assuring efficient and effective use of its resources.

The Bank is currently implementing Bank of Mongolia's (Central Bank) Regulations on Implementation of Sound Governance Principles in Banking Institutions<sup>7</sup>, approved on 26 December 2006, as well as the OECD (Organization for Economic Cooperation and Development) Principles of Corporate Governance<sup>8</sup>, originally issued in 1999, revised in 2003 and agreed by OECD governments in April 2004. Together these principles provide the basic framework of the Bank's corporate governance, including the rights and equitable treatment of shareholders, the role of stakeholders, public disclosure and transparency, and the responsibilities of the Board and management.

The Bank's corporate governance framework ensures that timely and accurate information disclosure is made on all material matters regarding the Bank, including its financial situation, performance, ownership, and internal controls. Furthermore, it will ensure the strategic guidance of the Bank, effective monitoring of management by the Board, and the Board's accountability to the Bank's shareholders and all public stakeholders.

## ■ CORPORATE GOVERNANCE STRUCTURE

The Bank continues to operate as a limited liability company, registered and incorporated under the laws of Mongolia. The Bank's ultimate authority lies with its shareholders. On behalf of the shareholders the Board has a policy setting role for the Bank, monitoring the activities of management and giving strategic guidance. The Chief Executive Officer (CEO) is appointed by the Board and is directly responsible for managing the day-to-day operations of the Bank, and reports on a regular basis to the shareholders and the Board. The CEO represents XacBank without the power of attorney as per the Bank Charter. The Board of Directors has established Standing Committees to focus on specific strategic areas. These Committees are governed by their respective Charters (i.e. By-laws) and report to the full Board during its regular and extraordinary meetings. Sub-committees or any other ad-hoc structure may be established by the Board in order to address specific or urgent issues from time to time. The Internal Audit Division (IAD) of the Bank reports to the Audit Committee, which in turn reports on the IAD's activities to the full Board of Directors. The full-time position of the Corporate Secretary was established at the Bank and its parent company level to facilitate a smooth functioning of the Board of Directors and the shareholders, and to assist in effective communication with the management.

## ■ ORGANIZATIONAL STRUCTURE AND MANAGEMENT PROCESSES

The Bank is comprised of branch offices and the head office with divisions and departments under overall leadership of the CEO. In order to further simplify and streamline the Bank's operations and enhance succession planning, the front-office units report directly to the Chief Executive Officer, and back-office units to the Deputy Chief Executive Officer, while the Bank's Integrated Risk Management Division reports to the Executive Board. The Internal Audit Division (IAD) continues to be directly accountable to the Bank's Board of Directors with a parallel reporting to the CEO. The IAD conducts on-site examinations of all branches and head office units, and reports to the Audit Committee of the Board. The management of the Bank has established the committees to ensure its proper functioning and follow-up. The composition and structure of the Bank committees is determined by the executive management in order to facilitate effective day-to-day management of its business affairs and sound internal controls.

The Bank has a nation-wide network of 84 branches and extension units. The extension units offer basic banking services and products, and located in the areas of strategic importance for the Bank where it is not feasible to open a full scale branch office. Branches consist of a director and line managers responsible for finance, customer relations and credit operations, with corresponding teams/officers under these managers. Branches have two main committees: Branch Director's Council and the Credit Committee which facilitate decision making processes at the field level.

## ■ ENVIRONMENTAL AND SOCIAL REPORTING SYSTEM

The Bank is strongly committed to the principles of sustainable development as exemplified by the implementation of its Social and Environmental Management System (SEMS) to address environmental issues, both social and ecological, arising from the Bank's operations since 2002. The Bank firmly believes that sustainable development can only come from educated and skilled people and businesses concerned equally about the Planet, People and Profit (3Ps). To institutionalize this triple-bottom line approach, the Sustainability Team was set up to ensure overall compliance of the Bank's business activities with not only national environmental legislation and bilateral agreements with investors and shareholders but also internationally recognized environmental norms and standards.

The Bank will further improve and enhance its social and environmental management and its reporting system, including revision of its current policy document and will conduct a social and environmental performance audit on its operational impact. The Bank has appointed an ex-officio Environmental and Social Manager at the parent company level, and compliance officer at the operational level, who are ensuring a proper operation and maintenance of the Bank's SEMS. The Bank compiles and provides environmental and social performance reports on regular basis to its strategic shareholders and international investors.

The Bank also systematically gathers data on social and environmental impact stemming out from its operations across

the country, and provides its shareholders and stakeholders with environmental and social reports on a regular basis. Furthermore, the Bank has initiated in-house environmental protection measures aimed at efficient use of energy, fuel, water, reducing paper consumption and waste, as well as seek to form business relations with partners, suppliers, and clients who follow similarly the environmental standards.

#### ■ BUSINESS CONDUCT AND CODE OF ETHICS

The Bank highly values personal integrity of its employees and business ethics at the all organizational levels, and aspires to further maintain its high public reputation for doing not only things right but also doing the right things. Moreover, the Bank is treating co-workers, customers, suppliers, shareholders and local communities with honesty and respect, as well as mitigates any conflict of interest situations at both management and operational levels.

The Bank management and co-workers strictly adhere to the following fundamental principles and basic standards of integrity, transparency and accountability, as approved and implemented through the relevant Code of Ethics:

- Integrity and Transparency: doing the "right thing" without compromising our customers, suppliers, and shareholders- even when circumstances make it difficult. We are clear, truthful and accurate in what we say and do;

- Respect and Honor: treating each other with respect and dignity; appreciating the diversity of our workforce, our customers and our local communities;
- Responsibility and Accountability: taking accountability for ethical decisions and actions, and asking for clarification when necessary and reporting concerns or violations in the workplace;
- Good Citizenship and the Rule of Law: complying with the spirit and intent of the laws that regulate our business; contributing to the strength and well being of our communities and shareholders.

The Bank's Code of Ethics for Employees as well as for the Management and the Board are approved by the Board of Directors. The Bank's orientation training program of the new employee includes the Code of Ethics and Corporate Culture sections which are of the highest priority for the Management. To monitor compliance with the Code of Ethics, the Bank runs at all its branch offices Box of Complaints and also the Bank's hotline also receives any related complaints or suggestions directly, as handled by the Internal Audit Division. The Chief Compliance Officer, Human Resource Management Department and Internal Audit Division have general responsibilities for monitoring the overall compliance of the Bank's Code Ethics, within their scope of respective work. The Board Governance, Nominations and Compensation (GNC) Committee oversees the compliance of the Code of Ethics ■

## Origins of the Bank's holding company TenGer Financial Group

X.A.C. and Goviin Ehlel, the two pioneering non-bank financial institutions of Mongolia merged in 2001 to create TenGer Financial Group, initially known as X.A.C.-GE Group. Each merging party brought unique, proven expertise to the table: one in creating self-employment through micro-lending, the latter in employment generation through small and medium enterprises' lending - two strong drivers for social and economic development in an emerging economy. The third non-bank financial institution that formed this development alliance was NetMon, which brought savings and loan cooperative franchise model to the equation.

TenGer Financial Group aims to build a transnational group of companies to deliver a full range of financial services to people and businesses. The Group will adhere to the highest norms of business conduct and put environmental sustainability as one of its mission pillars.

TenGer Financial Group entered the next phase of its development in 2007 by expanding beyond XacBank and Mongolia. With a core team of dedicated and passionate people TenGer Financial Group is working towards further expansion, both domestic and regional,

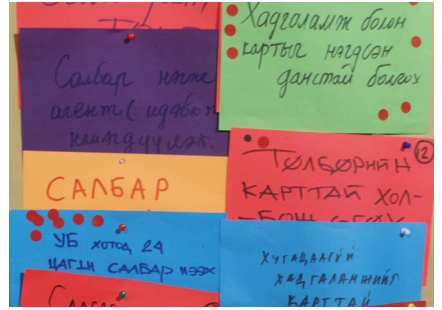
in tandem with XacBank, capitalizing upon the latter's experience and reputation. Successful pilot project of Mol Bulak Finance implemented in Kyrgyzstan helped to identify potential projects to be pursued in China and Russia for which proposals are being prepared for the approval by the Board.

In the past few years, TenGer Financial Group have adopted corporate governance model and developed Business Plan with the view of the regional expansion, successfully implemented a pilot project and identified new targets for growth both internationally and within Mongolia. The Group has managed to raise new equity at times of the global financial crisis, an effort that was duly recognized by the broader investment and development community. The flagship subsidiary of TenGer Financial Group- XacBank has maintained its lead positions in Mongolia as transparent and socially responsible corporation. Approval by shareholders and the Board of the Group of historic acquisition of 50 percent stake in TenGer Insurance and fresh capital injection into XacLeasing have been a manifestation of vote of confidence to the strategies and goals of the company. ■

# Our People



# Green Bank



We Love Our Motherland!



# Macroeconomic Environment And Prospects

Mongolia continues to develop and strengthen a market economy notwithstanding the severe adverse impact of the global economic slowdown during 2008-2009. The country experienced a turnaround in late 2009 and the beginning of 2010. The last quarter of 2010 ended with a broad-based recovery, supported by transportation, construction and wholesale and retail trade. The economy recorded a healthy growth of 6.1 percent for 2010, following a contraction of 1.3 percent in 2009. International reserves reached USD1.6 billion in September 2010, an all-time high for the nation.

The country economy's turnaround may be attributable to the authorities' policy response to the crisis, supported by significant resources from the international community, including a USD224 million stand-by loan facility from the IMF, of which only USD180 million was drawn down. In addition, overall global economic recovery, strong demand from China and an upswing in copper prices contributed to the recovery. At the same time, having identified and learnt from previous economic instabilities, legislative reforms and tightened fiscal framework (i.e. Fiscal Stability Law) have been approved for 2011 that is intended to encourage continued macroeconomic stability.

## ■ MACROECONOMIC DATA

	2008	2009	2010
Nominal GDP (MNT billions)	6,020	6,055	<b>8,255</b>
Nominal GDP (USD millions)	5,258	4,203	<b>6,690</b>
GDP per capita (USD)	1,921	1,552	<b>2,470</b>
Real GDP Growth	8.9%	-1.3%	<b>6.1%</b>
CPI (Ulaanbaatar) (y-o-y change)	23.2%	1.9%	<b>14.3%</b>
Exports (USD millions)	2,534	1,885	<b>2,899</b>
Imports (USD millions)	3,244	2,137	<b>3,277</b>

Source: Mongolia Quarterly Economic Update April 2011, The World Bank

## ■ NOMINAL GDP COMPOSITION BY SECTOR

	2008	2009	2010
Agriculture, forestry and fishing	19.2%	17.9%	<b>15.9%</b>
Mining and quarrying	20.2%	19.5%	<b>21.8%</b>
Manufacturing	6.6%	6.4%	<b>6.5%</b>
Wholesale and retail trade	7.2%	6.6%	<b>7.2%</b>
Transportation and storage	6.4%	8.3%	<b>8.1%</b>
Service activities	30.1%	32.3%	<b>28.4%</b>
Others	10.3%	9.0%	<b>12.1%</b>

Source: National Statistical Office of Mongolia, December 2010 Monthly Bulletin

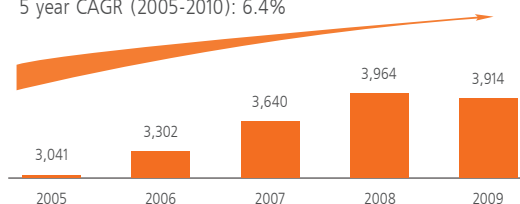
The signing of an investment agreement in October 2009 to develop the Oyu Tolgoi mine, which is considered to be one of the world's largest untapped copper deposits, is a major milestone in the development of Mongolia's mining sector and a key driver in its future economic growth. According to Asian Development Outlook 2011 by ADB, USD4 billion of investment is expected over the next two years in this project alone, an amount roughly equivalent to Mongolia's entire GDP in 2009. The mine is scheduled to start production in 2013. Preparations are also being made to develop the coal deposits of one of the largest undeveloped coalfields in the world, Tavan Tolgoi.

With the recent developments in the mining industry, Mongolia shows promising growth prospects. ADB expects Mongolia's economic growth to accelerate in 2011 and 2012, supported by high global mineral prices, development of new mines, and fiscal spending while IMF estimates that Mongolia will become the fourth-fastest growing economy in the world over the next five years ■

## Real GDP<sup>1</sup> trend of Mongolia

(MNT in billions)

5 year CAGR (2005-2010): 6.4%



Source: NSO  
1 GDP at constant price of 2005

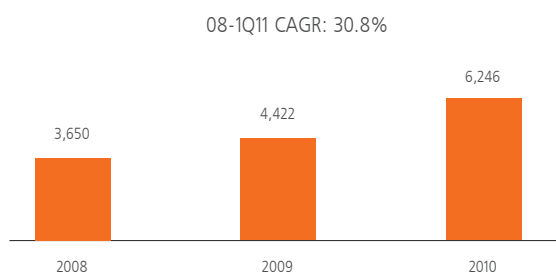
## Banking Sector Performance And Reform

Mongolia's banking and financial sector crisis of 2008-2009 was a significant setback for its economy, and highlighted the increased vulnerabilities of banks' balance sheets. At the apex of the economic crisis, the Parliament adopted a blanket guarantee on all commercial bank deposits in November 2008 to calm depositors' fears. The guarantee was adopted for a period of four years, with an amendment in March 2009, to include also current accounts. In the aftermath of the crisis, banking system profitability fell, and nonperforming loans more than doubled. Anod Bank was taken into conservatorship in December 2008 and a State Bank was established when Zoos Bank failed in November 2009.

The country has since successfully restored economic stability, which has in turn supported a turnaround for the banking sector. Banks have returned to profitability in 2010 and the average non-performing loan (NPL) ratio declined from a peak of 20 percent in 2009 to 8 percent in 2010. The system-wide Capital Adequacy Ratio (CAR) also showed improvement, increasing to 15.1 percent in 2010. Following the recovery, the authorities have tightened the coverage of the blanket deposit guarantee in June 2010, to eliminate coverage for interbank deposits and expand the restriction on the coverage of deposits of related parties. In addition, guarantees of deposits with interest paid in excess of the Central Bank Bill rate are no longer provided. The banking system as a whole has become more liquid. The ratio of liquid assets to short-term liabilities has increased to over 30 percent in 2010. The deposits-to-loans ratio has increased substantially since 2008 as banks again rely more heavily on domestic deposits to finance their loans, making the system less vulnerable to volatile funds.

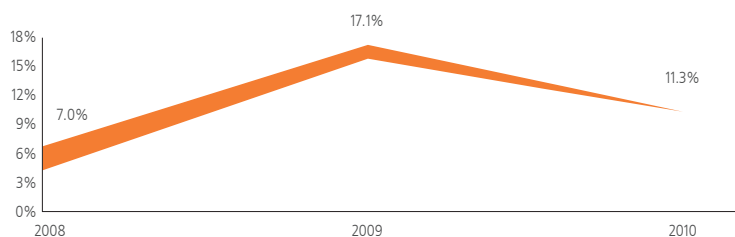
### Banking sector trends

Total banking assets increasing in synch with GDP growth  
(MNT in billions)



There is an on-going financial reform, and the Bank of Mongolia (Central Bank) has attempted to strengthen its regulatory capacity by (i) upgrading its bank supervision process; (ii) the introduction of a loan classification and loan loss provisioning system; (iii) the introduction of prudential norms; and (iv) improvement of enforcement procedures. The number of staff supervising the 14 banks and their branches has increased significantly, and they have undergone more training than in the past. Bank examinations are now driven more by risk assessments. Loan loss reserve requirements have increased. Performing loans now require a 1.0 percent reserve, while overdue loan provisions have increased to 5.0 percent from 1.0 percent. Loans must be classified as overdue if interest is overdue, even if the principal is up to date. These changes reflect greater prudence with a focus on obtaining earlier indications of loan problems. More recently, the authorities have further tightened prudential regulations on asset classification and loss provisions. New requirements mandate the recognition of restructured loans as nonperforming and the establishment of provisioning for excessive related-party loans. Recognition of the problem assets and the corresponding increase in loss provisions will reduce capital ratios and raise nonperforming loans ■

Non-performing loans have come off the peak  
(NPL ratio)



Source: BoM

1 Includes current account, deposits and government deposits

2 Calculated as dividing gross loans by customer deposits

## International ratings of XacBank



### Moody's Investors Service

Moody's Investors Service ([www.moody.com](http://www.moody.com)), a global credit rating agency, which performs international financial research and risk analysis on commercial and government entities.

	2010	2009	2008
Long and short term foreign currency deposit rating	B2	B2	B2
Long and short term local currency deposit rating	Ba3	Ba3	Ba1
Long and short term foreign currency issuer rating	Ba3	Ba3	D
Long and short term local currency issuer rating	Ba3	Ba3	Ba2
Bank financial strength rating (BFSR)	D	D-	Ba1

All the categories have "Stable" Outlook

## Fitch Ratings

KNOW YOUR RISK

Fitch Ratings ([www.fitchratings.com](http://www.fitchratings.com)) is a leading global rating agency committed to providing the world's credit markets with independent, timely and prospective credit opinions.

	2010	2009	2008
Foreign Currency: Long-Term IDR rating	B Stable	B Negative	B+Stable
Foreign Currency: Short-Term IDR rating	B	B	B
Local Currency: Long-Term IDR rating	B Stable	B Negative	B+Stable
Sovereign Risk: Foreign Long-Term IDR rating	B+ Stable	B Stable	B+Stable
Sovereign Risk: Local Long-Term IDR rating	B+ Stable	B Stable	B+Stable

The Outlook for all ratings is "Stable"



Planet Rating ([www.planetrating.com](http://www.planetrating.com)) is a specialized microfinance rating agency, offering evaluation and rating services to micro microfinance institutions, using the GIRAFE methodology

	2010	2006	2004
Governance		A	A
Information		B	B
Risk management		A	B
Activities		A	A
Financing and Liquidity		A	A
Efficiency and Profitability		A	B
Rating	4-	A	A-

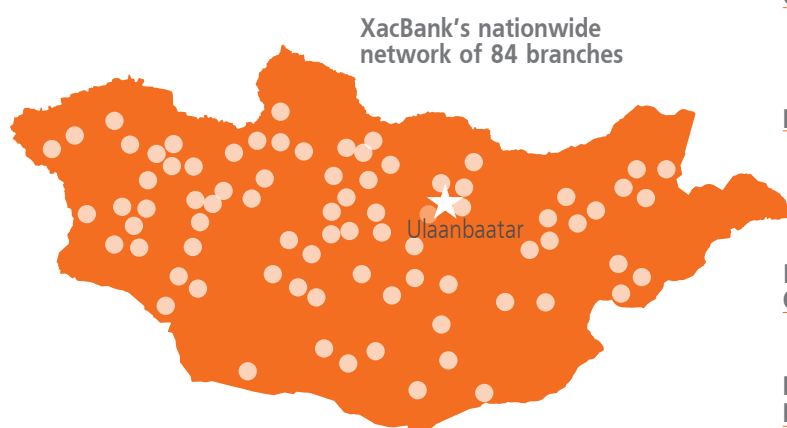
The highest rating grade offered by Planet Rating is 4+.

## 2010 Performance Highlights Of XacBank

The Bank produced healthy and accelerated growth in Assets, Loanbook, Deposit portfolio and Net profits during 2010 exceeding most of its performance targets. After the rights issue, XacBank has the highest capital adequacy ratio among all major Mongolian banks.

	2008	2009	2010
	<i>(MNT millions)</i>		
<b>Assets</b>	207,117,848	318,740,396	468,583,475
<b>Gross loans</b>	149,749,682	196,367,533	324,880,410
<b>Equity (Including Tier 2)</b>	24,631,860	36,786,672	48,117,643
<b>Net profit</b>	2,421,142	2,344,618	6,501,434
<b>employee #</b>	955	971	1 172
<b>branch #</b>	74	75	84
<b>NPL ratio</b>	1,2%	2,3%	1,46%
<b>RoAE</b>	17	11	22
<b>Public deposit</b>	76,407,667	126,320,816	235,265,539

The Bank is continued to maintain the lowest NPL ratio in the industry due to stringent underwriting practice and sophisticated risk management systems.



### NET PROFIT

MNT **6.5** bn ↑ 177.3%

### ASSET

MNT **468.5** bn ↑ 47%

### GROSS LOANS

MNT **324.8** bn ↑ 65.5%

### PUBLIC DEPOSIT

MNT **235** bn ↑ 86.2%

RETURN ON EQUITY **22.48**

NON-PERFORMING LOAN RATIO **1.46**

# Responsible Banking Services

## ■ BUSINESS BANKING ACTIVITIES

Our business banking activities are geared for providing comprehensive financial services to SME and Corporate customers operating in Mongolia.

**Small and Medium Enterprises.** The Bank has correspondent banking relationship with a dozen international banks from US, Canada, Germany, Japan, Russia, Korea and China to ensure prompt and reliable international transfers and settlements of its corporate and retail customers.

The Bank has expanded its lending operations to focus on SME customers to take advantage of the potential for high margins and rapid growth as well as a new source of future corporate customers. We classify SME loans as loans where the level of financing provided to customers is above MNT20 million. The Bank seeks to develop new revenue opportunities and new product offerings to service the needs of its SME customers. Our SME loan products include MNT-denominated and other foreign denominated loans to provide general working capital, finance leasing and facilitate long-term investment requirements, including capital expenditures, machinery purchases and real property related to the customer's business. To assist our SME customers, we have further enhanced our SME loan conditions whereby customers can, among other things, borrow up to MNT3 billion for a three to eight year period. With the increase in the bank's capital base, the maximum loan size will be increased going forward.

	Loan size	Term	Collateral
<b>working capital loans</b>	up to MNT3 bn	up to 3 years	real estate, movable assets, working capital, future income
<b>finance leasing loans</b>	up to MNT3 bn	up to 5 years	immovable assets/real estate
<b>investment loans</b>	up to MNT3 bn	up to 8 years	purchased by the loan and other assets and guarantees

The Bank has been committed to offering competitive terms to our SME customers across a wide variety of commercial sectors and have deepened our cooperation with the JICA so as to continue to offer our customers low interest loans for up to USD600 thousand for up

years. As of December 31, 2010, the total amount outstanding under this on-lending project was MNT11,289.4 million.

In order to assist its SME customers, the Bank offers free financial consultancy and business services at four of our branches. Since 2009 we have opened four specialised business service centres in Ulaanbaatar to provide customer services to SME customers in the mining sector and other expanding industries.

XacBank's increased presence in the SME business sector in recent years has enabled to improve the business efficiency due to the increased size of loans and deposits made by its SME customers, which has offset the downward trend in our net interest margin resulting from lower interest rates.

The SME sector accounted for MNT7,728 million and MNT12,118 million, or 43 percent, of the Bank's total operating income in each of 2009 and 2010. As at December 31, 2010 a the Bank's total SME loan portfolio was MNT126,780.8 million representing approximately 39.4 percent of the total loan portfolio outstanding. Additionally, XacBank's total amount of SME customer deposits has increased from MNT28,421.7 million as at December 31, 2009 to MNT75,319.2 million as at December 31, 2010.

**Trade Finance.** XacBank provides its SME customers and our micro-business customers with various types of documentary credit instruments, including providing all forms of letters of credit and guarantees. Letters of Credit are offered to our SME customers in order that they can enter into transactions with foreign trade partners. We provide all forms of letters of credit, including confirmed or unconfirmed irrevocable letters of credit, covered and uncovered irrevocable letter of credit, payment against documentation, deferred payment, and transferable letters of credit where the payment of goods required to made more than one companies. Further, we offer cash covered and non-cash covered domestic and foreign guarantees to our commercial customers. In order to develop our international trade finance abilities, we have enrolled in the following trade finance facilitation programmes: the Trade Facilitation Program managed by the EBRD, the Global Trade Facilitation Programme managed by the IFC as well as a Trade Finance Line with ING N.V. and the ADB which enables customers to carry out business with partners through numerous foreign banks. For 2009 and 2010, the total transaction volume of our trade finance business amounted to MNT3,358.8 million and MNT6,058.5 million. We believe the growth in trade finance activities between 2009 and 2010 was largely attributable to improvements in the Mongolian

*Under the partnership agreement with USAID, the Bank issued a total of MNT 8 billion worth loans to 80 SMEs with sufficient collaterals.*

to 10 years. In addition, we have worked with the Ministry of Food, Agriculture and Light Industries (MFALI) SME Development Fund for promoting SMEs to coordinate project loans funded by the Ministry with an interest rate of up to 1.0 percent for a term of up to three

economy and increased mining and infrastructure spending during such period which caused increased import activities in 2010, coupled with our effort to provide financing solutions for our customers to enable them to mitigate the risks associated with cross-border trade.

The Bank opened third and fourth Business Service Centers providing financial services to responsible mining suppliers as well as trade and service enterprises.



Amarsaihan Erdenebat:  
**IN TODAY'S SOCIETY, ONLY THOSE WHO MAKE  
BIG STEPS CAN WIN**

"I don't worship anyone but my father," says Mr Amarsaihan, the founder of Seruun Selbe Ltd. Upon entering his office, a verse hangs on the wall, saying, "Dripping sweat won't make a river, only think of what you can build, your hard work leaves behind gold"--a precept written by his author and journalist father.

Amarsaihan's life and career started just like these noble verse lines. Ten years ago, he used to run a small waste collection business, but now he is working as the Managing Director for his own business. Back in 1991, he started working for the transportation cooperative business founded by his father, which at that time collected waste from ger districts in Ulaanbaatar. When he first joined the business he borrowed 50,000 tugrugs from the state and bought two

**"If I didn't make a decisive move and apply for a loan, then I would have still be transporting gravels"**

new trucks in addition to the existing operation. However, soon he started transporting and supplying sand and gravel, to construction companies. Thus he continued to transport construction materials and in 2002 he established and took full ownership of Seruun Selbe as a small business operating with four vehicles and two supporting equipments. By becoming a XacBank customer in 2005, the company got the opportunity to expand its business for the first time.

"The people that used to carry sand and gravel with me back in those days are still doing the same thing today. If I didn't make a decisive move and apply for a loan, then I would have still been working with them. I understood one thing very well and that is that you achieve success only if you work for something, leveraging you to do more. Our company has stood up on its feet since we received the loan from XacBank." says Amarsaihan.

Seruun Selbe now owns over 20 heavy-load trucks and equipments as well as cement and sand processing factories along with road construction and maintenance services, making them a leading company that supplies nearly 20% of all domestic construction materials.

*The Bank signed a deposit placement agreement worth MNT13 billion with ING investment bank.*

**Treasury Activities.** The Bank's treasury activities include deposits with financial institutions, cash and liquidity management and foreign exchange trading. The Treasury Department manages our liquidity by taking deposits from and placing deposits with other banks. Our investment portfolio primarily consists of investments in the banking sector and infrastructure related initiatives and Bank of Mongolia Treasury Bills. Thus, XacBank applied a Value-at-Risk (VaR) licence to the Central Bank of Mongolia in 2010.

For 2009 and 2010, respectively, income generated from treasury activities accounted for MNT483.4 million and MNT5,119.6 million, or 2.6 percent and 17.9 percent of our total operating income.

#### ■ CONSUMER BANKING ACTIVITIES

XacBank provides consumer banking primarily to salaried Mongolians, senior citizens and students in Mongolia. The consumer market in Mongolia is expected to experience a period of growth due to the expansion of the Mongolian economy, which has seen an increase in average salaries of civil servants and private sector employees. The Bank believes that it is in a position to benefit from this growth through the products that it offers and the services it provide.

The Bank's consumer lending is targeted to assist individuals financing purchases of household items, communication technology, electric devices, cars, furniture and residences including ger dwellings and the applicable insulation materials. Consumer loans typically have a maturity ranging from one month to three years and are secured by the relevant person's salary or business income and other assets. Additionally, we offer our retail customers salary loans and student loans for school and university education. Typically, our retail customers repay these loans from their salaries, pensions and other periodic payments, which can be established on a direct debit basis for automatic deduction.

#### ■ MORTGAGE BANKING ACTIVITIES

Since XacBank launched its affordable housing mortgage line, its mortgage loan business has increased significantly during 2010 in line with the Mongolian housing market. As the population of Mongolia becomes more urbanised the demand for housing and housing finance has increased. Additionally, as household incomes increase from the development of the Mongolian market due to, among other things, the growth of the mining sector and foreign investment, the demand on the housing market increases. Due to

*The Bank works closely with 64 Savings and Credit Cooperatives (SCCs) in the rural provinces, all of which provides micro finances to 9,000 members. Nearly 52 per cent of the cooperatives members are female, while one third of the borrowers are herders.*

*"We have learnt a lot about money and its value from the very day the Aspire financial education program started in our school"*



## *The Bank launched the second “Organic Mongolia” program and invested MNT200 million in supporting 126 farmers growing organic produces.*

demand and the increase in our mortgage loan business, in 2010 we established a mortgage banking division which is separate from our retail banking division. We provide mortgage loan products to customers located in all areas of Mongolia, both in rural areas and in Ulaanbaatar city. Our mortgage loans are provided by all branches in rural areas with the exception of apartment mortgage loans which are only offered at branches in Ulaanbaatar city. The Bank has six specialised branches in Ulaanbaatar city, including our residential mortgage service centre which we opened in 2010 and which is focused on providing specialised services to our residential mortgage customers.

In Ulaanbaatar city, the Bank offers mortgage loans in respect of apartments and commercial properties. In rural areas, mortgages are offered in respect of Mongolian traditional ger dwellings. Our customers often use mortgage loans to move from a ger-district to an apartment in the city or in provincial centres, or to add rooms to an existing apartment. The average age of our mortgage customers is 38 years. The self-employed borrowers comprise 44 percent of the total mortgage borrowers whereas the salaried (employee) borrowers comprise of 45 percent of the total mortgage borrowers.

As of December 31, 2010, XacBank’s total mortgage loan portfolio was MNT57,795.6 million, representing 18.0 percent of the total loan portfolio outstanding. As of December 31, 2010, we extended mortgage loans to 1,974 and 2,126 customers located in Ulaanbaatar in the aggregate amount of MNT34,832 million, representing approximately 18.6 percent of the total Ulaanbaatar loan portfolio and approximately 10.8 percent of the total loan portfolio outstanding. The overall decline in size has been due to the aggressive growth of the SME and corporate loan portfolio. The Bank’s loan to value policy in respect of mortgage loans on real estate property is 80:100. All of our mortgages are 100 percent collateralised. As of December 31, 2010, the average mortgage loan size was MNT12.5 million and carried an interest rate of up to 17.39 percent per month.

### ■ RETAIL BANKING ACTIVITIES

XacBank provides a wide range of retail banking services, including lending, deposit-taking, payment, leasing services and other banking services to its micro finance customers and individual customers through our national branch network, which covers all areas of Mongolia and provides real-time domestic money transfers, as well

## *The “Aspire” program for promoting 14-18 years old children’s financial education has been running successfully and in 2010 7,058 children from 120 general education schools learnt personal finance management and other key life skills.*

### Aspire

#### A GIRL WITH BIG WISHES

A young girl named Gereltogtoh Munh and her peers in 10<sup>th</sup> grade at school number 79 in Bayanzurh District, attended ‘Aspire’ financial education program during 2010. She, who is strongly impelled to make her parents proud, lives with her parents and a brother in an underserved community in Sharhad. Many years ago her father caught in an industrial accident and became disabled, while her mother can only work part-time for a medical reason, which left Gereltogtoh to take the lead for the family from a very young age and focus on her study at the same time. Despite the difficulty at home, she excels at every school competitions and became her teacher’s most loved student. Recently she wrote an essay named “A world renowned Mongolian Soldier” and took a second place in a creative writing competition. Her dream is to become an economist, so much

so that she already started preparing for the exams that would let her into one of the top universities. Her teacher Enehdagul says “Our Gerel has the highest reputation in her class as she is a brilliant student. She has many transferable talents and this could only mean she would achieve a lot in today’s society”. When she was asked about how Aspire program has helped her in life, she told “We have learnt a lot about money and its value from the very day the Aspire financial education program started running at our school. We used to eagerly wait for the next lesson, which ran once a week only. Now we often chat about how much money we saved in our bank account and how much we earned in interest. As for me, I first opened an Aspire saving account with 10 thousand tugrugs but now I have increased it fivefold”.

## *A total of MNT2.7 billion Kiva loans were disbursed to 1,696 micro business owners.*

as international money transfer services, including Western Union and Eurogiro money transfer services for international remittances, and monitoring of accounts at all branches connected to our central servers. Additionally, the launch of internet, mobile phone and SMS banking, branchless solutions and the Saving and Credit Cooperatives franchise have enabled us to reach customers in all locations of Mongolia including very remote areas. The Bank's aim is to provide a full range of retail banking services, with particular emphasis on quality of service, to all of our customers.

As at December 31, 2010, XacBank had 49 rural branches and support centres located in every provincial centre of Mongolia, and 60 Savings and Credit Cooperatives franchises located in villages and towns throughout Mongolia. Additionally, the Bank has increased our retail presence within Ulaanbaatar and we now provide a full range of retail banking services through our 33 branches and support centres in Ulaanbaatar, including, among other services, micro and small business loans (short-term working capital and medium-term investment capital loans), consumer loans, finance leases, savings accounts, and various card and deposit products.

### ■ MICROFINANCE BANKING ACTIVITIES

XacBank is considered as the leading and most experienced provider of microfinance services in Mongolia, according to a study conducted by IFC and KfW in 2009. We have provided financing to microfinance customers since 1998. Customers in rural and remote areas of Mongolia represented 64.6 percent of the total microloan portfolio. In order to assist its customers to develop a sustainable business, the Bank extend not only micro-business loans to these customers but also micro-insurance, eco-products, child and youth savings accounts, long term saving products and payment services to its microfinance customers.

### ■ SAVING AND CREDIT COOPERATIVES

XacBank implemented a 'Development Guide' franchise service, since 2004, to local Savings and Credit Cooperatives (SCCs) to expand our financial services in rural areas. We provide each franchise group with technology and technical support, products, monitoring and financial services. In order to participate, they are required to, among other things, have at least 21 members, at least MNT2.0 million in share capital, and agree with the terms of the franchise contract. The franchise of the SCCs supports local economic growth and delivers multiple financial services to local residents. As of December 31, 2010 there were 60 active SCCs franchises.

The Bank has implemented a policy of withdrawing from direct lending through our mobile banking service in the remote rural areas of Mongolia in order to only lend through Savings and Credit Cooperatives and we have transferred our existing portfolio of loans to the relevant cooperative in a particular geographic area. Other than acting as lender to the SCCs, the Bank provides start-up information and training as well as continued technical support and advice to the Savings and Credit Cooperatives.

### ■ DEPOSITS SERVICE

Consistent with increased retail loan volumes in Mongolia, our retail deposit base has experienced strong growth in recent years primarily due to our extensive national branch network.

The Bank's total number of retail deposit accounts has increased from 285,131 accounts as of December 31, 2009 to 369,070 accounts as of December 31, 2010, primarily due to its development of branchless solutions, as well as to a lesser extent, its branch expansion.

	Year ended 31 December	
	2009	2010
	(MNT millions)	
Current accounts	3863,6	5 999,7
Demand deposits	20811	35 455,4
Term deposits	69923,8	113 207,7
<b>Total retail deposit</b>	<b>94 598,4</b>	<b>154 662,8</b>

### ■ LOAN PORTFOLIO

As of December 31, 2010, XacBank had a total loan portfolio of MNT321,690.8 million, of which 39.4 percent was SME loans and 75.7 percent was MNT-denominated. Our total loan portfolio has increased from MNT193,963.3 million as of December 31, 2009 to MNT321,690.8 million as of December 31, 2010, respectively, representing a compound annual growth rate of 48 percent. Interest income from loans to customers has increased in recent years reflecting our increased lending volume, which has been partially offset by decreasing average interest rates resulting from competitive market pressures. The average interest rates on our loans to customers were 22 percent and 19.3 percent as of December 31, 2009 and 2010, respectively.

XacBank's average loan size has also steadily increased from MNT2.3 million as of December 31, 2009 to MNT3.7 million as of December 31, 2010, respectively, primarily due to increased SME lending in both rural areas and Ulaanbaatar city, an increase in the average size of mortgages and, to a lesser extent, an increase in the average size of micro and small business loans.

*XacBank invested in supporting micro entrepreneurs in thriving business community areas by opening two micro credit centers in Ulaanbaatar.*

*The Bank enhanced its AMAR mobile banking service by opening 400 AMAR agents serving as cash withdrawal points.*



#### Mobile Bank AMAR AGENT

As part of an objective to make financial services accessible to all customers, XacBank invested a huge effort to widen its AMAR agent network nationwide and one of the agents newly joined the network was a young family lead by Amartaivan and his wife Tserenchunt. Originally from Tuv Aymag, the couple moved to Tolgoit, an isolated district of the fast expanding city of Ulaanbaatar city, with their two young children, in a hope to start a new life. As soon as they settled, they rented two floor commercial property to run a local shop selling all the local necessities. They quickly established themselves as a trusted supplier with their polite service and soon started earning 1.2 million tugrugs a month from the local shop business. However this was never enough for the family, as they paid nearly half of their earnings for the rent. So they put forward their interest to become an AMAR agent, with an intention to increase their income by offering the mobile banking service.

"We initially heard about AMAR service from the popular TV series called "Tough Class", and in the following days we were visited by a representative of AMAR service at XacBank at our shop, who fully introduced the service to us" they said with a smile. "In our local area the nearest bank is in 1 km distance, so we thought becoming an AMAR agent and work with XacBank was a wise option as it provides decent income for us, whilst being useful the local community, which is why went for it" said Tserenchunt. They also expressed their intention to extend their business further and to buy their shop eventually. The couple now pays their wholesale beverage supplier companies such as APU, Vitafit, and Tiger using AMAR too.

AMAR service agents are XacBank approved cashpoints serving AMAR service customers for daily transactions such as cash-dispensing or transferring payments. Moreover, these agents are also presented with an option to pay for their wholesale suppliers or service providers using the mobile banking service.

Amartaivan and his family is one of 400 AMAR service agents making financial services accessible to even the most isolated part of urban community by becoming trusted partners of XacBank, which is committed to implementing technological advancements to its business operation.

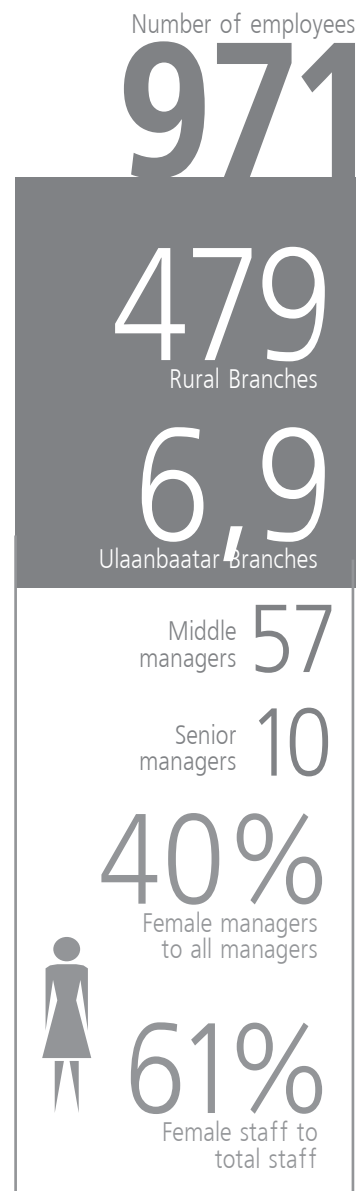
# Human Capital Indicators

2010

TO MANAGE DIVERSITY AS A COMPETITIVE ADVANTAGE, ENSURING EQUAL OPPORTUNITIES AND RESPECT TO ALL EMPLOYEES:



2009



**1086**

Employees, participated in training

TO PROMOTE PROFESSIONAL DEVELOPMENT, BY RECONCILING THE BANK'S AND INDIVIDUALS INTERESTS:

**619**

Employees, participated in training

# Human Capital Management

XacBank strives to retain a strong and loyal work force, and continue to ensure fair and adequate compensation, clean, safe and orderly working conditions and mindfulness of its employees' family and social responsibilities as a work-life balance. As a result of this, the Bank reduced its staff turnover by 4.9 percent to approximately 16 percent in 2009 and it remained at a similar level in 2010. In 2009-2010 the Bank carried out an internal restructuring which changed the focus of the staff from being product based to being client focused. In particular, the Bank's administrative support functions were separated from the front office credit functions. This reorganisation has strengthened internal controls. Additionally, in 2010 the Bank carried out a review of its employee compensation structure. The management has since implemented a new policy whereby high performing employees are awarded merit increases of 1.5 times those of average performing employees.

## ■ STAFF DEVELOPMENT AND SOCIAL WELFARE

XacBank believes in investing in its employees and therefore we have made available to our staff a housing programme that provides subsidised long term mortgages and a defined contribution retirement plan. Additionally, we run an English proficiency programme and have enhanced staff career development and training programmes. The Bank's internal Training and Development Centre, in cooperation with international training providers prepare and implement a number of training programmes designed to improve the professional skills of our employees, thereby ensuring that our workforce has an understanding of domestic and international banking standards and practices. In conjunction with the reorganisation in 2009-2010 the Training and Development Centre organised a series of workshops for relationship officers to upscale our employees on product knowledge, sales and communications skills. Moreover, a 360-degree feedback for all managers has been solicited for all managers and their professional development program is to be tailored based on the individual needs as aligned with the Bank's strategic goals and long and medium-term objectives.

The Senior Management Academy was organized in February 2010, for two weeks, during which the Bank's extended management team was taught by an experienced coach from the Duke University and Center for Creative Leadership. Under the Bank's Management and Leadership Development Program, at least four women managers attended leadership program in India and the United States.

The Bank organised repeated a two week credit training programme to 15 Chinese microfinance representatives and attended by the officials from the People's Bank of China in 2010, and an experience-sharing training was offered to the CFP Microcredit Company in September. Also, a one week mobile phone banking technology sharing workshop was organized for the Kyrgyz government and microfinance representatives. Furthermore, a regional seminar was held with IFC on 'Microfinance: International Regulation, Practice and Innovations' during October 12-14, 2010, for a delegation from Azerbaijan, Bosnia and Herzegovina, Kazakhstan, Kyrgyz Republic and Tajikistan.

## ■ EMPLOYEE COMPENSATION AND STOCK OWNERSHIP PLAN

The Bank's aggregate amount of salaries or other compensation, discretionary bonuses, other allowances, contributions to pension plans, contributions to social and health fund and benefits-in-kind paid by XacBank to its employees in 2009 and 2010 was approximately MNT6,422.2 million and MNT8,557.3 million, respectively. Key management compensation in 2009 and 2010 was approximately MNT286.9 million and MNT611.7 million respectively, including salaries, bonuses, the state pension plan and social security insurance.

Since 2002, XacBank has been implemented an Employee Stock Ownership Plan (ESOP), and was the first private sector institution in Mongolia to induct its employees into such company stock co-ownership arrangement. In 2010, the Bank's parent company - TenGer Financial Group - introduced a new plan (KESOP) for key employees of the Group, its subsidiaries and associates including the Bank. The key employees include members of the management team and other high performing staff identified by the management of TenGer and the Bank. It is designed as a defined contribution plan to employees to motivate them for longer-term sustainable value creation to the company. Under the current policy, individual employee allocations are calculated on the basis of relative pay and related to individual merit. The new KESOP fund is financed by the Bank at its inception, later financed by respective group company. This fund is not expected to operate as a separate legal entity, as in a case of the previous ESOP, but as a special purpose account held by the Bank and owned by the parent company ■

*Named as one of TOP20 employment generating companies in Mongolia, XacBank has a nation-wide network of 84 branches and over 1200 employees.*

## The United Nations Global Compact Principles

XacBank, as a good corporate citizen, has fully endorsed the United Nations Global Compact and strives to incorporate the ten principles in its corporate policies and business operations. The Bank also aims to move the sustainable development agenda forward on its performance related to human rights, labour rights, the environment and the fight against bribery and corruption through support of the Global Compact.

### Human rights

*Principle 1* Businesses should support and respect the protection of internationally proclaimed human rights; and

*Principle 2* make sure that they are not complicit in human rights abuses.

### Labour

*Principle 3* Business should uphold the freedom of association and the effective recognition of the right to collective bargaining;

*Principle 4* the elimination of all forms of forced and compulsory labour;

*Principle 5* the effective abolition of child labour; and

*Principle 6* the elimination of discrimination in respect of employment and occupation

### Environment

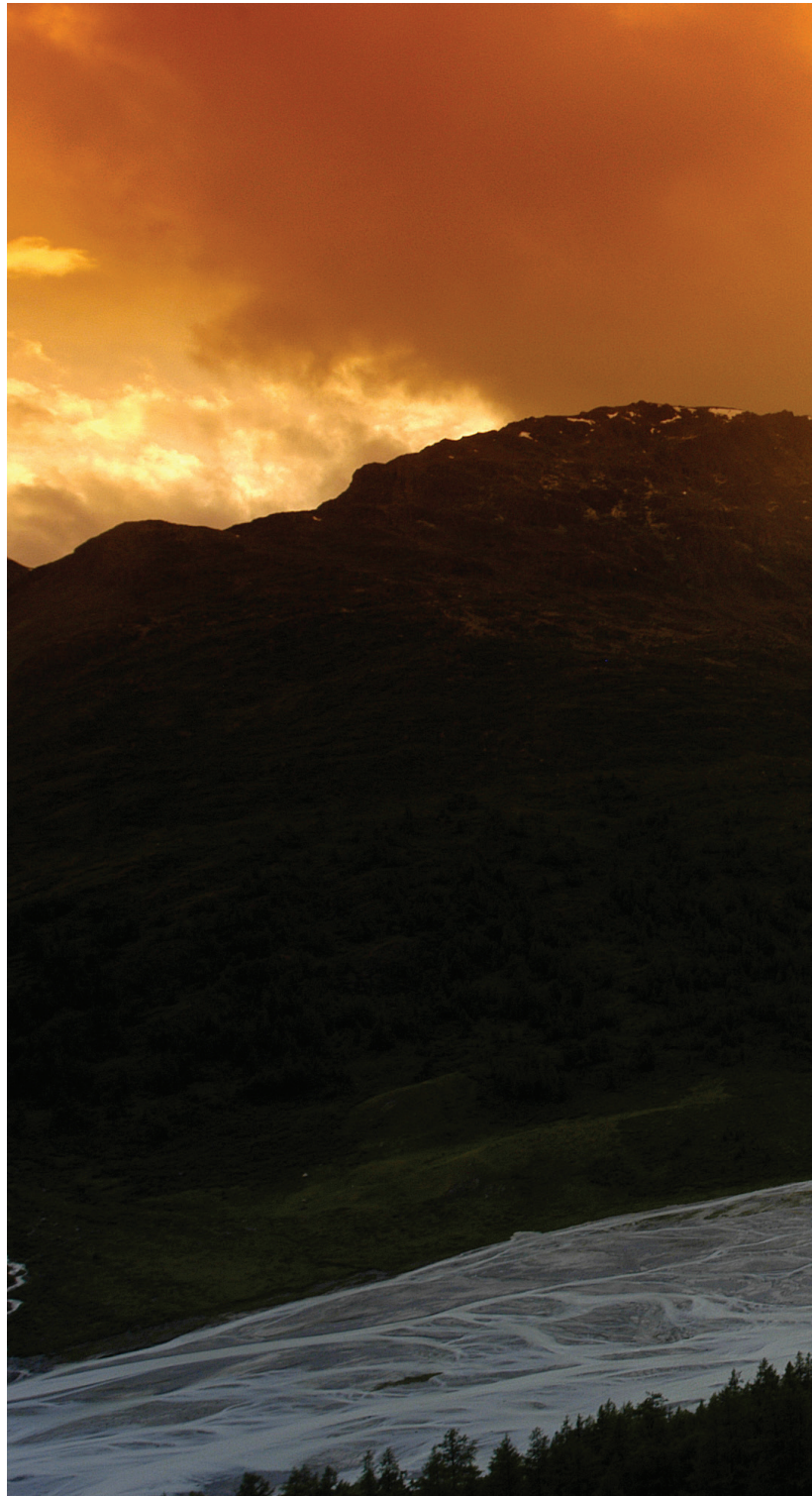
*Principle 7* Businesses are asked to support a precautionary approach to environmental challenges;

*Principle 8* undertake initiatives to promote greater environmental responsibility; and

*Principle 9* encourage the development and diffusion of environmentally friendly technologies

### Anti-corruption

*Principle 10* Businesses should work against corruption in all its forms, including extortion and bribery





Planet

*The third annual nationwide "Xac Meadow" campaign was organized and over 7,000 young trees were planted across selected locations, with 300 employees working to cultivate local green parks.*

# Social And Environmental Accountability

XacBank is firmly committed to corporate social responsibility and stewardship of the local environment and communities. In February 2010, we were named as 'The Social Responsibility Leader of 2009' by the Mongolian Management Association, and we received the 'Social Performance Reporting Award' in the silver category from the World Bank-led Consultative Group to Assist the Poor (CGAP) in 2010.

Internally, the Bank committed to fully complying with national and international environmental regulations applicable to our operations and business services. We provide environmental and social reports on a regular basis to our management and shareholders. Further, we have initiated in-house environmental protection measures aimed at efficient use of energy, fuel, water, reducing paper consumption and waste.

On an external level, the Bank has increased access to financial services in rural areas of Mongolia in the local community through the Savings and Credit Cooperatives franchise and our rural mobile banking services. We have implemented a policy to withdraw from direct lending through our mobile banking service in the rural areas of Mongolia in order to only lend through Saving and Credit Cooperatives and we have transferred our existing portfolio of loans to the Saving and Credit Cooperatives.

Our environmental responsibility initiative has gained traction as we have been supported by our business partners. The Saving and Credit Cooperatives, 'Zoos-Hurd' in Umnudelger soum in Hentiy aymag, 'Naran-Urgah' in Bayandun soum in Dornod aymag, have encouraged local people to protect the natural environment by cleaning and restoring clean water sources, as well as producing and distributing hand-made cotton bags. Further, in 2010 the Bank donated a total of MNT11.0 million to the Labour and Training Factory of Blind Citizens, in order for a sewing unit to be established to provide sewing training. This collaboration created at least 10 new jobs for blind and other disabled people.

In support of low-income women in remote areas of Mongolia, XacBank initiated, jointly with the EBRD and the Mongolian Women's Federation, a group lending programme whereby women's groups in Arhangay, Bulgan, Hentiy and Huvsgul aymags received low-interest loans without having to provide collateral. Group members are required to have a group saving initiative or common asset.

The Bank's employees initiated X.A.C (Golden Fund for Development Association/GFDA) NGO, in partnership with Lek En Linge High School of Netherlands, commenced the implementation of a Euro55 thousand aid project for High School Number 88 in the Bayanzurkh district. The project provided financial support for classroom repairs,

the purchase of training materials, the provision of a variety of training opportunities for students and teaching staff, sports and cultural equipment, university scholarships, extra-curricular activities and sponsorship for the national high school football tournament 'Boom-2020'.

During 2010, the Bank donated three Ger dwellings to destitute families in partnership with two Mongolian charities. In October 2010, we signed a cooperation agreement with WWF Mongolia and Nomadic Journeys LLC to establish an Environmental Preservation Fund for supporters of nature conservation. Income from the capital received is to be used for providing incentives to the local communities to conserve biodiversity.

XacBank introduced the 'Temuulel' or Aspire program to Mongolian girls with technical assistance from Women's World Banking (WWB). This is a financial education and savings product program which aims to give Mongolian girls essential capabilities for making their dreams come true. As they grow up, Mongolian girls can become confident and independent women by learning to set realistic goals, saving and managing their money. The Aspire program has two components: the first is the financial education program and the other is a set of saving products designed especially for girls. The Aspire program allows girls to both learn and then practice what that they have learned through offering attractive savings products for them. As of December 31, 2010, the Bank collaborated with 225 secondary schools, reaching 9,125 school children and 270 working girls through the financial education program. In October 2010, XacBank has started to offer savings and support program to boys. Totally, 4,863 Aspire accounts have opened and amount of its portfolio reached at MNT 283 million in the end of 2010. In addition, the Bank provided a part-time working opportunity for 82 university students by training them as peer educators. Moreover, the Bank selected 350 students from 117 secondary schools as student bankers. These students have provided FE trainings, savings tips and deposit information to their school girls.

In 2010 the Bank launched 'Aflatoun' program that provides children, aged 8-13, with the building blocks of life and empowers them to make a positive change in their lives and communities and eventually break the cycle of poverty in which many find themselves. Our Child Social and Financial Education (CSFE) program balances personal and social awareness with practical planning, saving and entrepreneurial skills. Aflatoun program provides children with Social and Financial Education in 76 countries and 30 other countries in preparation throughout the world. Aflatoun program is being implemented through GFDA and during its pilot stage, there were 10 schools involved. There were 356 students aged 8-11 from 11 classes which have had Aflatoun lessons including 175 boys and 181 girls in 2010.

*The Bank was selected and signed in as a partner of SEEP network to jointly promote financial education program for youth.*



### ■ ECO-BANKING ACTIVITIES

Consistent with its triple-bottom line mission, XacBank is committed to eco-banking solutions. Through our partnership with Micro Energy Credits in 2009, we became the first development finance bank in the Northern Hemisphere to sell our carbon offsets and access financing through the carbon markets. In 2009 we created a dedicated Eco Products unit at our headquarters in Ulaanbaatar to oversee all aspects of our Eco Products Programme, which is focused on lending that promotes the reduction of air and soil pollution. In September 2009, we launched our Eco Products Program, offering low interest loans for energy products to low-income customers in Mongolia. Through this programme we have assisted customers in reducing their fuel costs. Typically, low-income Mongolians would spend over a third of their monthly income on coal and wood for cooking and heating in the winter. However, by using the eco-loans we provide, our customers can purchase energy-efficient products such as energy-efficient stoves, solar panels or insulated gers and therefore not only have more efficient methods of heating but also reduce their greenhouse gas and CO<sub>2</sub> emissions through their reduced dependence on fuels such as coal and wood. We currently offer an eco-loan product which has an interest rate of 1.4 percent per annum with no down payment. Since its launch, the Bank has provided more than MNT453.0 million in eco-loans to its customers.

XacBank entered into a carbon purchase agreement with Micro Energy Credits (MECS) in October 2009, and we were presented by Micro Energy Credits with a cheque for the carbon emissions reductions derived from our first eco-loan. The cheque represented the first carbon revenue generated by a microfinance institution in Mongolia.

The Bank has increased its eco-banking exposure in the past two years and we are working with international financial institutions, including the Asia Development Bank (ADB), to provide financial solutions for energy efficient housing. Additionally, we provide credit support to customers focused on developing eco-friendly products such as providing financing to the Stove Emissions and Efficiency Testing Laboratory in Ulaanbaatar established by, among others, the Asian Development Bank, and developing ger blankets, a form of home insulation which reduces heating requirements by up to 50 percent. We currently offer an eco-loan product to our SME customers to manufacture eco-friendly products with an interest rate of 1.2% to 1.8% per annum. Since 2009 we have provided more than MNT1,731.9 million in loans to manufacturers of eco-friendly products.

XacBank, since 2009, with the assistance and collaboration of over 100 domestic and international organisations, distributed over 6,927 energy efficient products and reduced the energy costs of Ulaanbaatar city by approximately MNT708 million according to our internal data and publicly available sources. Further, in 2010 the Bank partnered with the Millennium Challenge Account (MCA), Mongolia to manage a subsidy programme promoting energy efficient products. As at December 31, 2010, XacBank distributed more than MNT1,540.0 million in subsidies to 2,089 customers to purchase eco-friendly products and six manufacturers to produce eco-friendly products ■

*In 2010, XacBank distributed over 7,000 units of eco products including fuel efficient stoves and refined ger insulations to residents living in ger districts. To assist the project's return, the Bank opened 4 eco product sale points in Ulaanbaatar's carbon emission zones with a view to expand the operation further in 2011.*

*Micro Energy Credits audited XacBank's carbon credit earnings made during 2010 and evaluated the Bank performance at 94.5%.*



Eco Bank

#### **XACBANK'S INVOLVEMENT IN COMBATING AIR POLLUTION**

Munhjargal heads a family of four. He, his wife Handsuren, and their two children live in the Chingeltey district of Ulaanbaatar city, which is considered as the epicenter of the city's carbon emissions from ger district residents using coal stoves to stay warm during the winter season. Two years ago, their only son was diagnosed with a brain tumor. When the parents heard the news, they immediately sold their family property and their car in order to pay for their son's medical treatment and started living in a rented house. However, the fund they raised from selling their properties was only sufficient to pay for day-to-day medical care but not for the necessary operation for their son. Nevertheless, the family was able to overcome the difficulties thanks to goodwill of their friends and neighbors and XacBank's Eco loan service. The operation was funded by a local MP, and at the same time they were provided with an opportunity

to buy an affordable, energy efficient, ger house from the local "Clear Air" project run by XacBank and the Mongolian Millennium Challenge Account.

The family also purchased a fuel efficient stove from the project, which according to Handsuren, allowed the family to reduce fuel costs by 30-50 per cent. After the first season, Handsuren fully understood the impact of living in an energy efficient home with 50 percent less smoke emission. This year Handsuren has become a community ambassador for the project and is working to spread the word, so that her friends and neighbors can benefit from these products as well. Speaking of her experience she said "I'm very grateful to XacBank for enabling us to have a roof over our heads that also benefits the environment and our family's health. Since moving into our new home we have been counting ourselves very lucky. We were even visited by the President Elbegdorj Tsahia this year, which is a good omen for us".

# Integrated Risk Management System

## ■ GENERAL OVERVIEW

XacBank has a clearly defined framework in order to manage its potential exposure to credit risk, liquidity risk, market risk, prepayment risk, operational risk and compliance risk which could result in direct loss of capital or effect our reputation to ensure that:

- employees clearly understand the requirement and measurement system in respect of the risks;
- our risk exposure is within the limits established by our Board of Directors;
- the risk measured is in line with our business strategy as approved by our Board of Directors;
- the capital allocation is consistent with the risk exposures; and
- our performance objectives are aligned with the risk tolerance.

The Bank's Board of Directors is responsible for the overall risk management approach and for approving our risk strategies and principles. However, there are separate independent bodies which are responsible for the management and implementation of the risk management policies and monitoring the risks, including:

- Risk Management Committee: The Risk Management Committee was established, with its main responsibility to approve, monitor and evaluate a comprehensive risk management policy for us as well as to monitor new and ongoing financial risks across each of our business departments. Additionally, it ensures that the appropriate risk limits are maintained and that adequate systems and standards for measuring such financial risk and performance are in place;
- Internal Audit Division: All internal risk management processes are audited on an annual basis by the Internal Audit Division which examines both the adequacy of our procedures and that our compliance with the procedures have been appropriately implemented. Internal Audit Division discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee;
- Integrated Risk Management Division: The Integrated Risk Management Division is directly responsible for implementing risk related procedures and for identifying, measuring, monitoring, and managing our daily financial positions and daily operational risk. It is also primarily responsible for our market risk, liquidity risk, credit portfolio risk and operational risk.

In general, the Bank's integrated risk management system is designed to focus on credit risk management, liquidity risk, market risk management, prepayment risk management, operational risk management and compliance risk management. The monitoring and controlling of risks is primarily performed based on limits set by us. These reflect our business strategy and market environment. Our senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis and the supervisory board

receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess all of our risks.

All levels of XacBank employees receive specifically tailored risk reports to ensure that all business divisions have access to extensive, necessary and up-to-date information. Additionally, more detailed reports including aggregate credit exposure, credit metric forecasts, hold limit exceptions, VaR, liquidity ratios and risk profile changes are provided to the Board of Directors, the Risk Management Committee and the head of each business division on a monthly basis.

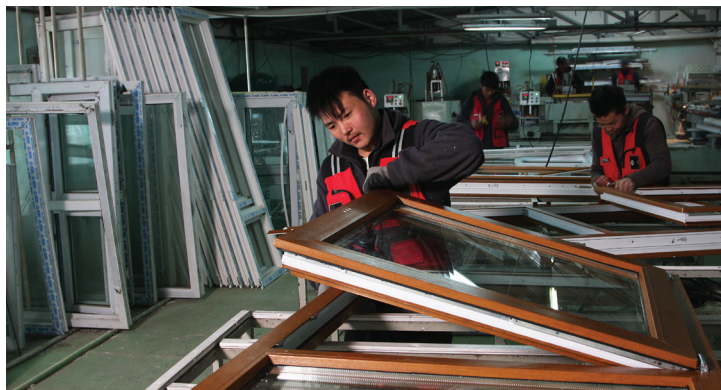
During 2010, the Bank received technical assistance from AFC, an international consulting company, in relation to our risk management and has since strengthened our risk management policies and procedures. In particular AFC provided such assistance to the Bank's Internal Audit Division, Integrated Risk Management Division and Treasury Department.

## ■ CREDIT RISK MANAGEMENT

The Bank's Risk Management Committee, through the Credit Risk Management Division (CRMD) promotes diversification of the loan portfolio of our lending activities. The CRMD limits the amount of risk which we accept in relation to one borrower, a group of borrowers, loan product type or to industry segments. Such risks are monitored on a revolving basis and subject to annual and semi-annual reviews. These limits are approved by the Board of Directors. The Bank also manages its credit risk through obtaining collateral and corporate and personal guarantees. We monitor the collateral offered as security for each of our loans throughout the term of the loan so as to verify that it is in existence and has not deteriorated in quality. The frequency with which collateral is monitored varies in accordance with the type of collateral. However, we perform physical inspections of collateral and regularly monitor the market value of collateral and request additional collateral in accordance with underlying agreements. Additionally, we monitor the market value of collateral obtained during our review of the adequacy of the allowance for impairment losses.

The Bank manages the credit quality of loans and advances to customers using an internal method of credit ratings whereby there are 4-grades available (the "4-Grade Risk Rating"). This method is modelled using parametric approaches that quantify the probability of default in determining the risk grade. By maintaining an accurate and consistent grading approach, we are able to compare credit exposure across all lines of loan products, Loan assessment and approval." The system is also supported by a number of financial and statistical analytics and reviewed with market and portfolio information. We have imposed internal lending limits which are in compliance with the regulations of the Bank of Mongolia. As a result, the total amount of loan exposure to a single borrower must not exceed 20.0 percent of our total capital and the total exposure for employee loans must not exceed 5.0 percent of the Bank's total capital.

*The Bank signed a USD5million, 8 year term subordinated loan agreement with IFC to increase the Bank's second tier capital and to support the strategic expansion of the Bank's lending to SMEs.*



Business Bank

### OPENING A WINDOW OF OPPORTUNITIES

Gantumur Luvsantseren is a timber processing engineer. He started his career in the construction sector in the early 90's and

now working as the Managing Director of "Tsonh Construction" Ltd, which employs 50 people.

Gantumur's professional business career began in 2003, when he first developed a business project to establish a plastic manufacturing business, which was deemed so successful that he secured an instant funding to make a head start. A year later, he was already able to expand his business to set up a window and door making unit, while in 2008 his second workshop making metal framed windows was opened. Two years later, the company received an additional loan from XacBank and the business was expanded into manufacturing of energy efficient windows. "Our company is where it is at today, thanks to the loans we received. People think of loans in two ways. Some think that it's a windfall revenue and so they fail to invest it right back into their business, whilst others believe that borrowing never helps you thrive, therefore they avoid loans as a funding tool. As long you believe in what you're building and that you work hard at it, then success would eventually follow" says Gantumur.

Today "Tsonh Construction" manufactures not only plastic windows and doors, but it has also implemented innovative technology and methods to its production, which won the company numerous acclaims from customers and the corresponding government ministry.

### ■ LIQUIDITY RISK MANAGEMENT

The Bank places significant emphasis on the effective management of its balance sheet and liquidity management. Our goal is to ensure that we will, even under adverse conditions, have sufficient liquidity to meet all of our contractual and regulatory financial obligations. We maintain a stable funding base primarily consisting of amounts due to other banks, corporate and retail customer deposits, other borrowed funds and subordinated debt. It is our policy to maintain a prudent mix of borrowed and core deposit base. In addition, we maintain a statutory deposit with the Central Bank of Mongolia equal to approximately 5.0 percent of customer deposits. The Asset and Liability Committee is responsible for monitoring and managing our liquidity risk together with the Risk Management Committee as well as carrying out cash flow analysis, re-pricing analysis and setting the applicable limits. XacBank calculates liquidity ratios on a daily basis in accordance with the requirements of the Bank of Mongolia. The Treasury Department receives this information and provides for an adequate portfolio of short-term liquid assets to ensure that we maintain sufficient liquidity.

In order to manage liquidity, the Bank monitors expected maturities of our liabilities and the maturities of our assets in order to avoid any potential funding pressures. The difference between assets and liabilities maturing within the same time frame are interpreted as mismatches. Any negative gaps, being when liabilities exceed the assets, within the short term are inferred as a general indicator of increased liquidity risk.

### ■ MARKET RISK MANAGEMENT

We are exposed to market risks including interest rate risk, currency risk and prepayment risk. We manage and monitor market risk using VaR and sensitivity analyses. We set limits on the amount of market risk that is acceptable. The overall responsibility for managing the market risk lies with the Treasury department which reviews and approves risk management policies and monitors their implementation.

Our lending, funding and investment activities give rise to interest rate risk which is measured by the extent to which changes in market interest rates impact our margins and net income. The interest rate risk is managed through the monitoring of interest rate gaps for stipulated periods. We establish interest rate risk limits based on the cost of funding, other operating costs, the inflation rates, the interest rate of the central bank securities and other factors, and to date such limits have not been reached.

The Bank may face financial losses arising from adverse movements in foreign exchange rates. In order to limit our exposure to such risk, our management set exposure limits which are monitored on a frequent basis by way of foreign exchange exposure mismatch and, since 2007, using a VaR simulation model. The VaR limits and exposures are reviewed regularly against the limits set by management. The Bank has financial assets and financial liabilities denominated in the local currency, U.S. dollar and Euro. The Bank faces financial losses arising from the prepayment of

## *XacBank successfully migrated its Core Banking System to FlexCube provided by Oracle for faster and more secure customer transactions.*

loans prior to the maturity date. However, in 2010, management calculated that there would be limited risk and no significant impact of changes in prepayment rates based on historic prepayment rates.

### ■ OPERATIONAL RISK MANAGEMENT

The Bank's main task of operational risk management is supporting and advising the management of our business units and branches with regards to the formulation, development and implementation of operational risk management policies, which are designed to limit any loss arising from inadequate internal policies, failed processes, systems failure, human errors, fraud or external events which would lead to financial losses and damage to our reputation.

In order to mitigate operational risk, we have implemented a dual control framework whereby we separate duties between front-office and back-office functions, control access to systems, implement authorisation and reconciliation procedures and implement staff education. All processes are assessed by the Internal Audit Division. The Internal Audit Division examines both the adequacy of our internal procedures and our compliance with the procedures by way of, among other things, conducting (planned and ad-hoc) on-site examinations of all branches and head office units. In particular, the Internal Audit Division focuses on: adherence by the branch management including the Branch Credit Committees and the Sub-Credit Committees to our internal policies; assessing the quality of analysis of the Branch Credit Committees, the Sub-Credit Committees and the Management Credit Committee; auditing the accounts, loan portfolios and inventories of the branches; and ensuring that the IT systems are adequately maintained. The Internal Audit Division discusses the results of all assessments with management, and reports its findings and recommendations to the Board of Directors, the Chief Executive Officer and the Audit Committee.

In order to ensure that we are resilient to any unforeseeable external or internal events and disasters, we have established an Emergency Committee whose objective is to ensure the continuity of our business at all times.

### ■ COMPLIANCE RISK

XacBank regularly monitors its operations to ensure that we are in compliance with both financial and non-financial requirements of the Law of Mongolia on Fighting Against Money Laundering and Terrorism Financing of July 8, 2006, the Bank of Mongolia (Central Bank) Regulation on Disclosure of Suspicious and Cash Money Transactions of July 2, 2007, and the Bank of Mongolia (Central Bank) Regulation on providing Information to the Authorities of May 12, 2009, as the parent company shareholders and institutional investors to ensure the mitigation of any significant financial and reputation loss. In accordance with such legislation, regulations and requirements, since 2007 the Bank implemented our own internal policy, 'Fighting Money Laundering and Terrorism Financing Activities'. In respect of this policy, we monitor transactions on a daily basis and regularly report to the Financial Information Unit of the Bank of Mongolia. Additionally, we complete 'Know

your Customer/KYC' procedures on all of our customers and have implemented reporting requirements in respect of any high value cash transactions, suspicious customers and suspicious transactions using our FlexCube core banking system which enables "real-time" monitoring of all transactions on a centralised basis. Currently, we are in compliance with requirements of the Law of Mongolia on Fighting Against Money Laundering and Terrorism Financing and the other applicable Mongolian regulations, our internal anti-money laundering and anti-terrorism financing policies and all KYC procedures.

### ■ INFORMATION TECHNOLOGY RISK

XacBank views information technology as an integral part of its core operations and committed to investing in the IT infrastructure to support its existing business operations and growth. On 3 May, 2010, the Bank rolled-out our new core banking system, FlexCube from Oracle Financial Software Services (OFSS). This system facilitates full-scale operational and analytical support for wire transfers and cash settlements, credit decisions, lending activities, bank deposit maintenance, transactions in foreign currencies and remote account management services such as internet banking, SMS banking and mobile phone banking.

The new system has the following advantages intended to support and enhance the Bank's overall operational efficiency and improve security including:

- ability to monitor 'real time' customer transactions, branch operations, our loan portfolio and the market as well as to create regular management reports;
- faster response time and improved service quality to meet the needs of our growing customer base especially the ability to process loan applications more quickly;
- more efficient risk management, in particular with respect to the ease of monitoring money laundering and fraud through our new core banking system;

The Bank has entered into an agreement with a card management system provider which will enable us to provide enhanced services to its customers.

The Bank invested approximately MNT0.841 billion on information technology infrastructure during 2008, which increased to MNT4.7 billion during 2009 and in 2010, and invested a further MNT1.3 billion. These investments were primarily for the development and implementation of our new core banking system, FlexCube provided by OFSS.

XacBank has a back-up server located at its Disaster Recovery Site outside of Ulaanbaatar which mirrors the server located at its head-office in Ulaanbaatar. Additionally both servers have two power lines and a back-up generator. The Bank will continue building its technical capacity for improving its risk management for the business continuity process ■





Profit

# Independent Auditor's Report



## TO THE SHAREHOLDERS AND BOARD OF DIRECTORS OF XACBANK LLC:

We have audited the accompanying financial statements of XacBank LLC (the "Bank") which comprise the statement of financial position as of 31 December 2010 and the statement of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.

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

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

### Opinion

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

Signed by:

A handwritten signature in black ink, appearing to read "Bayarmaa Davaa".

Bayarmaa Davaa  
Executive Director

PricewaterhouseCoopers Audit LLC

Approved by:

A handwritten signature in black ink, appearing to read "Carolyn Clarke".

Carolyn Clarke  
Partner  
22 April 2011  
Ulaanbaatar, Mongolia

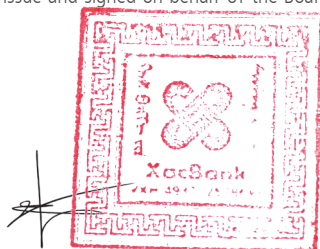


XacBank LLC

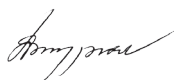
# Statement of Financial Position

In thousands of Mongolian Tugriks	Note	31 December 2010	31 December 2009 (restated)	1 January 2010 (restated)
<b>Assets</b>				
Cash and cash equivalents	7	92,537,762	72,309,165	31,541,849
Mandatory reserve with BOM	8	9,780,500	6,834,900	3,655,500
Due from other banks	9	19,438,657	20,641,544	4,031,663
Loans and advances to customers	10	321,690,771	193,963,327	148,644,479
Investment securities available for sale	11	23,300	3,191,051	518,666
Investment in associates	12	411,380	269,269	-
Intangible assets	13	3,526,039	2,845,516	2,023,990
Property and equipment	14	16,645,842	15,194,630	12,462,885
Deferred income tax asset	27	309,547	127,704	143,413
Current income tax prepayment		-	297,574	-
Other assets	15	4,219,678	3,065,717	4,095,404
<b>Total assets</b>		<b>468,583,476</b>	<b>318,740,397</b>	<b>207,117,849</b>
<b>Liabilities</b>				
Due to other banks	16	32,482,270	22,067,565	5,269,224
Customer accounts	17	237,193,052	127,401,676	77,060,479
Other borrowed funds	18	146,274,827	130,490,468	97,087,964
Current income tax liability		116,847	-	278,758
Other liabilities	19	3,495,320	1,089,189	761,262
Repurchase agreements		-	-	1,701,174
Deferred grants	20	303,609	384,055	102,157
Subordinated debt	21	14,103,479	8,813,103	3,707,110
<b>Total liabilities</b>		<b>433,969,404</b>	<b>290,246,056</b>	<b>185,968,128</b>
<b>Equity</b>				
Share capital	22	13,290,651	13,290,651	10,947,830
Share premium	22	5,252,103	5,252,103	2,594,922
Other reserves		10,531,368	8,353,389	5,185,768
Retained earnings		5,539,950	1,598,198	2,421,201
<b>Total equity</b>		<b>34,614,072</b>	<b>28,494,341</b>	<b>21,149,721</b>
<b>Total liabilities and equity</b>		<b>468,583,476</b>	<b>318,740,397</b>	<b>207,117,849</b>

Approved for issue and signed on behalf of the Board of Directors on 22 April 2011.



**Bat-Ochir Dugersuren**  
Chief Executive Officer



**Delgerjargal Bayanjargal**  
Chief Financial Officer

XacBank LLC

## Statement of Comprehensive Income

In thousands of Mongolian Tugriks	Note	2010	2009 (restated)
Interest income	23	57,585,452	40,463,148
Interest expense	23	(30,845,098)	(21,111,773)
<b>Net interest income</b>		<b>26,740,354</b>	<b>19,351,375</b>
Provision for loan impairment	10	(1,259,675)	(1,629,524)
<b>Net interest income after provision for loan impairment</b>		<b>25,480,679</b>	<b>17,721,851</b>
Fee and commission income	24	1,044,197	853,268
Fee and commission expense	24	(284,846)	(263,939)
Gains from sale of associate	12	353,144	-
Foreign exchange gains/(losses), net	25	1,033,971	(1,579,451)
Provision for other assets	15	(284,823)	(51,634)
Grant income	20	316,879	320,678
Grant expenses	20	(316,879)	(320,678)
Other operating income		246,844	298,103
Administrative and other operating expenses	26	(19,224,864)	(14,273,836)
<b>Profit before tax</b>		<b>8,364,302</b>	<b>2,704,362</b>
Income tax expense	27	(1,862,868)	(359,744)
<b>Profit for the year</b>		<b>6,501,434</b>	<b>2,344,618</b>
<b>Total comprehensive income for the year</b>		<b>6,501,434</b>	<b>2,344,618</b>

# Statement of Changes in Equity

In thousands of Mongolian Tugriks	Note	Share capital	Share premium	Other reserve	Retained earnings	Total equity
<b>Previously reported balance at 1 January 2009</b>		<b>10,947,830</b>	<b>2,594,922</b>	<b>5,185,768</b>	<b>3,167,621</b>	<b>21,896,141</b>
Effects of restatements	3	-	-	-	(746,420)	<b>(746,420)</b>
<b>Adjusted balance at 1 January 2009</b>		<b>10,947,830</b>	<b>2,594,922</b>	<b>5,185,768</b>	<b>2,421,201</b>	<b>21,149,721</b>
Total comprehensive income for 2009 (restated)	3	-	-	-	2,344,618	<b>2,344,618</b>
Share issue	22	2,342,821	2,657,181	-	-	<b>5,000,002</b>
Transfer to other reserves		-	-	3,167,621	(3,167,621)	-
<b>Balance at 31 December 2009 (restated)</b>		<b>13,290,651</b>	<b>5,252,103</b>	<b>8,353,389</b>	<b>1,598,198</b>	<b>28,494,341</b>
Total comprehensive income for 2010		-	-	-	6,501,434	<b>6,501,434</b>
Treasury shares transactions	22	-	-	-	2,663	<b>2,663</b>
Transfer to other reserves		-	-	2,177,979	(2,177,979)	-
Dividends declared	28	-	-	-	(384,366)	<b>(384,366)</b>
<b>Balance at 31 December 2010</b>		<b>13,290,651</b>	<b>5,252,103</b>	<b>10,531,368</b>	<b>5,539,950</b>	<b>34,614,072</b>

XacBank LLC

## Statement of Cash Flows

In thousands of Mongolian Tugriks	Note	2010	2009 (restated)
<b>Cash flows from operating activities</b>			
Profit before tax		8,364,302	2,704,362
Adjustments to:			
Impairment provisions	10	1,259,675	1,629,524
Amortisation and depreciation	26	2,129,466	1,831,035
Losses net of gains/(gains less losses) on disposal of property, plant and equipment		34,760	(4,396)
Amortisation of deferred grants	20	(316,879)	(320,678)
Gain from sale of associate		(353,144)	-
Provision for other assets	15	284,823	51,634
Foreign exchange translation gains less losses/(losses net of gains)	25	(506,781)	1,343,638
Interest income	23	(57,585,452)	(40,463,148)
Interest expenses	23	30,845,098	21,111,773
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>(15,844,132)</b>	<b>(12,116,256)</b>
Net increase in mandatory cash balances with the Central Bank of Mongolia		(2,945,600)	(3,179,400)
Net increase in due from other banks		(895,619)	(15,044,805)
Net increase in loans and advances to customers		(138,703,732)	(39,021,547)
Net (increase)/decrease in other assets		(1,640,191)	696,188
Net increase in due to other banks		9,942,465	16,524,840
Net increase in customer accounts		111,048,239	48,767,505
Net increase in other liabilities		2,554,334	310,167
<b>Cash from operations</b>		<b>(36,484,236)</b>	<b>(3,063,308)</b>
Income taxes paid		(1,448,447)	(638,502)
Interest received		56,757,901	40,291,661
Interest paid		(27,877,016)	(20,639,168)
Deferred grants received		236,433	602,576
<b>Net cash (used in)/from operating activities</b>		<b>(8,815,365)</b>	<b>16,553,259</b>

<b>Cash flows from investing activities</b>			
Purchase of securities available for sale		-	(2,998,183)
Proceeds from disposal of securities available for sale		2,954,396	305,939
Acquisition of associates		(139,086)	(269,269)
Proceeds from disposal of associates		551,119	-
Acquisition of property, plant and equipment	14	(3,444,612)	(4,659,819)
Proceeds from disposal of property, plant and equipment		60,443	284,145
Acquisition of intangible assets	13	(911,792)	(1,004,236)
<b>Net cash used in investing activities</b>		<b>(929,532)</b>	<b>(8,341,423)</b>
<b>Cash flows from financing activities</b>			
Proceeds from subordinated debt		6,828,005	4,043,407
Proceeds from other borrowed funds		38,967,406	32,565,996
Repayment of other borrowed funds		(11,891,716)	(9,151,484)
Repayment of repurchase agreement		-	(1,701,174)
Issue of ordinary shares	22	2,663	5,000,002
Dividends paid	28	(384,366)	-
<b>Net cash from financing activities</b>		<b>33,521,992</b>	<b>30,756,747</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>		<b>(3,548,498)</b>	<b>1,798,733</b>
<b>Net increase in cash and cash equivalents</b>		<b>20,228,597</b>	<b>40,767,316</b>
Cash and cash equivalents at the beginning of the year	7	72,309,165	31,541,849
<b>Cash and cash equivalents at the end of the year</b>	<b>7</b>	<b>92,537,762</b>	<b>72,309,165</b>

# Main Awards for 2010



**TOP 5 Bank**  
MNCCI and the government of Mongolia



**National Brand - the Best Franchiser**  
MNCCI and the government of Mongolia



**Business Excellence**  
MNCCI and the government of Mongolia



**Leading 20 Business**  
MNCCI and the government of Mongolia



**Excellence in CSR**  
MNCCI and the government of Mongolia

XacBank LLC

# Notes to the Financial Statements

31 December 2010

## ■ INTRODUCTION

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2010 for XacBank LLC (the "Bank").

The Bank was incorporated and is domiciled in Mongolia. The Bank is a limited liability company and was set up in accordance with Mongolian regulations. As of 31 December 2010 and 2009 the Bank's immediate and ultimate parent was TenGer Financial Group LLC (the "Parent" or "TenGer"), holding company incorporated and domiciled in Mongolia.

None of the shareholders of TenGer Financial Group LLC have the power to govern its financial and operating policies. Thus, TenGer has no immediate and ultimate parent or ultimate controlling party. Its shareholders are disclosed in Note 22.

**Principal activity.** The Bank's principal business activity is commercial and retail banking operations and financial services within the Mongolia. The Bank has operated under a full banking licence No. 24 issued by the Bank of Mongolia ("BOM") since 2001. The Bank has 55 branches within Mongolia as of 31 December 2010, apart from its Head Office (2009: 43 branches). The Bank has no representative offices.

**Registered address and place of business.** The Bank's registered address is: XacBank Building, Prime Minister Amar's Street, Sukhbaatar District, Ulaanbaatar, Mongolia.

**Presentation currency.** These financial statements are presented in Mongolian Tugriks ("MNT"), unless otherwise stated.

## ■ OPERATING ENVIRONMENT OF THE BANK

Mongolia displays many characteristics of an emerging market including relatively high inflation and interest rates. The recent global financial crisis had a severe effect on the Mongolian economy and the financial situation in the Mongolian financial and corporate sectors significantly deteriorated during 2009. However 2010 has seen a recovery in the domestic economy and the Mongolian currency and stock market has seen high growth following the recovery in commodity prices, continuation in demand from China and an increase in inbound investment.

The tax and customs legislation in Mongolia is subject to varying interpretations and frequent changes (refer to Note 31). The future economic performance of Mongolia is tied to the continuing demand from China and continuing high global prices for commodities as well as dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government together with tax, legal regulatory and political developments.

Management determined impairment provisions by considering the economic situation and outlook at the end of the reporting period. Provisions for loans to customers and other financial assets

are determined using the 'incurred loss' model required by the applicable accounting standards. These standards require recognition of impairment losses for receivables that arose from past events and prohibit recognition of impairment losses that could arise from future events, no matter how likely those future events are. Refer to Note 4.

Management is unable to predict all developments, which could have an impact on the Mongolian economy, and consequently what effect, if any, they could have on the future financial position of the Bank. Management believes it is taking all the necessary measures to support the sustainability and development of the Bank's business.

## ■ SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of preparation.** These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of available-for-sale financial assets. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 5).

**Associates.** Associates are entities over which the Bank has significant influence (directly or indirectly), but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The carrying amount of associates includes goodwill identified on acquisition less accumulated impairment losses, if any. Dividends received from associates reduce the carrying value of the investment in associates. Other post-acquisition changes in the Bank's share of net assets of an associate are recognised as follows: (i) the Bank's share of profits or losses of associates is recorded in the consolidated profit or loss for the year as share of result of associates, (ii) the Bank's share of other comprehensive income is recognised in other comprehensive income and presented separately, (iii); all other changes in the Bank's share of the carrying value of net assets of associates are recognised in profit or loss within the share of result of associates. However, when the Bank's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Bank does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Bank and its associates are eliminated to the extent of the Bank's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

**Disposals of associates.** When the Bank ceases to have significant influence, any retained interest in the entity is re-measured to its fair

value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Bank had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are recycled to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

**Financial instruments – key measurement terms.** Depending on their classification financial instruments are carried at fair value, cost, or amortised cost as described below.

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. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Bank may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured. Refer to Note 11.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling

agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

**Initial recognition of financial instruments.** All financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Bank commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

**Derecognition of financial assets.** The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred

the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

**Cash and cash equivalents.** Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include deposits with the central bank (Bank of Mongolia), other than required mandatory reserve, and all interbank placements with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

**Mandatory cash balances with the central bank.** Mandatory cash balances with the Bank of Mongolia are carried at amortised cost and represent non-interest bearing mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated statement of cash flows.

**Due from other banks.** Amounts due from other banks are recorded when the Bank advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortised cost.

**Loans and advances to customers.** Loans and advances to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortised cost.

**Impairment of financial assets carried at amortised cost.** Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Bank considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year. Uncollectible assets are written off against the related impairment

loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

**Repossessed collateral.** Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, other financial assets or inventories within other assets depending on their nature and the Bank's intention in respect of recovery of these assets and are subsequently accounted for in accordance with the accounting policies for these categories of assets.

**Renegotiated loans.** Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

**Credit related commitments.** The Bank enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the end of each reporting period.

In cases where the fees are charged periodically in respect of an outstanding commitment, they are recognised as revenue on a time proportion basis over the respective commitment period.

**Investment securities available for sale.** This classification includes investment securities which the Bank intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Investment securities available for sale are carried at fair value. Dividends on available-for-sale equity instruments are recognised in profit or loss

for the year when the Bank's right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired, at which time the cumulative gain or loss is reclassified from other comprehensive income to profit or loss for the year.

None of the Bank's investments in equity instruments have a quoted market price and the fair value of these equity investments cannot be reliably measured. All of the Bank's equity investments as of 31 December 2010 and 31 December 2009 are measured at cost (Note 11).

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. Given that fair value of the Bank's equity investments cannot be reliably determined, the Bank takes into consideration the following factors when assessing impairment of its equity investments: recoverability of its investment based on market conditions, realizable amount of investee's net assets, future cash flows from dividends (if any) etc. Impairment losses on equity instruments are not reversed and any subsequent gains are recognised in other comprehensive income. Management is not aware of impairment of any of its equity investments as of 31 December 2010 and 31 December 2009 and considers the overall amount of available-for-sale investments measured at cost as immaterial (Note 11).

**Embedded derivatives.** Certain derivative instruments embedded in other financial instruments are treated as separate derivative instruments when their risks and characteristics are not closely related to those of the host contract. Embedded derivatives are carried at their fair. Changes in their fair value are included in profit or loss for the year.

As of 31 December 2010 the Bank had no significant embedded derivatives. The management assessed that fair value of derivative embedded in credit linked deposit is not material as of 31 December 2009 (Note 11).

**Goodwill.** Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the net identifiable assets, liabilities and contingent liabilities of the acquired associate at the date of exchange. Goodwill on acquisitions of associates is included in the investment in associates. Goodwill is carried at cost less accumulated impairment losses, if any.

Goodwill that forms part of the carrying amount of an investment in an associate is not separately recognised and thus it is not tested for impairment separately from the carrying amount of an investment in an associate. The entire carrying amount of the investment in associate is tested for impairment as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its

carrying amount, whenever indications are identified that the investment may be impaired. An impairment loss recognised in those circumstances is not allocated to any asset (including goodwill) that forms part of the carrying amount of the investment in the associate. Accordingly, any reversal of that impairment loss is recognised to the extent that the recoverable amount of the investment in associate subsequently increases.

**Premises and equipment.** Premises and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired. At the end of each reporting period management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss for the year (within other operating income or expenses).

Depreciation. Construction in progress is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives in years
Premises	40 years
Furniture and office equipment	10 years
Computers and technical equipment	5 years
Motor vehicles	10 years
Leasehold improvements	over the term of the underlying lease

The residual value of an asset is the estimated amount that Bank would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

**Intangible assets.** The Bank's intangible assets other than goodwill have definite useful lives and primarily include capitalised computer software licenses.

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

Development costs that are directly associated with identifiable and unique software controlled by the Bank are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development and implementation team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight line basis over expected useful lives of 10 years.

Intangible assets are amortised using the straight-line method over their useful lives:

	Useful lives in years
Computer software (core banking software)	10 years
Capitalised internal software development costs	10 years
Other bank softwares	3-5 years

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less costs to sell.

**Operating leases.** Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

**Finance lease receivables.** Where the Bank is a lessor in a lease which transfers substantially all the risks and rewards incidental to ownership to the lessee, the assets leased out are presented as a finance lease receivable and carried at the present value of the future lease payments. Finance lease receivables are initially recognised at commencement (when the lease term begins) using a discount rate determined at inception (the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease).

The difference between the gross receivable and the present value represents unearned finance income. This income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return. Incremental costs directly attributable to negotiating and arranging the lease are included in the initial measurement of the finance lease receivable

and reduce the amount of income recognised over the lease term. Finance income from leases is recorded within interest income in profit or loss for the year.

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of finance lease receivables. The Bank uses the same principal criteria to determine whether there is objective evidence that an impairment loss has occurred as for loans carried at amortised cost. Impairment losses are recognised through an allowance account to write down the receivables' net carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the interest rates implicit in the finance leases. The estimated future cash flows reflect the cash flows that may result from obtaining and selling the assets subject to the lease.

**Due to other banks.** Amounts due to other banks are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortised cost. If the Bank purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from retirement of debt.

**Customer accounts.** Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

Other borrowed funds and subordinated debt. Other borrowed funds include loans obtained from international financial institutions and Mongolian government organizations, and promissory notes issued. These financial liabilities and subordinated debt are carried at amortized costs using effective interest rate method.

**Income taxes.** Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the profit or loss unless it relates to transactions that are recognised in the same or a different period in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the

initial recognition exemption deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction when initially recorded affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted by the Company. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

**Value added tax.** Management has assessed that the Bank has no VAT liabilities arising from non-banking activities, while banking activities are exempted from VAT, based on VAT Law. The Bank was not registered for VAT as a tax payer as of 31 December 2010 and 31 December 2009. Contingent liabilities arising from a litigation with tax authorities, which includes VAT liabilities, are disclosed in Note 31.

**Uncertain tax positions.** The Bank's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period. As of 31 December 2010 and 31 December 2009, management has assessed that recognition of provision for uncertain tax position is not necessary. Contingent liabilities arising from a litigation with tax authorities are disclosed in Note 31.

**Provisions for liabilities and charges.** Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

**Trade and other payables.** Trade payables are accrued when the counterparty has performed its obligations under the contract and are carried at amortised cost.

**Share capital and premium.** Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value

of shares issued is recorded as share premium in equity.

**Treasury shares.** Where the Bank purchases its own equity instruments, the consideration paid, including any directly attributable incremental external costs, net of income taxes, is deducted from equity attributable to the owners of the Bank until the equity instruments are reissued, cancelled or disposed of. Where such shares are subsequently disposed of or reissued, any consideration received is included in equity. Gains or losses on transactions with treasury shares are recognized in equity, within retained earnings (Note 22).

**Other reserves.** Other reserves represent appropriations of retained earnings, based on the decision of the Bank's Board of Directors. The purpose of other reserves is not specified at present. Other reserves are used for financing the Bank's operations and cannot be used for payment of dividends.

**Dividends.** Dividends are recorded in equity in the period in which they are declared. Any dividends declared after the end of the reporting period and before the financial statements are authorised for issue are disclosed in the subsequent events note.

**Income and expense recognition.** Interest income and expense are recorded for all debt instruments on an accruals basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Bank to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Bank does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to the present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.

All other fees, commissions and other income and expense items are generally recorded on an accruals basis by reference to completion of the specific transaction assessed on the basis of the actual service

provided as a proportion of the total services to be provided.

**Foreign currency translation.** The functional currency of the Bank is the currency of the primary economic environment in which the entity operates. Thus, the Bank's functional currency and presentation currency is the national currency of Mongolia, Mongolian Tugrik ("MNT").

Monetary assets and liabilities are translated into the Bank's functional currency at the official exchange rate of the Bank of Mongolia ("BOM") at the respective end of the reporting period. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into the Bank's functional currency at year-end official exchange rates of the BOM are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency including equity investments are translated using the exchange rates at the date when the fair value was determined. Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

At 31 December 2010 the principal rate of exchange used for translating foreign currency balances was USD 1 = MNT 1 256.46 (2009: USD 1 = MNT 1 442.84).

**Offsetting.** Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

**Staff costs and related contributions.** Wages, salaries and other salary related expenses are recognized as an expense in the year in which the associated services are rendered by the Bank's employees. Short term accumulating compensated absences such as paid annual leave are recognized when services rendered by employees that increase their entitlement to future compensated absences. Short term non-accumulating compensated absences such as sick leave are recognized when absences occur.

As required by the law, companies in Mongolia make contributions to the government pension scheme Social Security and Health Insurance Fund. Such contributions are recognized as an expense in the profit or loss as incurred. The Bank also contributes to a defined contribution plan. The contribution paid is recorded as an expense under personnel expenses in proportion to the services rendered by the employees to the bank. Overpaid contributions are recorded as receivables. The Bank has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme and defined contribution plan.

**Grants.** Grants received from international organizations for financing of the specified non-profit-oriented projects are initially recognized as liability (deferred grants) upon receipt of funds. Received funds related to the projects occurring in the following accounting periods are recorded on the statement of financial position as deferred grants as of the reporting date. Funds initially recorded as deferred grants are subsequently recognised in the statement of comprehensive income in the reporting period in which the expenditure on the specific project is incurred.

**Share-based payments.** The Bank recognises the services received or acquired in a share-based payment transaction when the services are received. The Bank recognises a corresponding increase in equity if the services were received in an equity-settled share-based payment transaction, or a liability if the services were acquired in a cash-settled share-based payment transaction.

For equity-settled share-based payment transactions with employees, the Bank measures services received, and the corresponding increase in equity indirectly, by reference to the fair value of the equity instruments granted. For cash-settled share-based payment transactions, the Bank measures the services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the Bank remeasures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

The information on Employee Stock Option Plan (ESOP) is given in Note 26.

**Sale and repurchase agreements and lending of securities.** Sale and repurchase agreements ("repo agreements") which effectively provide a lender's return to the counterparty are treated as secured financing transactions. Securities sold under such sale and repurchase agreements are not derecognised. The securities are not reclassified in the statement of financial position unless the transferee has the right by contract or custom to sell or repledge the securities, in which case they are reclassified as repurchase receivables. The corresponding liability is presented separately in the statement of financial position as 'repurchase agreements' and is carried at amortized cost.

Securities purchased under agreements to resell ("reverse repo agreements") which effectively provide a lender's return to the Bank are recorded as due from other banks or loans and advances to customers, as appropriate. The difference between the sale and repurchase price is treated as interest income and accrued over the life of repo agreements using the effective interest method.

**Restatements.** In 2010, the management performed a detailed review of the Bank's 2009 IFRS financial statements and accounting policies. This review identified certain errors in the 2009 IFRS financial statements. As a result, the following adjustments were

made in these financial statements in accordance with IAS 8 "Accounting policies, changes in accounting estimates and errors":

- Deferral of loan origination fee. The Bank has not deferred loan origination fees charged to its customers in 2009 and previous years. Loan origination fee is charged to the customers as a compensation for activities such as evaluating the customers' financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. In accordance with IAS 39 and IAS 18, such fees are an integral part of the effective interest rate of related financial instruments (issued loans) and are deferred and recognised as an adjustment to the effective interest rate. Based on available information, management estimated that non-deferral of loan origination fees has led to the overstatement of loans and advances to customers and retained earnings for the amount of MNT 995,227 thousand and as of 1 January 2009, and overstatement of loans and advances to customers, profit before taxation and retained earnings for the amount of MNT 1,285,530 thousand, MNT 290,303 thousand and MNT 995,227 thousand, respectively, in the financial statements for period ended 31 December 2009.
- Deferred tax arising from deferral of loan origination fees. As a result of the above adjustment, the Bank is entitled to a deferred tax asset arising from deductible temporary difference between the tax base and the carrying value of loans and advances to customers as of 31 December 2009 and 1 January 2009 (refer to Note 27). Consequently, the Bank has recognized a deferred tax asset arising from deferral of loan origination fees in the amount of MNT 321,383 thousand and MNT 248,807 thousand as of 31 December 2009 and 1 January 2009, respectively. Deferred income tax assets, deferred income tax liabilities and retained earnings as of 31 December 2009 and 1 January 2009 were adjusted accordingly, as well as income tax expense for year ended 31 December 2009.

Where necessary corresponding figures have been adjusted to conform to the presentation of the current year amounts. The following reclassification have been made in these financial statements:

- Classification of bank deposits with the maturity of less than three months. Deposits with banks with the original maturity of less than three months were presented within the line cash and cash equivalents within these financial statements. These deposits were presented within line due from other banks in the financial statements for the year ended 31 December 2009. The item due from other banks in these financial statements includes only bank deposits with original maturities above three months.
- Classification of cash on hand. Cash on hand, including cash in ATMs, which was presented as cash and short term funds in the financial statements for year ended 31 December 2009,

is classified as cash and cash equivalents in these financial statements.

- Presentation of mandatory reserve with Bank of Mongolia. Mandatory reserve with Bank of Mongolia as of 31 December 2009 and 1 January 2009 was presented within line due from other banks in the financial statements for the year ended 31 December 2009. Mandatory reserve is presented as a separate line on the face of statement of financial position in these financial statements.
- Investments in associates. The Bank had ability to significantly influence operational and financial policies of two of its investees as of 31 December 2009 (Note 12). These investments were presented within item financial investments in the financial statements for year ended 31 December 2009. These investments are presented as investments in associates on the face of the statement of financial position in these financial statements.
- Classification of financial investments. Treasury bills issued by the Bank of Mongolia have original maturity less than three months and meet definition of cash and cash equivalents. Thus, they are included in cash and cash equivalents in these financial statements and classified as loans and receivables for measurement purposes. Treasury bills issued by the Bank of Mongolia were included in line financial investments in financial statements for the year ended 31 December 2009. Equity investments (other than investments in associates) and deposit with Trade Development Bank (Note 11), which were presented within line financial investments and classified as available for sale for measurement purposes in the financial statements for the year ended 31 December 2009, are presented on the face of the statement of financial position as investment securities available-for-sale.
- Classification of leasehold improvements. Leasehold improvements are presented within property and equipment in these financial statements. These items were included in other assets in the financial statements for year ended 31 December 2009.
- Classification of deposits held as collateral for issued letters of credit and guarantees. Deposits held as collateral for issued

letters of credit and guarantees are presented within customer accounts in these financial statements. These items were included in other liabilities in the financial statements for year ended 31 December 2009.

- Presentation of current income tax prepayments. Current income tax prepayments are presented separately on the face of the statement of financial position in these financial statements, while they were included in other assets in the financial statements for year ended 31 December 2009.
- Presentation of loan origination fee income. Loan origination fee income represents an integral part of effective interest rate and thus it is presented within interest income in these financial statements. Related income was presented within the line net fee and commission income in the financial statements for year ended 31 December 2009.
- Presentation of foreign exchange gains and losses. Transaction and translation foreign exchange gains and losses are presented on a net basis on the face of the statement of comprehensive income in these financial statements. Foreign exchange losses (net) were presented within operating expenses in the financial statements for year ended 31 December 2009.
- Other improvements in presentation on the face of statement of comprehensive income. Fee and commission income (after reclassification of loan origination fees) and fee and commission expenses are presented separately on the face of the statement of comprehensive income in these financial statements. These items were previously included in item net fees and commissions. Further, impairment provision charges on other assets, which were previously included in operating expenses, are presented as a separate item in these financial statements. Similarly, release of impairment provision on loans and advances to customers is reclassified from operating expenses to provision for loan impairment.

The net impact of the above restatements and reclassifications on the Statement of Financial Position as of 31 December 2009 is presented below:

In thousands of Mongolian Tugriks	Year ended 31 December 2009 (as previously reported)	Restatement	Reclassifications	Year ended 31 December 2009 (restated)
<b>Assets</b>				
Cash and cash equivalents	-	-	72,309,165	72,309,165
Cash and short term funds	8,928,250	-	(8,928,250)	-
Mandatory reserve with BOM	-	-	6,834,900	6,834,900
Due from other banks	82,443,485	-	(61,801,941)	20,641,544
Loans and advances to customers	195,248,857	(1,285,530)	-	193,963,327
Financial investments	11,874,194	-	(11,874,194)	-

Investment securities available for sale	-	-	3,191,051	3,191,051
Investment in associates	-	-	269,269	269,269
Property, plant and equipment	14,781,681	-	412,949	15,194,630
Deferred income tax asset	-	127,704	-	127,704
Current income tax prepayment	-	-	297,574	297,574
Other assets	3,776,240	-	(710,523)	3,065,717
<b>Liabilities</b>				
Customer accounts	126,736,567	-	665,109	127,401,676
Other liabilities	1,754,298	-	(665,109)	1,089,189
Deferred tax liabilities	193,679	(193,679)	-	-
<b>Equity</b>				
Retained earnings	2,562,345	(964,147)	-	1,598,198

The net impact of the above restatements and reclassifications to the items of Statement of Comprehensive Income for the year ended 31 December 2009 is presented below:

In thousands of Mongolian Tugriks	Year ended 31 December 2009 (as previously reported)	Restatement	Reclassification	Year ended 31 December 2009 (restated)
Interest income	38,891,435	(290,303)	1,862,016	40,463,148
Provision for loan impairment	(1,641,519)	-	11,995	(1,629,524)
Net fees and commissions	2,451,345	-	(2,451,345)	-
Fee and commission income	-	-	853,268	853,268
Fee and commission expenses	-	-	(263,939)	(263,939)
Foreign exchange gains less losses	-	-	(1,579,451)	(1,579,451)
Provision for other assets	-	-	(51,634)	(51,634)
Administrative and other operating expenses	(15,892,926)	-	1,619,090	(14,273,836)
Income tax expense	(432,320)	72,576	-	(359,744)
<b>Profit after tax</b>	<b>2,562,345</b>	<b>(217,727)</b>	<b>-</b>	<b>2,344,618</b>

The net impact of the above restatements and reclassifications on the Statement of Financial Position items as of 1 January 2009:

In thousands of Mongolian Tugriks	Year ended 31 December 2008 (as previously reported)	Restatement	Reclassifications	Year ended 31 December 2008 (restated)
<b>Assets</b>				
Cash and cash equivalents	-	-	31,541,849	31,541,849
Cash and short term funds	7,488,261	-	(7,488,261)	-
Mandatory reserve with BOM	-	-	3,655,500	3,655,500
Due from other banks	24,287,029	-	(20,255,366)	4,031,663

Loans and advances to customers	149,639,706	(995,227)	-	148,644,479
Financial investments	7,972,388	-	(7,972,388)	-
Investment securities available for sale	-	-	518,666	518,666
Deferred income tax asset	-	143,413	-	143,413
<b>Liabilities</b>				
Customer accounts	76,982,135	-	78,344	77,060,479
Other liabilities	839,606	-	(78,344)	761,262
Deferred income tax liability	105,394	(105,394)	-	-
<b>Equity</b>				
Retained earnings	3,167,621	(746,420)	-	2,421,201

The restatements and reclassifications in the statement of financial position and statement of comprehensive income had an impact on information in notes 7, 8, 9, 10, 11, 12, 14, 15, 19, 23, 24, 25, 26 and 27 and had no impact on any other captions in the statement of financial position, statement of comprehensive income and related note disclosures.

The third statement of financial position as of 1 January 2009 is presented in these financial statements as a result of the restatements above described and changes in presentation. This requirement to present the additional opening statement of financial position, when the entity has made a restatement or reclassification, extends to the information in the related notes. Management considered materiality from the perspective of the users of financial statements, as well as absence of detailed information, and concluded that it is sufficient for the Bank to present such information on the face of the Statement of Financial Position and in extended disclosures within this note. The omission of third balances in those notes that have been impacted by a restatement or a reclassification, as well as in those notes not impacted by a restatement or a reclassification, is therefore, in management's view, not material.

The abovementioned restatements and reclassifications were reflected in the Statement of Cash Flows in these financial statements. Also, management decided to make certain other improvements in the Statement of Cash Flows in these financial statements. Management considered materiality from the perspective of the users of financial statements, and concluded that detailed disclosures of effect of restatements, reclassifications or other improvements on each financial statement line item of Statement of Cash Flows are not necessary, as omission of this information could not materially affect the decisions of the users of financial statements.

**Amendments of the financial statements after issue.** The Bank's shareholders and management have the power to amend the financial statements after issue ■

#### ■ CRITICAL ACCOUNTING ESTIMATES, AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

**Impairment losses on loans and advances.** The Bank regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in profit or loss for the year, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. A 10% increase or decrease in actual loss experience of loan portfolio compared to the loss estimates used would result in an increase or decrease in loan impairment losses of MNT 421,028 thousand (2009: MNT 315,891 thousand), respectively. Impairment losses for individually significant loans and individually assessed impaired loans are based on estimates of discounted future cash flows of the individual loans,

taking into account repayments and realisation of any assets held as collateral against the loans. A 10% increase or decrease in the actual loss experience compared to the estimated future discounted cash flows from individually assessed loans with impairment indicators, which could arise from differences in amounts and timing of the cash flows, would result in a increase or decrease in loan impairment losses of MNT 153,160 thousand (2009: MNT 122,981 thousand), respectively.

**Borrowings from governments organizations and international financial institutions.** The Bank obtains long term financing from Mongolian government organizations and international financial institutions at interest rates at which they ordinarily lend and which may be lower than rates at which the Bank could source the funds from other lenders. As a result of such financing, the Bank is able to advance funds to target customers as determined by its lenders, at advantageous rates. Management has considered whether gains or losses should arise on initial recognition of such instruments. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at market rates and no initial recognition gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment. The borrowings from international financial institutions or governments organizations amounted to MNT 18,470,624 thousand as at 31 December 2010 (2009: MNT 10,531,632 thousand) and are disclosed in Note 18.

**Depreciation of property and equipment, and amortization of intangible assets.** Buildings are depreciated on a straight-line basis over the estimated useful life of 40 years even though the lease period of the land on which the buildings are located is shorter than 40 years. In accordance with Law on Land, effective in Mongolia, the Bank is entitled to right to request for extension of the lease period and the authority shall extend the period of lease subject to certain conditions being met. Management believes that the Bank have met these conditions. Thus, management believes that the useful life of 40 years is reasonable and appropriate.

Further, management believes that the estimated useful lives of other fixed and intangible assets are reasonable and represent common life expectancies applicable to the Mongolian operating environment. Changes in the expected level of usage and technological developments could impact on the economic useful lives and the residual values of these assets, which could lead to revision of useful lives and depreciation charges in the future. Were the estimated useful lives to differ by 10% from management's estimates the impact on depreciation charge for the year ended 31 December 2010 would be to increase or decrease it by MNT 212,947 thousand (2009: increase or decrease by MNT 183,103 thousand).

Tax legislation. Mongolian, tax, currency and customs legislation is subject to varying interpretations. Refer to Note 31 ■

## ■ ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

### Standards effective for annual periods beginning on or after 1 January 2010

The following new standards and interpretations became effective for the Bank from 1 January 2010:

**IFRIC 17 Distributions of Non-Cash Assets to Owners** (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets should be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 did not have an impact on these financial statements.

**IFRIC 18 Transfers of Assets from Customers** (effective for annual periods beginning on or after July 2009). The interpretation clarifies the accounting for transfers of assets from customers namely the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue and the accounting for transfers of cash from customers. IFRIC 18 did not have an impact on these financial statements.

**IAS 27 Consolidated and Separate Financial Statements** (revised January 2010; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 requires an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interest") even if this results in the non-controlling interests having a deficit balance (the previous standard required the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost any investment retained in the former subsidiary has to be measured at its fair value. The revised IAS 27 did not have any impact on these financial statements.

**IFRS 3 Business Combinations** (revised January 2010; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 allows entities to choose to measure non-controlling interests using the previous IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance

on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead in a business combination achieved in stages the acquirer has to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss if any in profit or loss for the year. Acquisition-related costs are accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer has to recognise a liability for any contingent purchase consideration at the acquisition date. Changes in the value of that liability after the acquisition date are recognised in accordance with other applicable IFRSs as appropriate rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The revised IFRS 3 did not have a material impact on these financial statements.

**Group Cash-settled Share-based Payment Transactions-Amendments to IFRS 2 Share-based Payment** (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11 which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard. The Bank has considered and applied this amendment in these financial statements.

**Eligible Hedged Items-Amendment to IAS 39 Financial Instruments: Recognition and Measurement** (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment did not have a material impact on these financial statements.

**IFRS 1 First-time Adoption of International Financial Reporting Standards** (following an amendment in December 2010 effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The revised standard did not have a material impact on these financial statements.

**Additional Exemptions for First-time Adopters - Amendments to IFRS 1 First-time Adoption of IFRS** (effective for annual periods beginning on or after 1 January 2010). The amendments exempt

entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments did not have a material impact on these financial statements.

**Improvements to International Financial Reporting Standards** (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by an entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. In addition the amendments clarifying classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary published as part of the Annual Improvements to International Financial Reporting Standards which were issued in May 2010 are effective for annual periods beginning on or after 1 July 2009. The amendments did not have a material impact on these financial statements.

Unless otherwise stated above the amendments and interpretations did not have any significant effect on these financial statements ■

## ■ NEW ACCOUNTING PRONOUNCEMENTS

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2011 or later and which the Bank has not early adopted.

### **IFRS 9 Financial Instruments Part 1: Classification and Measurement.**

IFRS 9 issued in November 2009 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments an irrevocable election can be made at initial recognition to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated as at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2013 earlier adoption is permitted. The Bank is considering the implications of the standard, the impact on the Bank and the timing of its adoption by the Bank.

**Classification of Rights Issues – Amendment to IAS 32** (issued on 8 October 2009; effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives. The Bank does not expect the amendments to have any material effect on its financial statements.

**Amendment to IAS 24 Related Party Disclosures** (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities. The Bank is currently assessing impact of the amendments on its financial statements.

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

(effective for annual periods beginning on or after 1 July 2010). This IFRIC clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in profit or loss based on the fair value of the equity instruments compared to the carrying amount of the debt. The Bank is currently assessing the impact of the amendments on its financial statements.

**Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14** (effective for annual periods beginning on or after 1 January 2011). This amendment applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement. The Bank does not expect the amendments to have any material effect on its financial statements.

### **Improvements to International Financial Reporting Standards**

(issued in May 2010 and effective from 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous local GAAP carrying value to be used as deemed cost of an item of property plant and equipment or an intangible asset if that item was used in operations subject to rate regulation (ii) to allow an event driven revaluation to be used as deemed cost of property plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2010) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements in particular (i) by adding

an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2010); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report including transfers between the levels of fair value hierarchy changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; IFRIC 13 was amended to clarify measurement of fair value of award credits; and IAS 1 was amended to clarify the requirements for the presentation and content of the statement of changes in equity (reconciliation between the carrying amount at the beginning and the end of the period for each component of equity must be presented in the statement of changes in equity but its content is simplified by allowing an analysis of other comprehensive income by item for each component of equity to be presented in the notes). The Bank does not expect the amendments to have material effect on its financial statements.

**Limited exemption from comparative IFRS 7 disclosures for first-time adopters—Amendment to IFRS 1** (effective for annual periods beginning on or after 1 July 2010). Existing IFRS preparers were granted relief from presenting comparative information for the new disclosures required by the March 2009 amendments to IFRS 7 Financial Instruments: Disclosures. This amendment to IFRS 1 provides first-time adopters with the same transition provisions as included in the amendment to IFRS 7. The Bank does not expect the amendments to have any effect on its financial statements.

**Disclosures-Transfers of Financial Assets—Amendments to IFRS 7** (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised but the entity is still exposed to certain risks and rewards associated with the transferred asset additional disclosure is required to enable the effects of those risks to be understood. The amendment is not expected to have material impact on the Bank's financial statements.

**Recovery of Underlying Assets – Amendments to IAS 12** (issued in December 2010 and effective for annual periods beginning on or after 1 January 2012). The amendment introduced a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale. This presumption is rebutted if the investment property is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale. SIC-21, Income Taxes – Recovery of Revalued Non-Depreciable Assets, which addresses similar issues involving non-depreciable assets measured using the revaluation model in IAS 16, Property, Plant and Equipment, was incorporated into IAS 12 after excluding from its scope investment properties measured at fair value.

Unless otherwise described above the new standards and interpretations are not expected to significantly affect the Bank's financial statements ■

## ■ CASH AND CASH EQUIVALENTS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
Cash on hand	13,987,138	8,928,250
Cash balances with the BOM (other than mandatory reserve deposits)	24,914,571	26,155,618
Correspondent accounts with other banks	10,688,496	6,658,589
BOM treasury bills	42,947,557	8,413,874
Deposits with BOM with original maturity less than 3 months	-	14,620,922
Placements with other banks with original maturities of less than three months	-	7,531,912
<b>Total cash and cash equivalents</b>	<b>92,537,762</b>	<b>72,309,165</b>

None of the cash and cash equivalents as of 31 December 2010 and 31 December 2009 were collateralized. All balances as of 31 December 2010 and 31 December 2009 were neither past due nor impaired.

Current (correspondent) accounts with the Bank of Mongolia are not interest bearing, while term deposits with the Bank of Mongolia as of 31 December 2009 had an interest rate of 0.15% p.a. Correspondent accounts with other banks are generally non-interest bearing. Treasury bills issued by the Bank of Mongolia have maturity

of 7 days (2009: from 7 to 84 days) and an interest rate of 11% p.a. (2009: interest rate from 10% to 14% p.a.). Placements with other banks as of 31 December 2009 had maturities from 14 to 90 days and bear interest rates from 2.25% to 10% p.a.

The credit quality of cash and cash equivalents balances may be summarised based on Standard and Poor's ratings or equivalents of Moody's and/or Fitch ratings. The credit quality at 31 December 2010 was as follows:

In thousands of Mongolian Tugriks	Cash on hand	Cash balances with the BOM (other than mandatory reserve deposits)	Correspondent accounts and overnight placements with other banks	BOM treasury bills	Total
Neither past due nor impaired					
- Cash on hand	13,987,138	-	-	-	13,987,138
- Central Bank of the Mongolia	-	24,914,571	-	42,947,557	67,862,128
- AA- to AA+ rated	-	-	5,607,639	-	5,607,639
- A- to A+ rated	-	-	3,355,792	-	3,355,792
- Lower than A- rated	-	-	1,475,902	-	1,475,902
- Unrated	-	-	249,163	-	249,163
<b>Total cash and cash equivalents</b>	<b>13,987,138</b>	<b>24,914,571</b>	<b>10,688,496</b>	<b>42,947,557</b>	<b>92,537,762</b>

The credit quality of cash and cash equivalents balances may be summarised based on Standard and Poor's ratings or equivalents of Moody's and/or Fitch ratings. The credit quality at 31 December 2009 was as follows. The amounts as of 31 December 2009 presented below are adjusted for effect of reclassifications.

Placements with unrated banks in the amount of MNT 7,531,912 thousand relate to Mongolian banks other than top tier banks (i.e. medium or small sized banks). Management assesses the credit quality of placements with these banks based on the general reputation of the Mongolian market and other available information (such as publicly available financial statements) ■

In thousands of Mongolian Tugriks	Cash on hand	Cash balances with the BOM (other than mandatory reserve deposits)	Correspondent accounts and overnight placements with other banks	BOM treasury bills	Deposits with BOM with original maturity less than 3 months	Placements with other banks with original maturities of less than three months	Total
Neither past due nor impaired							
- Cash on hand	8,928,250	-	-	-	-	-	8,928,250
- Central Bank of the Mongolia	-	26,155,618	-	8,413,874	14,620,922	-	49,190,414
- AA- to AA+ rated	-	-	2,609,015	-	-	-	2,609,015
- A- to A+ rated	-	-	2,252,300	-	-	-	2,252,300
- Lower than A- rated	-	-	1,702,363	-	-	-	1,702,363
- Unrated	-	-	94,911	-	-	7,531,912	7,626,823
<b>Total cash and cash equivalents</b>	<b>8,928,250</b>	<b>26,155,618</b>	<b>6,658,589</b>	<b>8,413,874</b>	<b>14,620,922</b>	<b>7,531,912</b>	<b>72,309,165</b>

#### ■ MANDATORY RESERVE WITH BANK OF MONGOLIA

The Bank maintains mandatory reserves on current accounts with the Central Bank, the Bank of Mongolia, in accordance with the requirements of the Bank of Mongolia. The balances maintained with the Central Bank are set at percentages based on a 14-day period. As of 31 December 2010, the mandatory reserve required by the Bank of Mongolia was MNT 9,780,500 thousand (2009: MNT 6,834,900 thousand).

Mandatory reserve with the Bank of Mongolia is considered neither past due nor impaired as of 31 December 2010 and 31 December 2009.

The remaining amounts on current accounts with the Bank of Mongolia are not part of the mandatory reserve (i.e. these amounts are not restricted for use) and thus are included in cash and cash equivalents (Note 7) ■

#### ■ DUE FROM OTHER BANKS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
Due from other banks	19,438,657	20,641,544
<b>Total due from other banks</b>	<b>19,438,657</b>	<b>20,641,544</b>

Amounts due from other banks are not collateralised. Placements with other banks as of 31 December relate to other Mongolian banks and have maturity from 180 days to 539 days (2009: from 182 days to 362 days). These placements bear interest rates from 5% to 8.5% p.a. (2009: from 5% to 12.5% p.m.). The deposits in 2010 were mostly denominated in USD (2009: MNT and USD). For more information on foreign currency structure and management of financial risks, refer to Note 29.

All amounts due from other banks were neither past due nor impaired as of 31 December 2010 and 31 December 2009. Thus, no impairment provision was considered necessary.

All placements were made with the biggest Mongolian banks.

Analysis by credit quality of amounts due from other banks outstanding at 31 December 2010 and 31 December 2009 is as follows:

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
Neither past due nor impaired		
- BB- to BB+ rated	-	12,985,560
- B- to B+ rated	3,240,281	3,637,100
- unrated	16,198,376	4,018,884
<b>Total due from other banks</b>	<b>19,438,657</b>	<b>20,641,544</b>

Placements with unrated banks in the amount of MNT 16,198,376 thousand (2009: MNT 4,018,884 thousand) relate to Mongolian banks other than top tier banks (i.e. medium or small sized banks). As disclosed in Note 7, management assesses credit quality of placements with these banks based on the general reputation of the Mongolian market and other available information (such as publicly available financial statements).

At 31 December 2010 the Bank had balances with Ulaanbaatar City Bank with an aggregated amount of MNT 16,198,376 thousand (2009: Trade Development Bank in the amount of MNT 12,985,560 thousand). The aggregate amount of these deposits was 83% of the total amount due from other banks (2009: 63%). Refer to Note 32 for the estimated fair value of amounts due from other banks ■

## ■ LOANS AND ADVANCES TO CUSTOMERS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (restated)
Small and medium enterprises (SME)	126,780,798	61,188,128
Mortgage loan	58,662,396	42,335,073
Micro Business loan	58,503,609	33,251,117
Consumer loan	48,763,811	33,389,514
Finance leases	21,361,313	13,383,229
Other	11,829,128	13,575,175
Less: Provision for loan impairment	(4,210,284)	(3,158,909)
<b>Total loans and advances to customers</b>	<b>321,690,771</b>	<b>193,963,327</b>

Management assessed that borrowings from government and international financial institutions (unrelated parties) and loans issued from these funds at advantageous rates represent a separate market

segment (Note 4), hence no gains or losses have arisen on their initial recognition. Movements in the provision for loan impairment during 2010 are as follows:

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	SME
<b>Provision for loan impairment at 1 January 2010</b>	1,289,343	421,233	566,673	325,110	233,906	322,644	<b>3,158,909</b>
(Recovery of) / provision for impairment during the year	909,415	445,582	39,905	(11,241)	(52,887)	(71,099)	<b>1,259,675</b>
Amounts written off during the year as uncollectible	(17,441)	-	(52,779)	(35,888)	(13,801)	(88,391)	<b>(208,300)</b>
<b>Provision for loan impairment at 31 December 2010</b>	<b>2,181,317</b>	<b>866,815</b>	<b>553,799</b>	<b>277,981</b>	<b>167,218</b>	<b>163,154</b>	<b>4,210,284</b>

Movements in the provision for loan impairment during 2009 are as follows. The amounts presented below are adjusted for effect of reclassifications, where necessary.

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
<b>Provision for loan impairment at 1 January 2009</b>	544,270	134,788	371,786	227,412	95,472	314,692	<b>1,688,420</b>
Provision for impairment during the year (adjusted)	761,637	286,445	254,210	111,985	143,792	71,455	<b>1,629,524</b>
Amounts written off during the year as uncollectible	(16,564)	-	(59,323)	(14,287)	(5,358)	(63,503)	<b>(159,035)</b>
<b>Provision for loan impairment at 31 December 2009</b>	<b>1,289,343</b>	<b>421,233</b>	<b>566,673</b>	<b>325,110</b>	<b>233,906</b>	<b>322,644</b>	<b>3,158,909</b>

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

In thousands of Mongolian Tugriks	2010		2009 (restated)	
	Amount	%	Amount	%
Individuals	133,467,120	41%	97,669,860	50%
Trade	67,346,544	21%	35,375,548	18%
Retail and consumption	40,193,558	12%	19,593,925	10%
Production	39,464,564	12%	19,959,477	10%
Services	31,238,565	10%	16,921,367	9%
Agriculture	7,465,427	2%	4,113,932	2%
Construction	5,945,233	2%	2,961,342	1%
Other	780,044	0%	526,785	0%
Total loans and advances to customers (before impairment)	<b>325,901,055</b>	<b>100%</b>	<b>197,122,236</b>	<b>100%</b>

Loans to individuals mostly include consumer and mortgage loans. Due to diversification of the Bank's portfolio, which mostly consists of loans to SMEs, microfinance loans and loans to individuals, the aggregate amount of loans to the 30 biggest customers of MNT 33,380,750 thousand represent 10.2% of total loans and advances

to customers at 31 December 2010. Similarly, the aggregate amount of loans to the 30 biggest customers as of 31 December 2009 amounted to MNT 20,287,567 thousand and represented 10.3% of loan portfolio.

Information about collateral at 31 December 2010 is as follows:

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
Loans collateralised by:							
- real estate properties	77,332,355	49,011,213	44,036,640	14,392,212	2,587,964	1,292,971	188,653,355
- cash deposits	597,660	472,762	409,292	19,893,969	174,615	7,907,621	29,455,919
- vehicles	1,507,965	467,016	6,817,031	2,393,302	5,960,579	206,161	17,352,054
- equipment	1,139,475	488,599	3,926,631	2,648,162	10,604,804	433,473	19,241,144

- goods in turnover	719,026	67,762	36,401	1,131	22,019	29,654	875,993
Unsecured loans	45,484,317	8,155,044	3,277,614	9,435,035	2,011,332	1,959,248	70,322,590
<b>Total loans and advances to customers (before impairment)</b>	<b>126,780,798</b>	<b>58,662,396</b>	<b>58,503,609</b>	<b>48,763,811</b>	<b>21,361,313</b>	<b>11,829,128</b>	<b>325,901,055</b>

Information about collateral at 31 December 2009 is as follows.

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
Loans collateralised by:							
- properties	33,367,124	31,672,803	16,700,364	10,746,509	966,261	5,733,732	99,186,793
- cash deposits	757,547	58,511	75,783	9,277,519	75,328	3,767,663	14,012,351
- shares of companies	398,092	-	-	-	-	49,975	448,067
- vehicles	2,205,938	341,124	4,128,965	1,930,378	2,314,012	376,392	11,296,809
- equipment	1,425,220	178,637	4,915,234	3,536,109	6,699,334	723,133	17,477,667
- goods in turnover	367,425	1,028	21,239	9,374	5,422	9,589	414,077
- guarantees	398,771	250	51,734	6,584	-	3,717	461,056
- other assets	16,555	-	-	436,805	-	-	453,360
Unsecured loans	22,251,456	10,082,720	7,357,798	7,446,236	3,322,872	2,910,974	53,372,056
<b>Total loans and advances to customers (before impairment)</b>	<b>61,188,128</b>	<b>42,335,073</b>	<b>33,251,117</b>	<b>33,389,514</b>	<b>13,383,229</b>	<b>13,575,175</b>	<b>197,122,236</b>

The disclosure above represents the lower of the carrying value of the loan or collateral taken; the remaining part is disclosed within the unsecured exposures. The amounts presented above are adjusted for

effect of restatements or reclassifications.

Analysis by credit quality of loans outstanding at 31 December 2010 is as follows:

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
Neither past due nor impaired 2010							
- Excellent	31,022,355	3,305,691	6,300,350	14,069,881	9,256,917	10,498,234	74,453,428
- Good	13,342,386	13,762,369	3,652,329	17,771,315	3,852,233	165,758	52,546,390
- Satisfactory	74,346,350	39,064,269	47,394,115	16,183,437	7,857,761	909,132	185,755,064
- Substandard	584,021	82,810	126,417	141,790	53,592	41,562	1,030,192
- Loans renegotiated in 2010	1,900,453	1,771,475	76,132	48,662	8,489	703	3,805,914
<b>Total neither past due nor impaired</b>	<b>121,195,565</b>	<b>57,986,614</b>	<b>57,549,343</b>	<b>48,215,085</b>	<b>21,028,992</b>	<b>11,615,389</b>	<b>317,590,988</b>
Past due but not impaired							
- less than 30 days overdue	680,817	124,327	71,930	70,719	43,217	46,185	1,037,195
- 30 to 90 days overdue	283,060	18,393	158,122	93,370	59,557	9,675	622,177
<b>Total past due but not impaired</b>	<b>963,877</b>	<b>142,720</b>	<b>230,052</b>	<b>164,089</b>	<b>102,774</b>	<b>55,860</b>	<b>1,659,372</b>

Impaired loans							
- less than 30 days overdue	1,903,886	-	-	-	-	-	1,903,886
- 91 to 180 days overdue	997,525	264,190	125,455	75,491	45,401	1,783	1,509,845
- 181 to 360 days overdue	169,201	132,751	181,817	116,945	67,575	10,313	678,602
- over 360 days overdue	1,550,744	136,121	416,942	192,201	116,571	145,783	2,558,362
<b>Total impaired loans</b>	<b>4,621,356</b>	<b>533,062</b>	<b>724,214</b>	<b>384,637</b>	<b>229,547</b>	<b>157,879</b>	<b>6,650,695</b>
<b>Less impairment provisions</b>	<b>(2,181,317)</b>	<b>(866,815)</b>	<b>(553,799)</b>	<b>(277,981)</b>	<b>(167,218)</b>	<b>(163,154)</b>	<b>(4,210,284)</b>
<b>Total loans and advances to customers</b>	<b>124,599,481</b>	<b>57,795,581</b>	<b>57,949,810</b>	<b>48,485,830</b>	<b>21,194,095</b>	<b>11,665,974</b>	<b>321,690,771</b>

Analysis by credit quality of loans outstanding at 31 December 2009 is as follows. The amounts presented below are adjusted for effect of restatements or reclassifications, where necessary.

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
Neither past due nor impaired 2009							
- Excellent	4,092,022	-	4,566,855	2,040,665	623,283	6,099,209	17,422,034
- Good	9,350,654	1,122,623	847,589	5,256,719	1,757,767	4,468,303	22,803,655
- Satisfactory	40,609,158	36,364,970	26,018,774	24,645,955	10,256,340	2,476,537	140,371,734
- Substandard	-	52,389	-	20,388	-	452	73,229
- Loans renegotiated in 2009	2,531,391	4,069,913	590,163	697,258	186,649	145,176	8,220,550
<b>Total neither past due nor impaired</b>	<b>56,583,225</b>	<b>41,609,895</b>	<b>32,023,381</b>	<b>32,660,985</b>	<b>12,824,039</b>	<b>13,189,677</b>	<b>188,891,202</b>
Past due but not impaired							
- less than 30 days overdue	256,207	266,434	109,979	116,917	96,310	21,561	867,408
- 30 to 90 days overdue	413,987	40,194	212,143	101,540	64,811	70,510	903,185
<b>Total past due but not impaired</b>	<b>670,194</b>	<b>306,628</b>	<b>322,122</b>	<b>218,457</b>	<b>161,121</b>	<b>92,071</b>	<b>1,770,593</b>
Impaired loans							
- less than 30 days overdue	1,954,085	-	-	-	-	-	1,954,085
- 91 to 180 days overdue	418,413	133,657	240,732	138,562	106,448	8,582	1,046,394
- 181 to 360 days overdue	771,845	235,577	389,939	238,719	202,527	61,987	1,900,594
- over 360 days overdue	790,366	49,316	274,943	132,791	89,094	222,858	1,559,368
<b>Total impaired loans</b>	<b>3,934,709</b>	<b>418,550</b>	<b>905,614</b>	<b>510,072</b>	<b>398,069</b>	<b>293,427</b>	<b>6,460,441</b>
<b>Less impairment provisions</b>	<b>(1,289,343)</b>	<b>(421,233)</b>	<b>(566,673)</b>	<b>(325,110)</b>	<b>(233,906)</b>	<b>(322,644)</b>	<b>(3,158,909)</b>
<b>Total loans and advances to customers</b>	<b>59,898,785</b>	<b>41,913,840</b>	<b>32,684,444</b>	<b>33,064,404</b>	<b>13,149,323</b>	<b>13,252,531</b>	<b>193,963,327</b>

Credit quality analysis of neither past due nor impaired loans was based on internal rating system described in Note 29. All loans neither past due nor impaired were classified as performing in accordance with guidelines of the Bank of Mongolia.

The Bank applied the portfolio provisioning methodology prescribed by IAS 39, Financial Instruments: Recognition and Measurement, and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the end of the reporting period. The Bank's policy is to classify each loan as 'neither past due nor impaired' until specific objective evidence of impairment of the loan is identified. The impairment

provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are determined to be impaired.

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2010 was as follows:

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
Fair value of collateral - loans past due but not impaired							
- property	1,701,393	163,907	510,082	219,650	6,893	64,450	2,666,375
- cash deposits	-	20,000	3,601	158,038	74	26,071	207,784
Fair value of collateral - impaired loans							
- property	3,958,828	553,689	946,454	378,563	41,603	238,430	6,117,567
- cash deposits	-	-	12,400	423,922	22,476	45,666	504,464
<b>Total fair value of collateral</b>	<b>5,660,221</b>	<b>737,596</b>	<b>1,472,537</b>	<b>1,180,173</b>	<b>71,046</b>	<b>374,617</b>	<b>9,496,190</b>

The fair value of collateral in respect of loans past due but not impaired and in respect of loans determined to be impaired at 31 December 2009 was as follows:

In thousands of Mongolian Tugriks	SME	Mortgage	Micro Business	Consumer	Finance Lease	Other	Total
Fair value of collateral - loans past due but not impaired							
- property	2,483,160	372,395	435,455	308,419	1,350	322,600	3,923,379
- cash deposits	-	-	-	3,172,680	100	34,542	3,207,322
Fair value of collateral - impaired loans							
- property	5,799,178	440,920	1,097,363	465,402	108,220	462,840	8,373,923
- cash deposits	266,380	-	1,830	480,731	-	15,181	764,122
<b>Total fair value of collateral</b>	<b>8,548,718</b>	<b>813,315</b>	<b>1,534,648</b>	<b>4,427,232</b>	<b>109,670</b>	<b>835,163</b>	<b>16,268,746</b>

Neither past due nor impaired, but renegotiated loans represent the carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated. Past due but not impaired loans primarily include collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due but not impaired is

the whole balance of such loans, not only the individual instalments that are past due.

The fair value of real estate assets was determined at the loan inception by the Bank's appraisers using the Bank's internal guidelines, which are based on conservative estimates of the value

of property. Management believes that disclosed value of collateral is adequate and that loan portfolio is sufficiently covered by collateral, due to conservative policy for estimating value of collateral and general increase in the value of commercial and residential property in Mongolia, particularly in the capital Ulaanbaatar. During 2010 the Bank repossessed collateral in the amount of MNT 202,873 thousand (2009: MNT 100,853 thousand). Repossessed

collateral as of 31 December 2010 and 31 December 2009 is disclosed within other assets (Note 15).

Finance lease receivables mostly relate to leases of equipment and vehicles and are collateralized by leased assets, as disclosed above. Finance lease payments receivable (gross investment in the leases) and their present values are as follows:

In thousands of Mongolian Tugriks	Due within 1 year	Due between 1 and 5 years	Total
<b>Finance lease payments receivable at 31 December 2010</b>	<b>18,666,384</b>	<b>6,376,991</b>	<b>25,043,375</b>
Unearned finance income	(3,101,552)	(580,510)	(3,682,062)
Impairment loss provision	(121,924)	(45,294)	(167,218)
<b>Present value of lease payments receivable at 31 December 2010</b>	<b>15,442,908</b>	<b>5,751,187</b>	<b>21,194,095</b>
<b>Finance lease payments receivable at 31 December 2009</b>	<b>12,732,225</b>	<b>3,178,408</b>	<b>15,910,633</b>
Unearned finance income	(2,178,180)	(349,224)	(2,527,404)
Impairment loss provision	(187,063)	(46,843)	(233,906)
<b>Present value of lease payments receivable at 31 December 2009</b>	<b>10,366,982</b>	<b>2,782,341</b>	<b>13,149,323</b>

The amounts presented above are adjusted for effect of restatements. Refer to Note 32 for the estimated fair value of each

class of loans and advances to customers. Information on related party balances is disclosed in Note 34 ■

#### ■ INVESTMENT SECURITIES AVAILABLE FOR SALE

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
Corporate shares	23,300	224,300
TDBM credit linked deposit	-	2,966,751
Total investment securities available for sale	23,300	3,191,051

At 31 December the principal equity investment securities available for sale were:

Name	Nature of business	Country of registration	31 December	
			2010	2009 (adjusted)
Mongolian Banking Association Property Management (MBAPM)	property management	Mongolia	23,300	23,300
Mongolian Mortgage Corporation (MIK)	providing mortgage loans	Mongolia	-	201,000
Total			<b>23,300</b>	<b>224,300</b>

Management could not reliably estimate the fair value of the Bank's investment in shares of the Mongolian Banking Association Property Management (MBAPM) and Mongolian Mortgage Corporation (MIK). The investments are carried at cost of MNT 23,300 thousand (2009: MNT 224,300 thousand). The shares of the investees are not quoted, and recent trade prices are not publicly accessible. None

of these investments are collateralized. Management has assessed these investments for impairment based on available information and considers that no provision for impairment is necessary.

The Bank's representative is appointed to the Board of Directors of Mongolian Mortgage Corporation (MIK) during 2010. Thus, the Bank

has significant influence over the operations of this company as of 31 December 2010 and related investment is treated as investment in associate as of 31 December 2010 (Note 12).

The Trade and Development Bank of Mongolia (TDBM) credit linked deposit was issued by ING Bank N.V., the Netherlands, with maturity of less than two months (37 days). The return on deposit depended on return on bonds, (i.e. on timely repayment of principal and interest on bonds), issued by TDBM on 22 January 2007, as part of Euro Medium Term Note ("EMTN") which bear 8.625% per annum and were payable semi-annually. According to the contract, ING

Bank N.V. was entitled to reduce the amount of deposit, including related interest, that would be returned to the Bank, in case of credit default of TDBM bonds. The principal of the bonds was fully repaid on 22 January 2010 as scheduled and TDBM credit linked deposit was received back in January 2010. It was carried at fair value and considered neither past due nor impaired as of 31 December 2009. Based on the management's assessment of fair value of embedded derivative, management believes that fair value of embedded derivative is not material, and thus separate disclosure of embedded derivative is not considered necessary ■

#### ■ INVESTMENT IN ASSOCIATES

The table below summarises the carrying amount of the Bank's investment in associates.

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
Credit Information Bureau	210,380	71,293
Mongolian Mortgage Corporation (MIK)	201,000	-
Mol Bulak Finance	-	197,976
<b>Total investment in associates</b>	<b>411,380</b>	<b>269,269</b>

As of 31 December 2010 and 31 December 2009, the Bank has significant influence over Credit Information Bureau LLC, a company incorporated in Mongolia with principal activity of collecting and providing information about credit customers, which is further used for the assessment of customers' creditworthiness by the banks during loan approval process. As of 31 December 2009, the Bank owned 8.3% of the shares of Credit Information Bureau LLC, but was able to exercise significant influence through representation on the Board of Directors. During 2010, the Bank has made additional investment in this company and it owns 16.31% of its shares as of 31 December 2010.

The Bank owns 9.1% of the share capital of Mongolian Mortgage Corporation LLC (MIK) as of 31 December 2010 and 31 December 2009. During 2010, the Bank's representative was appointed to the Board of Directors of this investee and thus it is assessed that the

Bank has significant influence over the operational and financial decisions of this entity as of 31 December 2010. The investment was treated as available-for-sale investment as of 31 December 2009 (Note 11).

During 2009 the Bank has acquired 10% of the shares of Mol Bulak Finance, micro-finance institution in Kyrgyzstan. The Bank had significant influence on operational and financial policies of this entity, through its representation on investee's Board of Directors, until the sale of its investment during 2010. The Bank recognized a gain on sale of this entity in the amount of MNT 353,144 thousand.

At 31 December 2010, the Bank's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit
Credit Information Bureau LLC	1,276,612	5,848	-	6,732
Mongolian Mortgage Corporation LLC (MIK)	7,502,928	4,844,615	1,048,616	61,845
<b>Total</b>	<b>8,779,540</b>	<b>4,850,463</b>	<b>1,048,616</b>	<b>68,577</b>

As of 31 December 2009, the Bank's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/(loss)
Credit Information Bureau LLC	458,826	441,050	-	(26,225)
Mol Bulak Finance	21,347,678	19,096,089	4,905,054	416,533
<b>Total</b>	<b>21,806,504</b>	<b>19,537,139</b>	<b>4,905,054</b>	<b>390,308</b>

As of 31 December 2010 and 31 December 2009, investments in associates are carried at cost, as management assessed that the Bank's share in associates' financial results and equity movements is not material. In addition, the fair value of net assets and goodwill arising on the acquisition of associates have not been disclosed separately in these financial statements, as management believes

that carrying value of investments in associates is not material.

Based on available information, management believes that investments in associates are not impaired as of 31 December 2010 and 31 December 2009 and thus no provision for impairment is recognized in these financial statements.

## ■ INTANGIBLE ASSETS

In thousands of Mongolian Tugriks	Note	Intangible Assets		Total
		Computer software	Assets not yet available for use	
Cost at 1 January 2009		789,272	1,539,853	<b>2,329,125</b>
Accumulated amortization		(305,135)	-	<b>(305,135)</b>
<b>Carrying amount at 1 January 2009</b>		<b>484,137</b>	<b>1,539,853</b>	<b>2,023,990</b>
Additions		460,371	543,865	<b>1,004,236</b>
Amortization charge	26	(182,710)	-	<b>(182,710)</b>
<b>Carrying amount at 31 December 2009</b>		<b>761,798</b>	<b>2,083,718</b>	<b>2,845,516</b>
Cost at 31 December 2009		1,249,643	2,083,718	<b>3,333,361</b>
Accumulated amortization		(487,845)	-	<b>(487,845)</b>
<b>Carrying amount at 31 December 2009</b>		<b>761,798</b>	<b>2,083,718</b>	<b>2,845,516</b>
Additions		107,071	804,721	<b>911,792</b>
Transfers		2,541,112	(2,541,112)	-
Amortization charge	26	(231,269)	-	<b>(231,269)</b>
<b>Carrying amount at 31 December 2010</b>		<b>3,178,712</b>	<b>347,327</b>	<b>3,526,039</b>
Cost at 31 December 2010		3,897,826	347,327	<b>4,245,153</b>
Accumulated amortization		(719,114)	-	<b>(719,114)</b>
<b>Carrying amount at 31 December 2010</b>		<b>3,178,712</b>	<b>347,327</b>	<b>3,526,039</b>

Computer software mostly relates to core banking system implemented during 2010. Total cost of the system is MNT 2,541,112 thousand. Its expected useful life is 10 years ■

■ PROPERTY AND EQUIPMENT

In thousands of Mongolian Tugriks	Note	Property and Equipment							Total property and equipment
		Leasehold improvements	Premises	Vehicles	Office Furniture	Computer and Equipments	Others	Construction in progress	
Cost at 1 January 2009		-	7,514,921	2,053,878	1,036,774	3,519,750	99,524	801,929	15,026,776
Accumulated depreciation		-	(463,113)	(408,857)	(318,761)	(1,373,106)	(54)	-	(2,563,891)
<b>Carrying amount at 1 January 2009</b>		-	<b>7,051,808</b>	<b>1,645,021</b>	<b>718,013</b>	<b>2,146,644</b>	<b>99,470</b>	<b>801,929</b>	<b>12,462,885</b>
Additions (adjusted)		471,790	318,237	191,956	598,798	2,793,839	18,546	266,653	4,659,819
Transfers		-	752,122	-	-	-	-	(752,122)	-
Disposals		-	(18,317)	(181,389)	(4,567)	(8,210)	-	(67,266)	(279,749)
Depreciation charge (adjusted)	26	(58,841)	(190,656)	(196,669)	(147,237)	(1,044,088)	(10,834)	-	(1,648,325)
<b>Carrying amount at 31 December 2009 (adjusted)</b>		<b>412,949</b>	<b>7,913,194</b>	<b>1,458,919</b>	<b>1,165,007</b>	<b>3,888,185</b>	<b>107,182</b>	<b>249,194</b>	<b>15,194,630</b>
Cost at 31 December 2009 (adjusted)		471,790	8,566,963	2,064,445	1,631,005	6,305,379	118,070	249,194	19,406,846
Accumulated depreciation (adjusted)		(58,841)	(653,769)	(605,526)	(465,998)	(2,417,194)	(10,888)	-	(4,212,216)
<b>Carrying amount at 31 December 2009 (adjusted)</b>		<b>412,949</b>	<b>7,913,194</b>	<b>1,458,919</b>	<b>1,165,007</b>	<b>3,888,185</b>	<b>107,182</b>	<b>249,194</b>	<b>15,194,630</b>
Additions		217,315	149,929	509,548	464,543	784,834	51,466	1,266,977	3,444,612
Transfers		-	1,229,447	-	-	-	-	(1,229,447)	-
Disposals		-	-	(65,000)	(12,683)	(11,681)	-	(5,839)	(95,203)
Depreciation charge	26	(83,038)	(220,470)	(228,119)	(175,076)	(1,178,164)	(13,330)	-	(1,898,197)
<b>Carrying amount at 31 December 2010</b>		<b>547,226</b>	<b>9,072,100</b>	<b>1,675,348</b>	<b>1,441,791</b>	<b>3,483,174</b>	<b>145,318</b>	<b>280,885</b>	<b>16,645,842</b>
Cost at 31 December 2010		689,105	9,946,339	2,508,993	2,082,865	7,078,532	169,536	280,885	22,756,255
Accumulated depreciation		(141,879)	(874,239)	(833,645)	(641,074)	(3,595,358)	(24,218)	-	(6,110,413)
<b>Carrying amount at 31 December 2010</b>		<b>547,226</b>	<b>9,072,100</b>	<b>1,675,348</b>	<b>1,441,791</b>	<b>3,483,174</b>	<b>145,318</b>	<b>280,885</b>	<b>16,645,842</b>

## ■ OTHER ASSETS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
<b>Other financial assets:</b>		
Receivables on cash and settlements services	262,587	147,984
Receivables from broker account	195,171	36,200
Receivables from companies	14,460	57,947
Other financial assets	307,354	145,273
<b>Total other financial assets</b>	<b>779,572</b>	<b>387,404</b>
<b>Other non-financial assets:</b>		
Office materials and supplies	1,164,114	949,862
Prepayments for apartments	1,078,440	811,155
Prepayments into staff benefit fund	327,225	373,623
Prepayments for services	327,035	254,160
Reposessed collateral	303,726	100,853
Prepayments for staff benefits	138,204	91,501
Prepayments for rent	53,221	-
Receivables from employees	27,380	13,154
Other prepayments	104,406	5,889
Other non-financial assets	251,695	177,860
<b>Total other non-financial assets</b>	<b>3,775,446</b>	<b>2,778,057</b>
Less: provision for impairment	(335,340)	(99,744)
<b>Total other assets</b>	<b>4,219,678</b>	<b>3,065,717</b>

Movements in the provision for impairment of other financial assets during 2010 are as follows:

In thousands of Mongolian Tugriks	Receivables on cash and settlements services	Receivables from companies	Other financial assets	Total financial assets	Repos-sessed collateral	Total non-financial assets	Total
<b>Provision for impairment at 1 January 2010</b>	<b>5,033</b>	<b>46,502</b>	<b>8,570</b>	<b>60,105</b>	<b>39,639</b>	<b>39,639</b>	<b>99,744</b>
Provision for impairment during the year	-	-	20,736	20,736	264,087	264,087	<b>284,823</b>
Amounts written off during the year as uncollectible	(2,308)	(46,502)	(417)	(49,227)	-	-	<b>(49,227)</b>
<b>Provision for impairment at 31 December 2010</b>	<b>2,725</b>	<b>-</b>	<b>28,889</b>	<b>31,614</b>	<b>303,726</b>	<b>303,726</b>	<b>335,340</b>

Movements in the provision for impairment of other financial assets during 2009 are as follows. The amounts presented below are adjusted for effect of reclassifications.

In thousands of Mongolian Tugriks	Receivables on cash and settlements services	Receivables from companies	Other financial assets	Total financial assets	Repos-sessed collateral	Total non-financial assets	Total
<b>Provision for impairment at 1 January 2009</b>	<b>5,672</b>	<b>46,502</b>	<b>5,109</b>	<b>57,283</b>	-	-	<b>57,283</b>
Provision for impairment during the year (adjusted)	1,256	-	10,739	11,995	39,639	39,639	<b>51,634</b>
Amounts written off during the year as uncollectible	(1,895)	-	(7,278)	(9,173)	-	-	<b>(9,173)</b>
<b>Provision for impairment at 31 December 2009</b>	<b>5,033</b>	<b>46,502</b>	<b>8,570</b>	<b>60,105</b>	<b>39,639</b>	<b>39,639</b>	<b>99,744</b>

Analysis by credit quality of other financial assets outstanding at 31 December 2010 is as follows.

In thousands of Mongolian Tugriks	Receivables on cash and settlements services	Receivables from broker account	Receivables from companies	Other financial assets	Total
Neither past due nor impaired					
- Standard	227,679	195,171	14,460	215,307	652,617
<b>Total neither past due nor impaired</b>	<b>227,679</b>	<b>195,171</b>	<b>14,460</b>	<b>215,307</b>	<b>652,617</b>
Past due but not impaired					
- less than 30 days overdue	18,082	-	-	12,617	30,699
- 31 to 90 days overdue	16,147	-	-	29,181	45,328
<b>Total past due but not impaired</b>	<b>34,229</b>	<b>-</b>	<b>-</b>	<b>41,798</b>	<b>76,027</b>
Impaired					
- 91 to 180 days overdue	-	-	-	11,465	11,465
- 181 to 360 days overdue	679	-	-	12,427	13,106
- over 360 days overdue	-	-	-	26,357	26,357
<b>Total impaired</b>	<b>679</b>	<b>-</b>	<b>-</b>	<b>50,249</b>	<b>50,928</b>
<b>Less impairment provision</b>	<b>(2,725)</b>	<b>-</b>	<b>-</b>	<b>(28,889)</b>	<b>(31,614)</b>
<b>Total other financial receivables</b>	<b>259,862</b>	<b>195,171</b>	<b>14,460</b>	<b>278,465</b>	<b>747,958</b>

Analysis by credit quality of other financial assets outstanding at 31 December 2009 is as follows. The amounts presented below are adjusted for effect of reclassifications.

In thousands of Mongolian Tugriks	Receivables on cash and settlements services	Receivables from broker account	Receivables from companies	Other financial assets	Total
Neither past due nor impaired					
- Standard	128,206	36,200	7,976	96,787	269,169
<b>Total neither past due nor impaired</b>	<b>128,206</b>	<b>36,200</b>	<b>7,976</b>	<b>96,787</b>	<b>269,169</b>
Past due but not impaired					
- less than 30 days overdue	10,546	-	3,469	13,793	27,808
- 31 to 90 days overdue	2,244	-	-	6,582	8,826
<b>Total past due but not impaired</b>	<b>12,790</b>	<b>-</b>	<b>3,469</b>	<b>20,375</b>	<b>36,634</b>
Impaired					
- 91 to 180 days overdue	1,650	-	-	5,336	6,986
- 181 to 360 days overdue	296	-	-	16,023	16,319
- over 360 days overdue	5,042	-	46,502	6,752	58,296
<b>Total impaired</b>	<b>6,988</b>	<b>-</b>	<b>46,502</b>	<b>28,111</b>	<b>81,601</b>
<b>Less impairment provision</b>	<b>(5,033)</b>	<b>-</b>	<b>(46,502)</b>	<b>(8,570)</b>	<b>(60,105)</b>
<b>Total other financial receivables</b>	<b>142,951</b>	<b>36,200</b>	<b>11,445</b>	<b>136,703</b>	<b>327,299</b>

All neither past due nor impaired other financial assets as of 31 December 2010 and 31 December 2009 are classified as standard in accordance with the provisioning guidelines of the Bank of Mongolia (Note 29). Related customers are not rated. However, management believes that the quality of these receivables is adequate, given that creditworthiness and reputation of potential customers is thoroughly assessed. The Bank had no renegotiated (restructured) other financial assets as of 31 December 2010 and 31 December 2009.

The primary factors that the Bank considers in determining whether other financial assets are impaired are their overdue status. As a result, the Bank presents above an ageing analysis of receivables that are determined to be impaired.

Refer to Note 32 for the disclosure of the fair value of each class of other financial assets. Information on related party balances is disclosed in Note 34.

Repossessed collateral represents real estate assets acquired by the Bank in settlement of overdue loans. The Bank expects to dispose of the assets in the foreseeable future. The assets do not meet the definition of non-current assets held for sale and are classified as inventories in accordance with IAS 2, Inventories. The assets were initially recognised at fair value when acquired. Provision on repossessed collateral is determined in accordance with the guidelines of the central bank (Note 29). The management believes that compliance with the regulations of the central bank in terms of determining provision level on repossessed assets does not lead to material departures from IFRS.

Most of financial assets are of short-term nature. For detailed analysis of maturity refer to Note 29. Most of non-financial assets (prepayments) are expected to be recovered more than twelve months after year end ■

## ■ DUE TO OTHER BANKS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009
Correspondent accounts and overnight placements of other banks	509,030	-
Term placements due to other banks	31,973,240	22,067,565
<b>Total due to other banks</b>	<b>32,482,270</b>	<b>22,067,565</b>

Term placements from other banks include deposits from ING (MNT 14,735,351 thousand) and Ulaanbaatar City Bank (MNT 17,237,889 thousand). Deposits from ING bear interest rate ranging from 14% to 14.75% p.a. and have maturity of 3 years with maturity dates in 2012 and 2013. Deposits from Ulaanbaatar City Bank bear interest

rates ranging from 9% to 11.5% p.a. and have maturity from 180 days to 360 days.

None of these deposits is collateralized.

Refer to Note 32 for the disclosure of the fair value of each class of amounts due to other banks ■

## ■ CUSTOMER ACCOUNTS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
<b>Legal entities</b>		
- Current/settlement accounts	23,993,120	8,344,159
- Demand (savings) deposits	7,315,687	7,205,805
- Term deposits	51,221,372	17,253,179
<b>Individuals</b>		
- Current/settlement accounts	5,999,744	3,863,653
- Demand (savings) deposits	35,455,419	20,811,087
- Term deposits	113,207,710	69,923,793
<b>Total customer accounts</b>	<b>237,193,052</b>	<b>127,401,676</b>

The management currently does not monitor concentration of customer accounts per economic sectors. Thus, related information is not disclosed in these financial statements.

At 31 December 2010 the aggregate amount of the top 30 biggest customers is MNT 71,789,587 thousand (2009: MNT 27,068,719 thousand) or 30.3% of total customer accounts (2009: 21.3%).

At 31 December 2010 included in customer accounts are deposits of MNT 379,634 thousand (2009: MNT 665,109 thousand) held as collateral for irrevocable commitments under import letters of credit and guarantees. Refer to Note 31.

Refer to Note 32 for the disclosure of fair value of customer accounts. Information on related party balances is disclosed in Note 34 ■

## ■ OTHER BORROWED FUNDS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009
<b>Borrowed funds from foreign financial institutions</b>		
Netherland Development Finance Company	18,947,742	15,331,031
Developing World Markets (DWM)	14,992,966	2,893,414
Dexia Micro Credit Fund	10,293,030	11,807,569
ASN-Novib Funds	8,986,618	10,309,040
ResponsAbility SICAV (Lux)	8,684,820	7,810,341
Credit Suisse Microfinance Fund Management Company	8,531,499	5,461,352
BlueOrchard Finance S.A.	8,368,606	16,678,895
Triodos Sicav	5,939,571	1,277,142
Oikocredit Ecumenical Development Cooperative Society U.A	5,825,646	9,096,321
Dual Return Fund S.I.C.A.V.	5,789,499	5,147,472
European Bank for Reconstruction and Development	5,699,896	2,915,433
Stichting Triodos Doen	5,032,487	3,208,512
International Finance Corporation	3,754,920	5,865,194
Triodos Fair Share Fund	3,191,012	3,656,770
KfW, Frankfurt am Main	1,974,547	2,182,332
KIVA	1,533,990	937,822
Calvert Social Investment Foundation, Inc	1,529,899	1,757,499
Wallberg Invest S.A	1,267,464	1,455,745
Finethic Microfinance	1,266,679	1,454,563
Oyu Tolgoi micro loan	1,243,820	-
Monarch Community Fund LLC	634,727	728,995
ICFund Sicav	629,601	-
Vittana	23,151	755
DB-Global Commercial Microfinance Consortium, Ltd	-	6,658,429
<b>Total borrowed funds from foreign financial institutions</b>	<b>124,142,190</b>	<b>116,634,626</b>
<b>Borrowed funds from government organizations</b>		
SME Development Fund	6,961,212	5,149,249
Employment Generation Support Fund	4,641,318	3,053,601
Ministry of Food and Agriculture	2,523,000	-
Rural Poverty Reduction Program	2,436,365	2,795,118
Ministry of Finance/Japan Bank for International Cooperation	1,935,990	1,544,244
Micro Finance Development Fund	1,926,317	600,388
Ministry of Trade and Industry	873,123	703,242
Asian Development Bank	835,312	10,000
<b>Total borrowed funds from government organizations</b>	<b>22,132,637</b>	<b>13,855,842</b>
<b>Total borrowed funds</b>	<b>146,274,827</b>	<b>130,490,468</b>

All government organizations' borrowings stated above are related to the Government of Mongolia.

Terms of the main borrowing agreements are provided below.

Netherland Development Finance Company ("FMO")

The loans obtained from FMO comprise of the following:

- (i) USD 5,000,000, which was converted to MNT 5,850,450,000, bears interest at a rate of 11.83% (2009: 11.8%) per annum. The loan was obtained in 2007 to finance the bank's Housing and SME lending activities. The loan is repayable in 10 semi-annual instalments commencing October 2009 and is due to be fully repaid in April 2014.
- (ii) USD 5,000,000, which was converted to MNT 5,859,150,000, bears interest at a rate of 11.83% (2009: 11.8%) per annum. The loan was obtained in 2008 to finance the bank's Housing and SME lending activities. The loan is repayable in 10 semi-annual instalments commencing October 2009 and is due to be fully repaid in April 2014.
- (iii) USD 7,000,000, which bears interest at a rate of 6.45% (2009: 6.43%) at the end of reporting period. The loans were obtained in 2009 (USD2,000,000) and 2010 (USD5,000,000) to finance the bank's Housing loan. The loan are repayable in 16 semi-annual instalments commencing October 2011 and is due to be fully repaid in April 2019.
- (iv) USD 2,500,000, with first disbursement after converted to MNT 889,875,000 bears interest rate of 9.5% per annum at the end of reporting period. The loan was obtained in 2009 to finance the bank's Ger loan. The loan is repayable in 5 semi-annual instalments commencing April 2011 and is due to be fully repaid in April 2013.
- (v) USD 2,500,000, with first disbursement after converted to MNT 889,875,000 bears interest rate of 9.5% per annum at the end of reporting period. The loan was obtained in 2009 to finance the bank's solar loan. The loan is repayable in 5 semi-annual instalments commencing April 2011 and is due to be fully repaid in April 2013.

#### Developing World Markets (DWM)

The loans obtained from DWM comprise of the following:

- (i) The loan obtained from DWMS, amounting to USD 2,000,000, bears interest at a rate of 8.25% (2009: 8.25%) per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro-finance and small-medium enterprise lending activities. The loan is due to be fully repaid in June 2011.
- (ii) The loan obtained from SNS/DWM is amounting to MNT 3,108,550,000, bears interest at a rate of 12% per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2011.

- (iii) The loan obtained from SNS II/DWM is amounting to MNT 6,217,100,000, bears interest at a rate of 12% per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2011.
- (iv) The loan obtained from DWM is amounting to MNT 3,108,550,000, bears interest at a rate of 12% per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2011.

#### Dexia Micro Credit Fund ("DMCF")

- (i) The Bank issued the promissory note in 2008 for a principal amount of USD3,000,000 to finance the expansion of Bank's lending activities. The note bears interest at a rate of 7.25% (2009: 7.25%) per annum. The loan is due to be fully repaid in April 2011.
- (ii) The Bank issued the promissory note in 2009 for a principal amount of USD5,000,000 to finance the expansion of Bank's lending activities. The note bears interest at a rate of 7% (2009: 7%) per annum. The loan is due to be fully repaid in July 2012.

#### ASN-Novib Funds

- (i) USD2,500,000, which bears interest interest at a rate of 7.75% (2009: 7.75%) per annum. The loan was obtained in 2008 to support further expansion of the Bank's micro-finance and SME lending activities. The loan is due to be fully repaid in December 2012.
- (ii) USD4,500,000, which bears interest interest at a rate of 7.75% (2009: 7.75%) per annum. The loan was obtained in 2008 to support further expansion of the Bank's micro-finance and SME lending activities. The loan is due to be fully repaid in May 2012.

#### ResponsAbility SICAV (Lux)

The loans obtained from responsAbility SICAV (Lux) is in the form of promissory notes and comprise the following:

- (i) USD 1,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in July 2013.
- (ii) USD 2,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in July 2013.
- (iii) USD 2,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the

liquidity and working capital of the Bank. The loan is due to be fully repaid in August 2013.

- (iv) USD 250,000, which bears interest at a rate of 5.76% (2009: 5.48%) per annum at the statement of financial position date. The loan was obtained in 2009 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2012.
- (v) USD 750,000, which bears interest at a rate of 4.96% per annum at the statement of financial position date. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2013.
- (vi) USD 750,000, which bears interest at a rate of 4.96% per annum at the statement of financial position date. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2013.

#### Credit Suisse Microfinance Fund Management Company

The loans obtained from Credit Suisse Microfinance Fund Management Company is in the form of promissory notes and comprise of the following:

- (i) USD 2,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in June 2013.
- (ii) USD 1,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in August 2013.
- (iii) USD 750,000, which bears interest at a rate of 5.76% (2009: 5.48%) at the statement of financial position date. The note was issued in 2009 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in December 2012.
- (iv) USD 3,000,000, which bears interest at a rate of 4.96% at the statement of financial position date. The note was issued in 2010 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in December 2013.

#### BlueOrchard Finance S.A.

The loans obtained from BlueOrchard Finance S.A. comprise of the following:

- (i) USD 6,500,000, which bears interest at a rate of 8.25% (2009: 8.25%) per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro-finance lending activities. The loan is repayable in four equal quarterly instalments

commencing from June 2010 and is due to be fully repaid in March 2011.

- (ii) USD 5,000,000, which bears interest at a rate of 8% (2009: 8%) per annum. The loan was obtained in 2007 to finance the expansion of the Bank's micro-finance lending activities. The loan is due to be fully repaid in June 2012.

#### Triodos Sicav

The loans obtained from Triodos Sicav comprise of the following:

- (i) USD 3,000,000, which bears interest at a rate of 8% (2009: 8%) per annum. The loan was obtained in 2009 (USD 900,000) and 2010 (USD 2,100,000) to finance the expansion of the Bank's micro loan portfolio. The loan is due to be fully repaid in January 2013.
- (ii) USD 1,750,000, which bears at a rate of 7.75% per annum. The loan was obtained in 2010 to finance the micro loan portfolio. The loan is due to be fully repaid in October 2013.

#### Oikocredit Ecumenical Development Cooperative Society U.A ("Oikocredit")

The loans obtained from Oikocredit comprise the following:

- (i) USD 1,500,000 which bears interest at a rate of 4.09% (2009: 4.37%) per annum. The loan was obtained in 2007 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal semi-annual installments commencing February 2010 and is due to be fully repaid in August 2011.
- (ii) USD 1,500,000 which bears interest at a rate of 7% (2009: 7%) per annum. The loan was obtained in 2008 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in six equal semi-annual installments commencing February 2011 and is due to be fully repaid in August 2013.
- (iii) MNT4,309,320,000, which was replaced with existing EUR 2,000,000 loan in 2009 to finance the Bank's micro-finance and SME lending activities. The loan bears interest at a rate of 7.25% (2009: 12.34%) per annum at the end of reporting period. The loan is repayable in three equal semi-annual installments commencing August 2010 and is due to be fully repaid in August 2011.

#### Dual Return Fund SICAV

The loans obtained from Dual Return Fund SICAV are in the form of promissory notes and comprise of the following:

- (i) USD 1,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in May 2013.

- (ii) USD 2,000,000, which bears interest at a rate of 7.5% (2009: 7.5%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in August 2013.
- (iii) USD 500,000, which bears interest at a rate of 7% (2009: 7%) per annum. The note was issued in 2009 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in November 2012.
- (iv) USD 1,000,000, which was converted to MNT 1,286,410,000 and bears interest at rate of 12% per annum. The note was issued in 2010 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in November 2012.

#### European Bank for Reconstruction and Development ("EBRD")

USD 4,000,000, which was converted to MNT 5,450,040,000, bears interest at a rate of 15.65% per annum at the statement of financial position date. The loan was obtained in 2010 to assist the development of the micro and small business sector in Mongolia. The loan is repayable in seven equal semi-annual instalments commencing July 2011 and is due to be fully repaid in July 2014.

#### Stichting Triodos Doen

The loans obtained from Stichting Triodos Doen comprise of the following:

- (i) MNT 1,000,000,000, which bears interest at a rate of 14% (2009: 14%) per annum. The loan was obtained in 2006 to finance the expansion of the Bank's lending activities. The loan is due to be fully repaid in September 2013.
- (ii) MNT 1,200,000,000, which bears interest at a rate of 14% (2009: 14%) per annum. The loan was obtained in 2007 to finance the expansion of the Bank's lending activities. The loan is due to be fully repaid in April 2011.
- (iii) MNT 1,400,000,000, which bears interest at a rate of 14% (2009: 14%) per annum. The loan was obtained in 2009 (MNT 980,000,000) and 2010 (MNT 420,000,000) to finance the expansion of the Bank's micro loan portfolio. The loan is due to be fully repaid in January 2013.
- (iv) MNT 1,400,000,000, which bears interest at a rate of 14% per annum. The loan was obtained in 2010 to finance the expansion of Bank's micro loan portfolio. The loan is due to be fully repaid in September 2013.

#### International Finance Corporation ("IFC")

USD 5,000,000, which bears interest at a rate of 4.247% (2009: 4.72%) per annum. The loan was obtained in 2008 to finance the Bank's microfinance and SME lending activities. The loan is repayable in ten semi-annual instalments which commenced on June 2009 and

is due to be fully repaid in December 2013.

#### Triodos Fair Share Fund

The loans obtained from Triodos Fair Share Fund comprise of the following:

- (i) USD 500,000, which bears interest at a rate of 8.5% (2009: 8.5%) per annum. The loan was obtained in 2006 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in July 2011.
- (ii) USD 2,000,000, which bears interest at a rate of 8.25% (2009: 8.25%) per annum. The loan was obtained in 2007 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in April 2011.

#### KfW, Frankfurt am Main ("KfW")

The loan obtained from KfW, amounting to USD 1,371,508 equivalent of EUR 900,000, bears interest at rate of 4.25% (2009: 5.375%) per annum at the end of reporting period. The loan was obtained in 2008 to assist the development of the micro and small business sector in Mongolia, to improve the living situation of low income individuals, to promote the urban development by financing housing projects, to strengthen the Bank's equity basis and refinancing situation for business expansion and for the financing of consulting services to improve the Bank's risk management with respect to its microfinance lending business. The loan is due to be fully repaid in July 2017.

#### KIVA

KIVA supports local lenders that provide small loans to individuals or groups in developing countries with its 0% interest rate funds. KIVA loan balance is MNT 1,533,990 thousand as at end of reporting period and has no stated maturity date.

Calvert Social Investment Foundation Foundation.Inc ("CSIF")

- (i) The loan obtained from CSIF is in the form of promissory notes issued by the foundation for a principal amount of USD 700,000. The note was obtained in 2004, 2005 and 2006 respectively, to finance the Bank's micro-finance and SME lending activities. The notes bear interest at a rate of 6% (2009: 6%) p.a. The loan is due to be fully repaid in December 2012.
- (ii) The loan obtained from CSIF is in the form of promissory notes issued by CSIF for a principal amount of USD 500,000. The note was obtained in 2008 to finance the Bank's micro-finance and SME lending activities. The note bears interest at a rate of 6.3% (2009: 6.3%) per annum. The loan is due to be fully repaid in December 2012.

#### Wallberg Invest SA

The loans obtained from Wallberg Invest SA are in the form of a promissory notes, amounting to USD 1,000,000, bears interest at a

rate of 7% (2009: 7%) per annum. The loan was obtained in 2009 to finance the Bank's micro-finance and SME lending activities. The loan is due to be fully repaid in November 2012.

#### Finethic Microfinance

The loan obtained from Finethic Microfinance is in the form of a promissory note issued by the foundation for a principal amount of USD 1,000,000. The note was obtained in 2008 to increase the liquidity and expansion of the Bank's microfinance and small medium enterprise lending activities. The note bears interest at rate of 7.5% (2009: 7.5%) per annum. The loan is due to be fully repaid in May 2013.

#### Oyu Tolgoi LLC

The loan obtained from Oyu Tolgoi LLC is subsidiary Loan and amount is USD 1,000,000. The Loan was obtained in 2010 to support Small and Medium sized Entrepreneurs Loan Facility Project. Loan has 0% interest rate per annum and is due to be fully paid in October 2013.

#### Monarch Community Fund, LLC

The loan obtained from Monarch Community Fund, amounting to USD 500,000, bears interest at rate of 6.0% (2009: 6.0%) per annum. The loan was obtained in 2008 to finance the Bank's micro-finance and SME lending activities. The loan is due to be fully repaid in April 2011.

#### ICFund Sicav

The loans obtained from ICFund Sicav are in the form of promissory notes, amounting to USD 500,000, bears interest at a rate of 4.96% per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2013.

#### SME Development Fund

The Bank obtained MNT 6,928 billion loan from SME Development Fund during the year to support micro and medium businesses. The loan bears interest rate at 3.6% per annum and is due to be fully repaid in May 2012.

#### Income Generation Fund \IGF\

The loans obtained from Income generation fund comprise of the following:

- MNT 2.945 billion which bears non interest rate. The loan was obtained in Dec 2009 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in June 2011. Agreement term is 18 months.
- MNT 1,674,400,000 which is non-interest bearing, but if not disburse fully within 6 months, will accrued monthly interest of 0.3%. The loan was obtained in 2010 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in September 2011. Agreement term is 12 months.

#### Ministry of Food and Agriculture

The loan obtained from Ministry of Food and Agriculture in 2010 amounted MNT 2,500,000 thousand and has interest rate 3.6% and is to be fully paid in May 2013.

#### Rural Poverty Reduction Program

The loans obtained from Rural Poverty Reduction Program comprise of the following:

- (i) USD 1,823,380 loan which bear interest at 6%. The loan was obtained in 2004 and is due to be paid fully in December 2017.
- (ii) MNT 120,000,000 loan which bear interest at 5%. This Loan was obtained in 2009 and is due to be paid fully in April 2019.

#### Ministry of Finance and Japan Bank for International Cooperation ("JBIC")

The Bank obtained MNT 1,922,000 thousand loan from Ministry of Finance and JBIC during the 2010 to support micro and medium businesses. The loan bears interest rate at 4.5% (2009: 4.8%) per annum and is due to be fully repaid in January 2019.

#### Microfinance development fund \MDF\

The loans obtained from Microfinance development fund comprise of the following:

- MNT 720.0 millions which bears interest at a rate of 8.1% per annum. The loan was obtained in 2008 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in July 2011.
- MNT 600.0 millions which bears interest at a rate of 8.1% per annum. The loan was obtained in 2009 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in November 2012.
- USD 1.0 millions which bears interest at a rate of 8.1% per annum. The loan was obtained in 2010 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in March 2013.

#### Ministry of Trade and Industry

The objective of the loan is to support micro and medium businesses. The loans comprise of the following:

- (i) MNT 369 million, which bears interest at a rate of 1.2% (2009: 1.2%) per annum. The loan was obtained in 2006 and was due in November 2008. However, the loan was then further extended and will be due to be fully repaid in January 2013.
- (ii) MNT 3.0 billion which bears interest at a rate of 3.6% per annum. The loan is due to be fully repaid in January 2015.

#### Asian Development Bank

The fund is dedicated to support "Value Added Cost Network" of Rural Development in Mongolia and Bank signed in contract of funding in 2010. ADB funds 50% of loans with 0% interest rate and Bank funds 50% by its own fund. There is no stated maturity date

for repayment but such kind of loans have 7 years period.

Refer to Note 32 for disclosure of the fair value of each class of other borrowed funds. Information on related party balances is disclosed in Note 34.

Most of the borrowing agreements stated above require compliance with certain debt covenants, which can be grouped in the following categories:

- capital related ratios (such as risk weighted capital adequacy ratio, solvency ratio, ratio between tier 1 capital and total capital);
- financial risks related ratios (such as maturity mismatches, currency mismatches, aggregate foreign currency open position, single currency foreign exchange risk ratio, negative liquidity gap ratio, aggregate interest rate risk ratio and interest rate risk ratio);
- credit related ratios (such as portfolio at risk, open loan exposure ratio, write off ratio, single largest borrowers to the equity ratio, related party lending ratio and aggregate large exposures ratio);

- other ratios (deposits to loans ratio, interest coverage ratio, shareholding in single entity, fixed assets to total assets, fixed assets plus equity investments ratio, overhead ratio etc.).

In case of non-compliance, related borrowing would default i.e. the borrowing is immediately payable on demand. For this reason, quarterly monitoring of debt covenants is carried out by relevant departments and officers (Finance and Accounting Division, including CFO, Integrated Risk Management Division, Treasury, Credit Administration Division etc.). In case of anticipated or noted non-compliance with certain covenants, appropriate action is taken by management, such as requesting waiver letter or negotiating new agreement with permanently changed limits (ratios).

As of 31 December 2010, the Bank complied with all covenants, apart from a covenant stated in the following agreements with DWM: SNS/DWM, SNS/DWM II and DWM. For more information refer to Note 31 ■

## ■ OTHER LIABILITIES

Other liabilities comprise the following:

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009 (adjusted)
<b>Other financial liabilities:</b>		
Liabilities for settlements of transactions	2,089,813	173,212
Joint funds for issuing loans	326,362	188,855
Payables for apartments purchased	301,178	77,220
Other received funds for issuing loans	228,484	143,400
Loan repayment advances	201,716	139,191
Payables for services	189,876	161,064
Finance lease payables	8,806	85,922
Other	66,560	70,990
<b>Total other financial liabilities</b>	<b>3,412,795</b>	<b>1,039,854</b>
<b>Other non-financial liabilities:</b>		
Prepayments from banks for using card system	81,581	24,528
Taxes payable other than on income	944	24,807
<b>Total other non-financial liabilities</b>	<b>82,525</b>	<b>49,335</b>
<b>Total other liabilities</b>	<b>3,495,320</b>	<b>1,089,189</b>

Most of the other financial liabilities are expected to be settled within twelve months after the year-end. Detailed maturity analysis of other financial liabilities is given in Note 29. All non-financial liabilities are of short-term nature ■

## ■ DEFERRED GRANTS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009
Consultative Group to Assist the Poorest ("CGAP")	216,807	143,933
SEEP	60,545	-
Foundation EKO	15,069	-
United States Agency for international Development ("USAID")	6,709	24,613
International Finance Corporation ("IFC")	2,315	2,659
Women's World Banking ("WWB")	2,164	21,451
Employment Generation Support Fund	-	191,399
<b>Total deferred grants</b>	<b>303,609</b>	<b>384,055</b>

Movements in deferred grants are presented in the following table:

In thousands of Mongolian Tugriks	Deferred grants
<b>Balance at 1 January 2009</b>	<b>102,157</b>
Received during the year	602,576
Recognized in statement of comprehensive income	(320,678)
<b>Balance at 31 December 2009</b>	<b>384,055</b>
Received during the year	236,433
Recognized in statement of comprehensive income	(316,879)
<b>Balance at 31 December 2010</b>	<b>303,609</b>

## ■ SUBORDINATED DEBTS

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009
International Finance Corporation	6,221,352	-
KfW, Frankfurt am Main	4,133,760	4,506,447
Incofin Impulse Microfinance Investment Fund	3,748,367	4,306,656
<b>Total subordinated debt</b>	<b>14,103,479</b>	<b>8,813,103</b>

### Subordinated convertible loans from KfW, Frankfurt am Main ("KfW")

The Bank received USD 2,747,230 equivalent of EUR 1,800,000 under a 10-year subordinated convertible loan from KfW. The subordinated convertible loan has a maximum interest rate to be capped at 9.0% per annum. The effective interest rate at the reporting date is 6% per annum.

The subordinated convertible loan can be fully repaid by cash on 20 July 2017 or to be converted into equity shares of the Bank's parent company TenGer Financial Group LLC. A conversion option can be

exercised only if TenGer's shareholders approve issue of additional share capital and some of the existing shareholders of TenGer decide not to use their pre-emptive rights. In such case, TenGer has obligation to offer remaining shares to KfW at the same price as to the existing shareholders. The price of new shares to be issued shall be fixed by the Shareholders Meeting of TenGer that authorizes the capital increase. In such circumstances KfW can exercise conversion option either through purchase of shares for cash consideration or through requesting the Bank to repay outstanding balance of subordinated debt, which would enable KfW to use returned funds for purchase shares of TenGer. The amount of consideration to be

paid by KfW for acquisition of shares of TenGer is the same under both options.

The new shares to be acquired by KfW using conversion option shall be common shares with full voting powers, shall rank pari passu to all other shares of TenGer Financial Group LLC and shall not exceed 20% of the aggregate share capital of TenGer.

The Bank cannot repay subordinated convertible loan prior to the maturity date, except in the case of revocation of its banking license, its insolvency, liquidation or restructuring and with the prior approval of the Bank of Mongolia. The debt ranks after all other creditors in case of liquidation.

#### Subordinated loan from Incofin Impulse Microfinance Investment Fund

The subordinated loan is to be repaid by cash in one amount 84 months after the first disbursement date, which is December 2016. The loan bears interest at a rate of 9.25% per annum.

#### Subordinated loan from International Finance Corporation

During 2010 the Bank received subordinated convertible debt of USD 5,000,000 from International Finance Corporation (IFC), which is due for repayment on 15 December 2018. The agreement with

IFC contains conversion option with the same characteristics as conversion option specified in the agreement with KfW, disclosed above. Accordingly, conversion option can be exercised only if the existing shareholders of TenGer make decision on increase in share capital of TenGer and some of these shareholders decide not to use their pre-emptive rights. In such situation, IFC is entitled to purchase remaining shares of TenGer at the same price offered to shareholders. As KfW, IFC is entitled to make decision on whether shares are to be purchased for cash consideration or through requesting the Bank to repay outstanding balance of subordinated debt.

The new shares to be acquired by IFC using conversion option shall be common shares with full voting powers, shall rank pari passu to all other shares of TenGer Financial Group LLC and shall not exceed 20% of the aggregate share capital of TenGer.

The Bank cannot repay subordinated convertible loan prior to the maturity date, except in the case of revocation of its banking license, its insolvency, liquidation or restructuring and with the prior approval of the Bank of Mongolia.

The loan carries a variable interest rate of 6MLibor+6.5% per annum. Effective interest rate as of 31 December 2010 is 6.92 % per annum. The debt ranks after all other creditors in case of liquidation ■

## ■ SHARE CAPITAL AND PREMIUM

In thousands of Mongolian Tugriks except for number of shares	Number of outstanding shares	Ordinary shares	Share premium	Total
At 1 January 2009	10,947,830	10,947,830	2,594,922	13,542,752
New shares issued	2,342,821	2,342,821	2,657,181	5,000,002
<b>At 31 December 2009</b>	<b>13,290,651</b>	<b>13,290,651</b>	<b>5,252,103</b>	<b>18,542,754</b>
<b>At 31 December 2010</b>	<b>13,290,651</b>	<b>13,290,651</b>	<b>5,252,103</b>	<b>18,542,754</b>

The nominal registered amount of the Bank's issued share capital is MNT 13,290,651 thousand (2009: MNT 13,290,651 thousand). Share premium represents the excess of contributions received over the nominal value of shares issued.

During 2010 the Bank was involved in transactions with treasury shares. All shares purchased were sold during 2010 at a price higher than their purchase price. Thus, the Bank has a recognized gain from

treasury share transactions in the amount of MNT 2,663 thousand, which is recognized within retained earnings.

All shares as of 31 December 2010 and 31 December 2009 are owned by Tenger Financial Group LLC.

The shareholders of Tenger Financial Group LLC as of 31 December 2010 and 31 December 2009 and percentages of ownership are as follows:

In thousands of Mongolian Tugriks	31 December 2010	31 December 2009
EIT Capital Management LLC	25.03%	25.10%
BlueOrchard Private Equity Fund	16.61%	16.66%
Mercy Corps	13.63%	13.67%
International Financial Corporation (IFC)	13.52%	13.56%
European Bank for Reconstruction and Development (EBRD)	9.97%	10.00%
Triodos Fair Share Fund	7.46%	7.48%
Stichting Triodos-Doen	7.46%	7.48%
Open Society Forum	2.87%	2.88%
UB Rotary Club	1.63%	1.63%
Mongolian Women's Federation	1.09%	1.09%
Private individuals	0.43%	0.20%
Other legal entities	0.30%	0.25%
<b>Total ordinary shares</b>	<b>100%</b>	<b>100%</b>

The following shareholders had ability to significantly influence operating and financial decisions of the Parent through their shareholding and rights to be represented on the Board of Directors as of 31 December 2010 and 31 December 2009:

- EIT Capital Management LLC;
- BlueOrchard Private Equity Fund;
- Mercy Corps;

- International Financial Corporation (IFC);
- European Bank for Reconstruction and Development (EBRD);
- Triodos Fair Share Fund;
- Stichting Triodos-Doen.

The transactions with the shareholders of the Parent are disclosed in Note 34 ■

## ■ INTEREST INCOME AND EXPENSE

In thousands of Mongolian Tugriks	2010	2009 (restated)
<b>Interest income</b>		
Loans and advances to customers	53,485,146	38,370,519
Cash and cash equivalents	2,394,292	1,357,073
Due from other banks	1,691,405	705,728
Debt investment securities available for sale	14,609	29,828
<b>Total interest income</b>	<b>57,585,452</b>	<b>40,463,148</b>
<b>Interest expense</b>		
Customer accounts	16,785,951	11,138,340
Due to other banks	9,820,173	9,256,105
Other borrowed funds	3,425,675	378,248
Subordinated debt	813,299	339,080
<b>Total interest expense</b>	<b>30,845,098</b>	<b>21,111,773</b>
<b>Net interest income</b>	<b>26,740,354</b>	<b>19,351,375</b>

## ■ FEE AND COMMISSION INCOME AND EXPENSE

In thousands of Mongolian Tugriks	2010	2009 (adjusted)
Fee and commission income		
Settlement transactions	388,220	295,949
Opening and maintenance of customers' current accounts	223,274	221,751
Loan form application fees	186,693	174,302
Banking guarantees and letters of credit	88,788	44,682
Foreign currency transactions	84,747	62,465
Other	72,475	54,119
Total fee and commission income	1,044,197	853,268
Fee and commission expense		
Settlement transactions	240,260	218,415
Other	44,586	45,524
Total fee and commission expense	284,846	263,939
Net fee and commission income	759,351	589,329

## ■ FOREIGN EXCHANGE GAINS / (LOSSES), NET

In thousands of Mongolian Tugriks	2010	2009 (adjusted)
Realized foreign exchange gains/(losses), net	527,190	(235,813)
Unrealized foreign exchange translation gains/(losses), net	506,781	(1,343,638)
<b>Total foreign exchange gains/(losses), net</b>	<b>1,033,971</b>	<b>(1,579,451)</b>

Realized foreign exchange gains/(losses) include foreign exchange gains from trading in foreign currencies ■

## ■ ADMINISTRATIVE AND OTHER OPERATING EXPENSES

In thousands of Mongolian Tugriks	2010	2009 (adjusted)
Salary costs	8,557,290	6,422,210
Depreciation of property and equipment (Note 14)	1,898,197	1,648,325
Rent	1,298,578	890,052
Social security contributions	937,526	707,173
Advertising and marketing services	920,081	507,306
Security services	887,278	670,083
Materials and supplies	739,896	635,550
Information and telecommunication services	729,296	557,710
Repair and maintenance	616,327	447,580
Events	575,150	221,695
Business trip expenses	481,767	386,139
Transportation	453,990	373,767
Amortisation of intangible assets (Note 13)	231,269	182,710
Professional services	206,779	176,099
Insurance	76,766	69,307
Taxes other than on income	55,513	47,824
Training expenses	36,994	27,346
Other	522,167	302,960
<b>Total administrative and other operating expenses</b>	<b>19,224,864</b>	<b>14,273,836</b>

Included in social security contributions are pension contributions of MNT 596,607 thousand (2009: MNT 450,019 thousand). During 2010, TenGer Financial Group LLC has introduced Employee Stock Option Plan ("ESOP"), which relates to key employees (such as management team members and other high performing staff as identified by the respective management) of TenGer and its subsidiaries and associates. The main factors affecting the allocated number of shares of TenGer per each employee are employee's annual compensation and annual performance rating. A key employee is entitled to 30% of shares after one year of service (i.e. for services provided in period from 1 January 2010 to 31 December 2010), 30% of shares after two years of service (i.e. for services provided in period from 1 January 2011 to 31 December 2011) and 40% of shares after three years of service (i.e. for services provided in period from 1 January 2012 to 31 December 2012). Given that ESOP related to 2009 performance was announced to nominated key employees in May 2010, the vesting period is approximately two years and seven months.

TenGer is in the process of establishing ESOP Fund for the purposes of this program, which is planned to be financed by the Bank. The Fund is not expected to operate as a separate legal entity, but as an account for special purpose, owned by TenGer, opened and held with the Bank. If employment is terminated or employee dies, all allocated shares are to be sold to TenGer (based on the vested percentage) at the price that approximates fair market value of TenGer shares. TenGer is obliged to make payment to employees who terminated employment based on signed ESOP contracts with employees. Other entities of TenGer Financial Group, including the Bank, have no obligations to make payment. Total amount allocated to ESOP Fund amounts to MNT 120,000 thousand. . The Bank has not recognized any transactions related to share-based payments arising from the above program in these financial statements. Management assessed that fair value of shares planned to be issued under above described ESOP is not material and thus non-recognition of share-based payments does not materially affect these financial statements ■

## ■ INCOME TAXES

In thousands of Mongolian Tugriks	2010	2009 (restated)
Current income tax charge	2,044,711	344,035
Deferred income tax (credit)/charge	(181,843)	15,709
<b>Income tax expense for the year</b>	<b>1,862,868</b>	<b>359,744</b>

The Bank provides for income taxes on the basis of income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purposes. The income tax rate for profits of the Bank is 10% for the first MNT 3 billion (2009: MNT 3 billion) of taxable income, and 25% (2009: 25%) on the

excess of taxable income over MNT 3 billion (2009: MNT 3 billion) in accordance with Mongolian tax legislation.

A reconciliation between the expected and the actual taxation charge is provided below.

In thousands of Mongolian Tugriks	2010	2009 (restated)
<b>Profit before tax</b>	<b>8,364,302</b>	<b>2,704,362</b>
Theoretical tax charge at statutory rate (2010: 25%; 2009: 25%)	2,091,076	676,091
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Income which is exempt from taxation	(126,695)	(1,408)
- Non-deductible expenses	348,487	135,061
- Effect of income subject to lower tax rate	(450,000)	(450,000)
<b>Income tax expense/(credit) for the year</b>	<b>1,862,868</b>	<b>359,744</b>

Differences between IFRS and statutory taxation regulations in Mongolia give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary

differences is detailed below and is recorded at the rate of 25% (2009: 25%). Deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

In thousands of Mongolian Tugriks	1 January 2010 (restated)	Credited/ (charged) to profit or loss	31 December 2010
Tax effect of deductible/(taxable) temporary differences			
Property and equipment - accelerated tax depreciation	(193,679)	(60,473)	(254,152)
Loans and advances to customers – deferral of loan origination fees	321,383	242,316	563,699
Net deferred tax asset	127,704	181,843	309,547

In thousands of Mongolian Tugriks	1 January 2009 (restated)	Credited/ (charged) to profit or loss (restated)	31 December 2009 (restated)
Tax effect of deductible/(taxable) temporary differences			
Property and equipment - accelerated tax depreciation	(105,394)	(88,285)	(193,679)
Loans and advances to customers – deferral of loan origination fees	248,807	72,576	321,383
Net deferred tax asset	143,413	(15,709)	127,704

## ■ DIVIDENDS

In thousands of Mongolian Tugriks	2010	2009
Dividends payable at 1 January	1,113	1,113
Dividends declared during the year	384,366	-
Dividends paid during the year	(384,236)	-
Dividends payable at 31 December	1,243	1,113

All dividends are declared and paid in Mongolian Tugriks.

## ■ FINANCIAL RISK MANAGEMENT

The risk management function within the Bank is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. Such risk could either result in a direct loss in earnings and capital or may result in constraints on the Bank's ability to meet its objectives.

Financial risk is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The primary objectives of the Bank's risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

The Bank has a defined risk management framework which is not designed to eliminate risk but to optimize the risk and return trade off. The risk management framework is in place to ensure that:

- individuals who manage the risks clearly understand the requirement and measurement system;
- the Bank's risk exposure is within the limits established by the Board of Directors;
- the risk measured is in line with the business strategy as approved by the Board of Directors;
- the capital allocation is consistent with the risk exposures; and
- the Bank's performance objectives are aligned with the risk tolerance.

The Board of Directors is responsible for the overall risk management approach and for approving risk management strategies and principles. Also, the Board of Directors is ultimately responsible for identification and management of risks. Overall risk management process is also monitored by the Supervisory Board. However, there are separate independent bodies responsible for managing and monitoring risks i.e. for implementing risk management approach, principles and strategies approved by the Board of Directors. Risk Management Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. Risk Management Committee is

responsible for anticipating and managing new and ongoing financial risk across business departments and maintaining appropriate limits on risk taking, adequate systems and standards for measuring financial risk and performance, risk reporting (including reporting to the Board of Directors), and management review process.

Integrated Risk Management Division has direct accountability for implementing risk related procedures and ensuring adequate identification, measurement, monitoring, and management of the Bank's financial position and risks at operational level on daily basis. Its responsibilities mainly include market risk, liquidity risk, credit portfolio risk, and operational risk.

Risk management processes throughout the Bank are audited annually by the internal audit function, that examines both the adequacy of the procedures and the Bank's compliance with the procedures. The results of all assessments are discussed with Management. Internal audit reports its findings and recommendations to the Audit Committee. In general, the Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur. Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank, as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

As part of its overall risk management, the Bank uses VaR and sensitivity analysis to manage exposures resulting from changes in interest rates, foreign currencies, credit risks, and exposures arising from forecast transactions. A monthly briefing is given to the Executive Committee and all other relevant members of the Bank on the utilization of market limits, analysis of VaR and liquidity and any

other risk developments.

Information compiled from all business activities is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, Risk Management Committee and the head of each business division on monthly basis. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, value at risk (VaR), liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry and customer risks takes place. The Supervisory Board receives a comprehensive risk report on quarterly basis. Also, management assesses the appropriateness of impairment provision on quarterly basis.

In 2010 the Bank has strengthened its risk management with the technical assistance from international consulting company AFC, as part of program of economic cooperation with Federal Republic of Germany and other international consultant companies.

Credit risk. The Bank takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties giving rise to financial assets. The Bank's maximum exposure to credit risk is reflected in the carrying amounts of financial assets on the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. For guarantees and commitments to extend credit, the maximum exposure to credit risk is the amount of the commitment. Refer to Note 31. The credit risk is mitigated by collateral as disclosed in Notes 10.

In 2010, the Bank's lending strategy was significantly amended in accordance with economic circumstances and mid-term future prospects of Mongolian economy. The strategic goals are to reflect Basel credit risk managing strategies in the Bank's credit policies, to keep credit risk at a minimum level, to distinguish loan underwriting and origination stages, to make accurate risk assessments of borrowers and to process loan applications swiftly. The Bank manages and monitors credit risk by differentiating loan portfolio and using two approaches for monitoring credit risk: individual (loan) approach and portfolio based risk approach. The Bank's Risk Management Committee, through Credit Administration Division (CAD) promotes diversification of the loan portfolio. The CAD structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower or groups of borrowers, loan product types and industry segments of the economy. Limits on the level of credit risk by product and industry sector are reviewed regularly at the meetings of the Board of Directors. Such risks are monitored on a revolving basis and subject to an annual or semi-annual review.

The Bank Management established two credit committees, which are responsible for approving loans of up to 8 percent of Tier I Capital for individual borrowers and legal entities:

- Credit committee, headed by chief credit officer, which reviews and approves above MNT 300 million (other than those for

which approval of the Board Credit Committees is required).

Credit Committee meets three times a week. It is also responsible for issuing guidance to the junior level credit committees.

- Sub-Credit Committees at branch level, which are generally authorized to approve loans below MNT 300 million. Credit limits delegated to bank branches vary depending on the size of branch, experience of branch personnel, quality of loan portfolio and other factors. These credit committees generally meet twice a week.

Loan applications originated at the branch level, which are processed and assessed for credit risk at branch level, are passed on to the relevant credit committee (based on the amount of the loan) for approval of loan. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees.

In order to monitor credit risk exposures, regular on site-monitoring is executed by the Credit Review Department, based on a structured analysis focused on the customer's business and financial performance. Any significant exposures against customers with deteriorating creditworthiness are reported to and reviewed by Credit Review Department and further reported to the Credit Committee. Off-site monitoring methods are used to monitor exposures to credit risk prior to the approval of loans, as well. From 2006 the Bank has adopted a loan risk assessment system that serves to accurately determine credit risk related to individual loan and/or customer, and thus ensure keeping credit risk at minimum or approving loans at proper terms. During 2010 the Bank, based on the recommendations of the international advisors, updated current internal system and developed specialized systems that were introduced for all loan products. These risk rating systems are:

- Consumer loan and micro loan credit scoring (designed for micro, consumption and rural loan products);
- Intermediate SME rating system (for loans between MNT 20-100 million or approximately USD 15,000 to 80,000);
- Risk rating for SME loans (above MNT100 million or approximately USD 80,000).

Bank's risk rating systems are dependent on quantitative and qualitative parameters of the borrower. For individual borrowers (including entrepreneurs) personal characteristics and sense of civil responsibilities are priority. In case of SME borrowers parameters such as corporate governance, profitability, financial stability and risk profile of industry sector play significant role. Aside from the rating systems stated above, PPI and GPI scoring systems are used to determine the level of implementation of socio-economic targets (including ecological targets) by prospective borrowers, such as level of socio-economic friendliness of the business and actions taken toward poverty reduction. In most cases, result of such scoring affects interest rates at which loans to specific borrower are issued. In order to monitor credit risk exposures, regular reports are produced by the responsible credit risk officers at branch level based on a structured analysis focused on the customer's business

and financial performance, as well as on monitoring collection of loans. Any significant exposures against customers with deteriorating creditworthiness are reported to and reviewed by the Credit Administration Division. The Credit Administration Division is also responsible for monitoring aging reports per branches and investigating reasons for unusually high or low levels of overdue and/or impaired loans, which is one of criteria for selection of branches which will be visited. The Credit Administration Division is responsible for reporting on quality of loan portfolio to the Credit Management Committee and the Risk Management Committee. The branches do not have the authority to make decisions on restructuring loans and such requests are forwarded to the Bank's Head Office.

The amount and type of collateral depends on the assessment of the credit risk of the borrower or counterparty and the type of loan granted. The Bank follows the collateral guidelines set by the Credit Management Committee in determining the type and value of collateral to be obtained. The main types of collateral are as follows:

- cash deposits, guarantees, real estate property and inventories for small business, consumer, agricultural, SME and employee loans;
- mortgages on residential properties and vehicles for mortgage loans;
- cash, equities and real estate properties for wholesale loans;
- cash deposits for deposit backed loans.

The Bank performs physical inspection of the collateral and regularly monitors the market value of collateral, requests additional collateral in accordance with underlying agreement, and monitors the market value of collateral obtained during its review of adequacy of the allowance for impairment losses. Information on collateral is given in Note 10.

As of 31 December 2010 and 31 December 2009, the Bank uses internal credit rating system briefly described below. The description of Credit Risk Grading System of the Bank used during 2010 and previous years is provided below:

Credit rating	Grade Description
A	Excellent
B	Good
C	Satisfactory
D	Substandard

The Bank's 4-Grade Risk Rating was used in order to categorize exposures according to the risk profile. The 4-Grade Risk Rating is modelled using parametric approaches that quantify probability of default in determining the risk grade. Both quantitative and qualitative historic experience provided background for the Bank's Credit Risk Management Department for the assumptions used. The grading system is supported by a variety of financial and statistical analytics, combined with processed portfolio and market information

to provide the main inputs for the measurement of counterparty risk. All risk grades are tailored to the various loans exposures and are derived in accordance with the Bank's grading policy across all risk groupings reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. This facilitated the management of the applicable risks and the comparison of credit exposures across all lines of loan products. The Bank's policy is to maintain accurate and consistent risk grades across the credit portfolio. As of 31 December 2010 (as well as at the end of the previous reporting periods), the Bank has monitored credit quality of loans primarily based on classification of loans based on provisioning guidelines defined by the Bank of Mongolia, which is used for impairment provision calculation in accordance with the Regulations on Asset Classification and Provisioning, jointly approved by the Bank of Mongolia and Ministry of Finance. These provisioning guidelines are based on expected loss model. In accordance with these regulations, the Bank is required to determine the quality of loans and advances based on their qualitative factors and time characteristics (i.e. delays in repayment). Loans are classified into the following five groups: performing, in arrears, substandard loans, doubtful loans, and loss. Specified provision rate is applied to loans in each group for the purposes of determining impairment provision in accordance with the provisioning guidelines of the Bank of Mongolia. Further, the Bank separately monitors restructured/renegotiated loans, as well as loans from watch list. Loans are included in watch list mostly based on delay or in cases when borrower faces financial difficulties which may affect its ability to repay loan. The information on credit quality of loans neither past due nor impaired is given in Note 10. As stated above, responsible department of the Bank reviews ageing analysis of outstanding loans and follows up on past due balances. Management therefore considers it appropriate to provide ageing and other information about credit risk as disclosed in Note 10. Credit quality of other financial assets is disclosed in Notes 7, 8, 9, 10, 11 and 15. Further, credit quality of loan portfolio is monitored through ensuring compliance with debt covenants (credit related ratios) specified in certain borrowing agreements (e.g. EBRD, IFC, FMO, Blue Orchard Finance S.A. etc.), refer to Note 18. Compliance with these covenants is monitored on quarterly basis by Credit Administration Division. Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Bank uses the same credit policies in assuming conditional obligations as it does for on-balance sheet financial instruments, through established credit approvals, risk control limits and monitoring procedures. Exposure to credit risk as a result of credit related commitments is given in Note 31. The management believes that no provision on credit related commitments (such as issued guarantees, letters of credit etc.) is necessary as of 31 December 2010 and 31 December 2009, refer to Note 31.

Restructuring and/or renegotiating of loans is done on case by case basis. A loan can be renegotiated only if the borrower faces

temporary cash flow problem which would have reasonable evidence of future recovery. Proposal to restructure a loan is prepared by a credit officer and the final decision is made at head office by Credit Committee, which comprises of senior managers. Restructured loans are reported to the Board of Directors as well. The amounts of restructured loans are given in Note 10.

The Bank performs impairment assessment in accordance with IFRS requirements on quarterly basis. The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. Impairment provision is determined through individual (specific) assessment and collective assessment. Specific assessment includes individually significant exposures and exposures with identified impairment indicators. Collective assessment includes exposures, which are not individually significant as well as individually significant exposures without objective evidence of impairment.

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of the other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review by the management. The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired.

For more details on accounting policy and methods used for determining impairment provision refer to Notes 3 and 4. Credit quality of loans and advances to customers and amounts of impairment provision are disclosed in Note 10.

**Market risk.** The Bank takes on exposure to market risks. Market risks arise from open positions in (a) currency, (b) interest rate and (c) equity products, all of which are exposed to general and specific market movements. The Bank manages and monitors market risk using Value at Risk (VaR) and sensitivity analyses. Except for the

foreign currency concentration, management believes that the Bank is not significantly exposed to market risk.

**Currency risk.** Management sets limits on the level of exposure by currencies, which are monitored on a frequent basis. Apart from monitoring foreign exchange exposure mismatch, the Bank has been applying Value-at-Risk ("VaR") simulation model to manage and measure foreign exchange risk since March 2007.

VaR is a method used to estimate any negative change in the market value of a portfolio at a given confidence level and over a specified time horizon. The Bank utilizes a full automatic VaR tool, which calculates VaR in variance-covariance, and historical and Monte Carlo simulation ways. The Bank is one of the only two banks licensed by the Bank of Mongolia (BoM) to assess foreign currency risk by using the maximum expected loss method (VaR) in the sector. Use of VaR under the formal authorization of the central bank exempts banks from regulatory requirement of complying with limits on foreign currency positions determined by the regulations of the Bank of Mongolia (e.g. position in any single foreign currency should not exceed 15 percent of capital and the total position in foreign currencies should be less than 40 percent of capital).

The VaR models are designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The Bank uses Variance/Covariance model to assess possible changes in foreign currency portfolio based on historical data from the past one day. The VaR methodology employed by the Bank uses a one-day period, using 99% confidence level, of the potential loss that is not expected to be exceeded if the current market risk positions were to be held unchanged for one day, and are determined by observing market data movements over a 250-day period. The use of a 99% confidence level means that, within one day horizon, losses exceeding the VaR figure should occur, on average, not more than once every hundred days.

The use of VaR has limitations because it is based on historical correlations and volatilities in market prices and assumes that future price movements will follow a statistical distribution. Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under or over-estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99% confidence level. VaR is an integral part of the Bank's market risk management since March 2007, VaR limits and exposures are reviewed regularly against the limits by management. The estimated potential one-day losses on its foreign currency denominated financial instruments, as calculated by the VaR model are the following:

In thousands of Mongolian Tugriks	2010	2009
End of the year	28,346	17,731
Average Daily	13,207	29,316
Highest	87,834	79,145
Lowest	775	2,998

In addition, foreign currency risk is monitored on quarterly basis by Treasury Department, which ensures the Bank's compliance with relevant debt covenants (refer to Note 18).

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2010:

In thousands of Mongolian Tugriks	MNT	USD	Euro	Other	Total
<b>Assets</b>					
Cash and cash equivalents	65,959,221	20,320,138	2,235,523	4,022,880	92,537,762
Mandatory reserves in BOM	9,780,500	-	-	-	9,780,500
Due from other banks	30,000	19,408,657	-	-	19,438,657
Loans and advances to customers	243,602,004	77,615,736	28,626	444,405	321,690,771
Investment securities available for sale	23,300	-	-	-	23,300
Other financial assets	509,993	237,126	-	839	747,958
<b>Total financial assets</b>	<b>319,905,018</b>	<b>117,581,657</b>	<b>2,264,149</b>	<b>4,468,124</b>	<b>444,218,948</b>
<b>Liabilities</b>					
Due to other banks	32,482,270	-	-	-	32,482,270
Customer accounts	215,714,780	16,919,990	2,274,107	2,284,175	237,193,052
Other borrowed funds	57,845,784	88,429,043	-	-	146,274,827
Other financial liabilities	1,279,245	2,021,915	-	111,635	3,412,795
Subordinated debt	-	14,103,479	-	-	14,103,479
<b>Total financial liabilities</b>	<b>307,322,079</b>	<b>121,474,427</b>	<b>2,274,107</b>	<b>2,395,810</b>	<b>433,466,423</b>
<b>Net position</b>	<b>12,582,939</b>	<b>(3,892,770)</b>	<b>(9,958)</b>	<b>2,072,314</b>	<b>10,752,525</b>

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2009. The amounts presented below are restated or adjusted for reclassifications (Note 3).

In thousands of Mongolian Tugriks	MNT	USD	Euro	Other	Total
<b>Assets</b>					
Cash and cash equivalents	38,031,505	27,596,660	4,201,000	2,480,000	72,309,165
Mandatory reserves in BOM	6,834,900	-	-	-	6,834,900
Due from other banks	1,163,204	19,478,340	-	-	20,641,544
Loans and advances to customers	125,311,495	68,314,772	327,195	9,865	193,963,327
Investment securities available for sale	224,300	2,966,751	-	-	3,191,051
Other financial assets	278,422	48,877	-	-	327,299
<b>Total financial assets</b>	<b>171,843,826</b>	<b>118,405,400</b>	<b>4,528,195</b>	<b>2,489,865</b>	<b>297,267,286</b>

<b>Liabilities</b>					
Due to other banks	18,132,019	-	3,935,546	-	22,067,565
Customer accounts	107,686,553	18,003,601	663,657	1,047,865	127,401,676
Other borrowed funds	38,319,960	92,170,508	-	-	130,490,468
Other financial liabilities	895,239	144,591	-	24	1,039,854
Subordinated debt	-	8,813,103	-	-	8,813,103
<b>Total financial liabilities</b>	<b>165,033,771</b>	<b>119,131,803</b>	<b>4,599,203</b>	<b>1,047,889</b>	<b>289,812,666</b>
<b>Net position</b>	<b>6,810,055</b>	<b>(726,403)</b>	<b>(71,008)</b>	<b>1,441,976</b>	<b>7,454,620</b>

**Interest rate risk.** Interest rate risk arises when there is a mismatch between positions, which are subject to interest rate adjustment within a specified period. The Bank's lending, funding and investment activities give rise to interest rate risk. The immediate impact of variation in interest rate is on the Bank's net interest income, while a long term impact is on the Bank's net worth since the economic value of the Bank's assets, liabilities and off-balance sheet exposures will be affected. The management has established limits on the interest rate gaps. Net positions (gaps) are monitored on a daily basis and hedging strategies are used to ensure positions

are maintained with the established limits.

In addition, interest rate risk is monitored on quarterly basis by Treasury Department, which ensures the Bank's compliance with relevant debt covenants (refer to Note 18). The table below summarises the Bank's exposure to interest rate risks. The table presents the aggregated amounts of the Bank's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing or maturity dates. The amounts as of 31 December 2009 presented below are adjusted for effect of restatements or reclassifications.

In thousands of Mongolian Tugriks	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Non-interest bearing	Total
<b>31 December 2010</b>						
Total financial assets	109,642,395	129,745,474	60,331,269	88,554,782	55,945,028	444,218,948
Total financial liabilities	83,235,573	100,481,357	90,230,270	109,993,088	49,526,135	433,466,423
<b>Net interest sensitivity gap at 31 December 2010</b>	<b>26,406,822</b>	<b>29,264,117</b>	<b>(29,899,001)</b>	<b>(21,438,306)</b>	<b>6,418,893</b>	<b>10,752,525</b>
<b>31 December 2009</b>						
Total financial assets	60,331,245	73,153,400	59,605,480	58,316,901	45,860,260	297,267,286
Total financial liabilities	53,299,664	60,447,348	50,584,333	93,689,639	31,791,682	289,812,666
<b>Net interest sensitivity gap at 31 December 2009</b>	<b>7,031,581</b>	<b>12,706,052</b>	<b>9,021,147</b>	<b>(35,372,738)</b>	<b>14,068,578</b>	<b>7,454,620</b>

All of the Bank's debt instruments reprice within 5 years except those at fixed interest rate of MNT 3,895,001 thousand, which matures in 6 year (2009: all reprice within 5 years except those at fixed interest rate of MNT 4,965,720 thousand which mature in 6.5 year).

At 31 December 2010, if interest rates at that date had been 200 basis points lower (2009: 200 basis points lower) with all other variables held constant, profit for the year would have been MNT 532,392 thousand (2009: MNT 400,896 thousand higher) lower, mainly as a result of lower interest income on variable interest assets. If interest rates had been 200 basis points higher (2009: 200 basis points higher), with all other variables held constant, profit would

have been MNT 532,392 thousand (2009: MNT 400,896 thousand lower) higher, mainly as a result of higher interest income on variable interest assets.

The Bank's exposure to interest rate risk at the end of the reporting period is not representative of the typical exposure during the year. For the average exposure during 2010, if interest rates had been 200 basis points lower (2009: 200 basis points lower) with all other variables held constant, profit for the year would have been MNT 48,850 thousand (2009: MNT 319,715 thousand higher) lower, [mainly] as a result of lower interest income on variable interest assets.

For the average exposure during 2010, if interest rates had been

200 basis points higher (2009: [200] basis points higher), with all other variables held constant, profit would have been MNT 48,850 thousand (2009: MNT 319,715 thousand lower) higher, [mainly] as a result of higher interest income on variable interest assets.

**Other price risk.** The Bank has limited exposure to equity price risk, as the overall amount of equity investments as of 31 December 2010 and 31 December 2009 was not significant (refer to Notes 11 and 12). Further, available for sale equity investments are carried at cost, as they are not publicly traded. Management is highly involved and approves all transactions related to equity investments. Prepayment risk arises when borrowers repay their loans before due date, which can cause losses to a bank. The Bank is exposed to prepayment risk through providing loans which give the borrower the right to early repay the loans. Due to high competition among banks on the Mongolian market and strong economic growth of the Mongolian economy, prepayment risk is always present, regardless of the level of both fixed and floating interest rates. Thus, management closely monitors prepayment risk and places a great focus on how the risk would impact maturity gap and interest income and takes necessary steps, based on estimated impact. Based on annual historic prepayment rates, management has assessed that the current year profit and equity at the end of the current reporting period would not have been significantly impacted by changes in prepayment rates and that prepayment risk does not have material impact on these financial statements (2009: no material impact).

**Geographical risk concentrations.** The Bank is exposed to geographical concentration risk, as almost all of its financial assets are placed in Mongolia as of 31 December 2010 and 31 December 2009. Although major part of financial liabilities relates to Mongolia, the concentration is lower in case of financial liabilities, as major part of other borrowed funds and all subordinated debt is received from international financial institutions. The management believes that the Bank's exposure to geographical concentration risk is mitigated due to high customer diversification and industry diversification.

**Other risk concentrations.** Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location. In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. At the individual basis, the Bank of Mongolia ("Central Bank") sets the following limits:

- i. The maximum amount of the overall credit exposures issued and other credit-equivalent assets to the individual and his/her related persons shall not exceed the 20 percent of the capital of the Bank;
- ii. The maximum amount of the credit exposures issued and other credit-equivalent assets shall not exceed the 5 percent of the capital for one related person to the bank, and the aggregation of overall lending to the related persons shall not exceed 20 percent of the capital of the Bank.

Management monitors and discloses concentrations of credit risk by obtaining reports listing exposures to borrowers. The Bank's exposure to concentration risk, including industry concentration risk, is disclosed in Notes 10.

**Liquidity risk.** Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns, guarantees etc. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Liquidity risk is managed by the Asset Liability Committee of the Bank.

The Bank seeks to maintain a stable funding base primarily consisting of amounts due to other banks, corporate and retail customer deposits, other borrowed funds and subordinated debt. It is the Bank's policy to maintain a prudent mix of borrowed and core deposit base. The Bank invests the funds in diversified portfolios of liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements. In addition, the Bank maintains a statutory deposit with the Central Bank of Mongolia equal to 5% of customer deposits.

The liquidity management of the Bank requires considering the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans; and monitoring liquidity ratios against regulatory requirements. The Bank calculates liquidity ratios on a daily basis in accordance with the requirement of the Bank of Mongolia. These ratios are:

- Liquidity ratio, which is calculated as the ratio of liquid assets to total liabilities. The ratio was 27.9 percent at 31 December 2010 (2009: 35.2 percent).
- Local currency liquidity ratio, which is calculated as the ratio of local currency liquid assets to local currency liabilities. The ratio was 25.1 percent at 31 December 2010 (2009: 31.8 percent).
- Foreign currency liquidity ratio, which is calculated as the ratio of foreign currency assets to foreign currency liabilities. The ratio was 33.7 percent at 31 December 2010 (2009: 38.9 percent).

The Treasury Department receives information about the liquidity profile of the financial assets and liabilities. The Treasury Department

then provides for an adequate portfolio of short-term liquid assets, largely made up of short-term liquid trading securities, deposits with banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole. The daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury Department. Treasury Department is also responsible for monitoring the Bank's compliance with debt covenants, which include liquidity related ratios (limits), on quarterly basis, refer to Note 18. The table below shows financial assets and liabilities at 31 December 2010 by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows, including gross loan commitments and financial guarantees. Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in the statement

of financial position is based on discounted cash flows. The table below shows maturity analysis of financial assets based on their contractual maturities except for assets that are readily saleable in case it would be necessary to meet cash outflows on financial liabilities. Such financial assets are included in the maturity analysis based on their expected date of disposal. Impaired loans are included at their carrying amounts net of impairment provisions and based on the expected timing of cash inflows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The maturity analysis of financial instruments at 31 December 2010 is as follows:

In thousands of Mongolian Tugriks	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
<b>Assets</b>							
Cash and cash equivalents	92,590,205	-	-	-	-	-	92,590,205
Mandatory reserves in BOM	-	-	-	-	-	9,780,500	9,780,500
Due from other banks	4,639,670	8,720,889	6,437,604	-	30,000	-	19,828,163
Loans and advances to customers	19,026,172	88,062,825	91,243,501	194,800,303	74,171,554	-	467,304,355
Investment securities available for sale	-	-	-	-	-	23,300	23,300
Other financial assets	547,958	-	-	200,000	-	-	747,958
<b>Total financial assets</b>	<b>116,804,005</b>	<b>96,783,714</b>	<b>97,681,105</b>	<b>195,000,303</b>	<b>74,201,554</b>	<b>9,803,800</b>	<b>590,274,481</b>
<b>Liabilities</b>							
Due to other banks	7,028,157	6,801,973	7,987,001	15,070,941	-	-	36,888,072
Customer accounts	77,298,969	68,029,789	67,483,604	32,986,363	32,875,498	-	278,674,223
Other borrowed funds	2,784,931	25,007,563	26,414,319	99,419,590	14,851,272	-	168,477,675
Other financial liabilities	2,790,546	74,780	69,478	477,991	-	-	3,412,795
Subordinated debt	807,911	407,062	499,329	3,964,785	15,440,259	-	21,119,346
Financial guarantees and letters of credit (Note 31)	763,930	444,458	916,374	-	-	-	2,124,762
Gross loan commitments (Note 31)	5,005,906	-	-	-	-	-	5,005,906

<b>Total potential future payments for financial obligations</b>	<b>96,480,350</b>	<b>100,765,625</b>	<b>103,370,105</b>	<b>151,919,670</b>	<b>63,167,029</b>	<b>-</b>	<b>515,702,779</b>
<b>Net position</b>	<b>20,323,655</b>	<b>(3,981,911)</b>	<b>(5,689,000)</b>	<b>43,080,633</b>	<b>11,034,525</b>	<b>9,803,800</b>	<b>74,571,702</b>
<b>Aggregate position</b>	<b>20,323,655</b>	<b>16,341,744</b>	<b>10,652,744</b>	<b>53,733,377</b>	<b>64,767,902</b>	<b>74,571,702</b>	<b>-</b>

The Bank conducts maturity analysis on assets and liabilities (divided into local currency and key foreign currencies) by incorporating cash inflows and outflows arising from repayment of loans and withdrawals of deposits. The Asset and Liability Committee (ALCO) and Risk Management Committee of the Bank monitor liquidity risk, and carry out cash flow analysis and repricing analysis on a monthly basis. Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment disclosed in the above maturity analysis because the Bank does not generally expect the third party to draw funds

under the agreement. The total outstanding contractual amount of commitments to extend credit as included in the above maturity table does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

The maturity analysis of financial instruments at 31 December 2009 is as follows. The amounts below are adjusted for effect of restatements or reclassifications.

In thousands of Mongolian Tugriks	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
<b>Assets</b>							
Cash and cash equivalents	68,152,413	4,184,528	-	-	-	-	72,336,941
Mandatory reserves in BOM	-	-	-	-	-	6,834,900	6,834,900
Due from other banks	112,516	1,672,590	19,870,595	-	30,000	-	21,685,701
Loans and advances to customers	14,376,145	61,045,166	54,983,017	110,110,775	67,437,069	-	307,952,172
Investment securities available for sale	2,981,601	-	-	-	-	224,300	3,205,901
Other financial assets	227,299	-	-	100,000	-	-	327,299
<b>Total financial assets</b>	<b>85,849,974</b>	<b>66,902,284</b>	<b>74,853,612</b>	<b>110,210,775</b>	<b>67,467,069</b>	<b>7,059,200</b>	<b>412,342,914</b>
<b>Liabilities</b>							
Due to other banks	4,953,821	2,868,385	15,914,047	-	-	-	23,736,253
Customer accounts	51,446,512	37,127,226	21,129,521	21,907,196	25,681,796	-	157,292,251
Other borrowed funds	3,058,066	11,347,122	22,096,918	109,107,387	7,465,358	-	153,074,851
Other financial liabilities	595,949	111,650	-	332,255	-	-	1,039,854
Subordinated debt	626,206	280,607	344,211	2,733,110	9,791,216	-	13,775,350
Financial guarantees and letters of credit (Note 31)	734,564	94,101	85,099	-	-	-	913,764
Gross loan commitments (Note 31)	1,786,555	-	-	-	-	-	1,786,555

<b>Total potential future payments for financial obligations</b>	<b>63,201,673</b>	<b>51,829,091</b>	<b>59,569,796</b>	<b>134,079,948</b>	<b>42,938,370</b>	<b>-</b>	<b>351,618,878</b>
<b>Net position</b>	<b>22,648,301</b>	<b>15,073,193</b>	<b>15,283,816</b>	<b>(23,869,173)</b>	<b>24,528,699</b>	<b>7,059,200</b>	<b>60,724,036</b>
<b>Aggregate position</b>	<b>22,648,301</b>	<b>37,721,494</b>	<b>53,005,310</b>	<b>29,136,137</b>	<b>53,664,836</b>	<b>60,724,036</b>	<b>-</b>

The Bank does not use the above maturity analysis based on undiscounted contractual maturities of liabilities to manage liquidity. Instead, the Bank monitors expected maturities and the resulting expected liquidity gap.

The maturity analysis of financial instruments at 31 December 2010 is as follows:

In thousands of Mongolian Tugriks	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
<b>Assets</b>							
Cash and cash equivalents	92,537,762	-	-	-	-	-	92,537,762
Mandatory reserves in BOM	-	-	-	-	-	9,780,500	9,780,500
Due from other banks	4,552,819	8,485,361	6,370,477	-	30,000	-	19,438,657
Loans and advances to customers	12,130,268	64,603,726	69,747,836	137,200,958	38,007,983	-	321,690,771
Investment securities available for sale	-	-	-	-	-	23,300	23,300
Other financial assets	547,958	-	-	200,000	-	-	747,958
<b>Total financial assets</b>	<b>109,768,807</b>	<b>73,089,087</b>	<b>76,118,313</b>	<b>137,400,958</b>	<b>38,037,983</b>	<b>9,803,800</b>	<b>444,218,948</b>
<b>Liabilities</b>							
Due to other banks	5,238,712	6,076,041	6,805,558	14,361,959	-	-	32,482,270
Customer accounts	73,685,373	61,937,683	62,676,095	19,154,285	19,739,616	-	237,193,052
Other borrowed funds	108,200	20,738,927	22,483,652	89,570,232	13,373,816	-	146,274,827
Other financial liabilities	2,790,546	74,780	69,478	477,991	-	-	3,412,795
Subordinated debt	-	-	-	-	14,103,479	-	14,103,479
<b>Total financial liabilities</b>	<b>81,822,831</b>	<b>88,827,431</b>	<b>92,034,783</b>	<b>123,564,467</b>	<b>47,216,911</b>	<b>-</b>	<b>433,466,423</b>
<b>Net position</b>	<b>27,945,976</b>	<b>(15,738,344)</b>	<b>(15,916,470)</b>	<b>13,836,491</b>	<b>(9,178,928)</b>	<b>9,803,800</b>	<b>10,752,525</b>
<b>Cumulative position</b>	<b>27,945,976</b>	<b>12,207,632</b>	<b>(3,708,838)</b>	<b>10,127,653</b>	<b>948,725</b>	<b>10,752,525</b>	<b>-</b>

The maturity analysis of financial instruments at 31 December 2009 is as follows.  
The amounts below are adjusted for effect of restatements or reclassifications.

In thousands of Mongolian Tugriks	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
<b>Assets</b>							
Cash and cash equivalents	68,131,365	4,177,800	-	-	-	-	72,309,165
Mandatory reserves in BOM	-	-	-	-	-	6,834,900	6,834,900
Due from other banks	-	1,133,205	19,478,339	-	30,000	-	20,641,544
Loans and advances to customers	9,142,540	45,711,264	41,727,023	66,968,572	30,413,928	-	193,963,327
Investment securities available for sale	2,966,751	-	-	-	-	224,300	3,191,051
Other financial assets	227,299	-	-	100,000	-	-	327,299
<b>Total financial assets</b>	<b>80,467,955</b>	<b>51,022,269</b>	<b>61,205,362</b>	<b>67,068,572</b>	<b>30,443,928</b>	<b>7,059,200</b>	<b>297,267,286</b>
<b>Liabilities</b>							
Due to other banks	4,633,112	2,125,894	15,308,559	-	-	-	22,067,565
Customer accounts	51,033,037	33,898,028	18,513,567	9,816,708	14,140,336	-	127,401,676
Other borrowed funds	898,084	7,212,174	17,962,365	97,465,734	6,952,111	-	130,490,468
Other financial liabilities	595,949	111,650	-	332,255	-	-	1,039,854
Subordinated debt	-	-	-	-	8,813,103	-	8,813,103
<b>Total financial liabilities</b>	<b>57,160,182</b>	<b>43,347,746</b>	<b>51,784,491</b>	<b>107,614,697</b>	<b>29,905,550</b>	<b>-</b>	<b>289,812,666</b>
<b>Net position</b>	<b>23,307,773</b>	<b>7,674,523</b>	<b>9,420,871</b>	<b>(40,546,125)</b>	<b>538,378</b>	<b>7,059,200</b>	<b>7,454,620</b>
<b>Cumulative position</b>	<b>23,307,773</b>	<b>30,982,296</b>	<b>40,403,167</b>	<b>(142,958)</b>	<b>395,420</b>	<b>7,454,620</b>	<b>-</b>

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

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

**Operational risk.** Operational risk is risk of loss arising from inadequate internal policies, failed processes, human errors and fraud, and systems failure, or external events. In order to assess, monitor, and control the operational risk effectively at the Bank

level, the Bank has prepared policies and procedures, and also designed and implemented the internal structure of operational risk management.

As the part of the business continuity management, to ensure the resilience of the business to any unforeseeable external or internal events and disasters and to continue its normal operation at adequate level, the Bank has established an Emergency Committee which works in close cooperation with all divisions and departments. The objective of the management of the Bank's business continuity is to put the Bank back in business within the shortest possible time in the event that its operation is disrupted due to unforeseeable events or disasters.

#### ■ MANAGEMENT OF CAPITAL

The Bank's objectives when managing capital are (i) to comply with the capital requirements set by the Bank of Mongolia, including capital adequacy ratio, (ii) to safeguard the Bank's ability to continue as a going concern, (iii) to ensure that Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value, (iv) to ensure the Bank's compliance with debt covenants specified in the borrowing agreements with international financial institutions.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, obtained new debt and/or customer deposits or sell assets to reduce debt.

The amount of capital that the Bank managed as of 31 December 2010 was MNT 34,614,072 thousand (2009: MNT 28,494,341 thousand). Compliance with capital adequacy ratios set by the Bank

**Compliance risk.** The Bank monitors its operation regularly in order to mitigate the Bank's exposure to the following risks: risk to incur penalties due to non-compliance with both financial and non-financial requirements required by the stakeholders of the Bank, including the Bank of Mongolia (BoM), its shareholders and foreign investors, risk of significant financial losses and reputational risk. In the process of monitoring, all divisions and departments work in cooperation with each other, based on the Bank's policies and procedures. In particular, compliance with legal requirements is ensured by the Legal Department. With regard to anti-money laundering and anti-terrorism financing, the Bank monitors transactions on daily basis and regularly reports to the Financial Information Unit of the Bank of Mongolia ■

of the Mongolia is monitored monthly with reports outlining their calculation reviewed and signed by the Chief Financial Officer. Compliance with debt covenants specified in the borrowing agreements with international financial institutions is also monitored on quarterly basis.

During 2010 and 2009 the Bank has complied with all capital requirements imposed by the Bank of Mongolia. The compliance with debt covenants is disclosed in Notes 18 and 31.

The Bank of Mongolia requires commercial banks to maintain a minimum core capital adequacy ratio (which is defined as ratio between tier I capital and risk weighted assets) of 6% (2009: 5%) and risk weighted capital ratio (which represents ratio between total regulatory capital and risk weighted assets) of at least 12% (2009: 10%). These ratios are calculated on the basis of total capital and total assets as adjusted for their intrinsic risk characteristics (i.e. risk weighted assets), as disclosed below. The capital adequacy ratios of the Bank as of 31 December 2010 and 31 December 2009 are as follows:

In thousands of Mongolian Tugriks	2010	2009 (restated)
<b>Tier I capital</b>		
Share capital (statutory fund)	13,290,651	13,290,651
Share premium	5,252,103	5,252,103
Other reserves	10,531,368	8,353,389
Retained earnings	5,539,950	1,598,198
<b>Total tier I capital</b>	<b>34,614,072</b>	<b>28,494,341</b>
<b>Tier II capital</b>		
Subordinated debt	14,103,479	8,813,103
<b>Total tier II capital</b>	<b>14,103,479</b>	<b>8,813,103</b>
<b>Total regulatory capital / capital base</b>	<b>48,717,551</b>	<b>37,307,444</b>
<b>Core capital adequacy ratio</b>	<b>9.71%</b>	<b>12.86%</b>
<b>Risk weighted capital ratio</b>	<b>13.66%</b>	<b>16.83%</b>

Breakdown of risk weighted assets is given below.

Risk weight factor	31 December 2010		31 December 2009	
	Assets	Risk weighted assets	Assets (restated)	Risk weighted assets (restated)
0%	91,629,765	-	64,761,043	-
20%	10,730,518	2,146,104	35,000,410	7,000,082
50%	44,829,677	22,414,838	18,876,360	9,438,180
100%	327,533,183	327,533,183	205,202,565	205,202,565
150%	2,986,230	4,479,345	-	-
<b>Total</b>	<b>477,709,373</b>	<b>356,573,470</b>	<b>323,840,378</b>	<b>221,640,827</b>

## ■ CONTINGENCIES AND COMMITMENTS

**Legal proceedings.** From time to time and in the normal course of business, claims against the Bank may be received. On the basis of its own estimates and both internal and external professional advice management is of the opinion that no material losses will be incurred in respect of claims and accordingly no provision has been made in these financial statements. Total Bank's estimated exposure as of 31 December 2010 with regard to the legal proceedings, other than litigation with tax authorities described below, amounts to MNT 106,125 thousand.

**Tax legislation.** Mongolian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by tax authorities.

Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. Mongolian transfer pricing legislation provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions, including those related to domestic transfer pricing. In case of deviation of transaction terms from market terms the tax authorities have the right to adjust taxable items and to impose additional taxes, fines and interest penalties. Given the brief nature of the current Mongolian transfer pricing rules, the impact of any such challenge cannot be reliably estimated. However, it may be significant to the financial position and/or the overall operations of the entity. Mongolian tax legislation does not provide definitive guidance in certain areas, specifically in areas such as VAT, withholding tax,

corporate income tax, personal income tax and other areas. From time to time, the Bank adopts interpretations of such uncertain areas that reduce the overall tax rate of the Bank. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices. The impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial position and/or the overall operations of the entity.

As a result of tax inspection conducted during 2010, the Bank is currently involved in the litigation with tax authorities, which challenge the Bank's tax position primarily with regard to VAT and corporate income tax. Management assessed that total possible losses that could arise from this litigation, including fines, interest and penalties in five-year open period up to the date of approval of these financial statements amount to MNT 679,780 thousand. Though tax authorities claim the Bank's VAT liability related to income generated from non-banking activities, management believes that the Bank's position is appropriate and sustainable on the court, since the Bank applied for registration for VAT purposes during 2009 and its application was rejected by relevant state authority. The treatment of certain fixed assets for the purposes of calculating tax depreciation is not clear and is subject to different interpretations of parties involved in this legal case. For these reasons management believes that it is unlikely that the Bank will suffer material losses as a result of this litigation, and no provision is thus recognized in these financial statements.

The Bank's management believes that its interpretation of the relevant legislation is appropriate and the Bank's positions related to tax and other legislation will be sustained. Management believes that tax and legal risks related to areas, other than those addressed in current litigation with tax authorities, are remote. The management performs regular re-assessment of tax risk and its position may change in the future as a result of the change in conditions that cannot be anticipated with sufficient certainty at present.

**Operating lease commitments.** The Bank has no long-term non-cancellable operating leases, but annual operating leases and long

term land leases (Note 4), which can be cancelled under relatively short notice. Thus, management believes that the amount of the future minimum lease payments under non-cancellable operating leases is not material.

**Compliance with covenants.** The Bank is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Bank including growth in the cost of borrowings and declaration of default. For more information on borrowing agreements that contain debt covenants, refer to Note 18.

Management believes that the Bank was in compliance with covenants as at 31 December 2010, apart from borrowings with DWM, stated in Note 18. The management believes that breach of related covenant (solvency ratio) does not have adverse consequences on the Bank's liquidity and that related borrowings are not payable on demand as of 31 December 2009, since the Credit Committee of DWM approved a waiver related to solvency ratio violation. The related borrowings amount to MNT 12,434,200 thousand, are due for repayment in December 2011 and were classified according to their maturity in maturity analyses within these financial statements (refer to Note 29).

**Capital expenditure commitments.** At 31 December 2010 the Bank has contractual capital expenditure commitments in respect of premises and equipment totalling MNT 118,624 thousand (2009: MNT 25,532 thousand), which mostly relate to the renovation and maintenance

of buildings (i.e. the Bank's branches).

**Credit related commitments.** The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate or cash deposits and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments, if the unused amounts were to be drawn down. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Outstanding credit related commitments are as follows:

In thousands of Mongolian Tugriks	2010	2009
Undrawn credit lines	5,005,906	1,786,555
Guarantees issued	1,486,700	279,852
Import letters of credit	638,062	633,912
<b>Total credit related commitments</b>	<b>7,130,668</b>	<b>2,700,319</b>

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

The Bank's management believes that fair value of issued guarantees, letters of credit, and loan and credit line commitments is not material as of 31 December 2010 and 31 December 2009. Credit related commitments are denominated in currencies as follows:

In thousands of Mongolian Tugriks	2010	2009
Mongolian Tugriks	3,707,019	1,239,937
US Dollars	3,423,649	1,460,382
<b>Total credit related commitments</b>	<b>7,130,668</b>	<b>2,700,319</b>

The Bank has not recognized provision on credit related commitments, as the management is not aware of any losses incurred due to the deterioration of the financial conditions of the

customers. As of 31 December 2010 and 31 December 2009 losses on credit related commitments are not considered probable and cannot be reliably measured.

## ■ FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price. Where quoted market prices are not available, the Bank used valuation techniques. The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based

on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Fair value of financial instruments carried at amortised cost, which have short term maturities approximates their carrying value.

### (a) Fair values of financial instruments carried at amortised cost.

Fair values of financial instruments carried at amortised cost are as follows:

In thousands of Mongolian Tugriks	2010		2009	
	Carrying amount	Fair value	Carrying amount (restated)	Fair value (restated)
<b>Financial Assets</b>				
Cash and cash equivalents	92,537,762	92,537,762	72,309,165	72,309,165
Mandatory reserve with the BOM	9,780,500	9,780,500	6,834,900	6,834,900
Due from other banks	19,438,657	19,438,657	20,641,544	20,641,544
Loans and advances to customers	321,690,771	322,396,328	193,963,327	194,342,507
Other financial assets	747,958	747,958	327,299	327,299
<b>Total financial assets carried at amortised cost</b>	<b>444,195,648</b>	<b>444,901,205</b>	<b>294,076,235</b>	<b>294,620,175</b>
<b>Financial liabilities</b>				
Due to other banks	32,482,270	32,808,071	22,067,565	22,067,565
Customer accounts	237,193,052	237,193,052	127,401,676	127,401,676
Other borrowed funds	146,274,827	145,978,340	130,490,468	130,757,130
Subordinated debt	14,103,479	14,557,023	8,813,103	8,820,730
Other financial liabilities	3,412,795	3,412,795	1,039,854	1,039,854
<b>Total financial liabilities carried at amortised cost</b>	<b>433,466,423</b>	<b>433,949,281</b>	<b>289,812,666</b>	<b>290,086,955</b>

Discount rates used depend on currency, maturity of the instrument and credit risk of the counterparty and were as follows:

	2010	2009
Loans and advances to customers	7.4% to 29.7% p.a.	9.5% to 25.5% p.a.
Due to other banks	13.1% to 13.9% p.a.	-
Other borrowed funds	7.1% to 13.1% p.a.	7.3% to 11.3% p.a.
Subordinated debt	7.0% p.a.	7.2% p.a.

*(b) Analysis by fair value hierarchy of financial instruments carried at fair value.*

For financial instruments carried at fair value, the level in the fair value hierarchy into which the fair values are categorised are as follows:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: valuation techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. Significance of a valuation input is assessed against the fair value measurement in its entirety.

As of 31 December 2010 and 31 December 2009, all equity investments (classified as available for sale financial assets) are

carried at cost, as the shares of investees are not quoted and other information for estimating their fair value is not publicly available (Note 11).

As of 31 December 2009, the Bank had investment in TDBM credit linked deposit (Note 11). Fair value of this deposit was determined using discounted cash flow model which incorporates both observable and non-observable data. Observable inputs included assumptions regarding current interest rate. Non observable inputs include assumption of future default rate and market liquidity discounts. However, given short-term nature of deposit (i.e. maturity of only 37 days) and market conditions relevant for TDBM, management assessed that fair value of this deposit is not sensitive to non-observable inputs, while input which has a significant effect on the recorded fair value (current interest rate) is observable. Thus, this deposit is considered as level 2 according to fair value hierarchy.

Fair value of TDBM credit linked deposit at inception amounted to its transaction price of MNT 2,978,323 thousand. Fair value of this deposit as of 31 December 2009, determined using valuation technique described above, amounted to MNT 2,966,751. Loss of MNT 11,572 thousand, representing the difference between its transaction price and fair value as of 31 December 2009, was recognised in profit or loss for the year.

## ■ PRESENTATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT CATEGORY

For the purposes of measurement, IAS 39, Financial Instruments: Recognition and Measurement, classifies financial assets into the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss ("FVTPL"). Financial assets at fair value through profit or loss have two subcategories: (i) assets

designated as such upon initial recognition, and (ii) those classified as held for trading. In addition, finance lease receivables form a separate category.

The following table provides a reconciliation of financial assets with these measurement categories as of 31 December 2010:

In thousands of Mongolian Tugriks	Loans and receivables	Available-for-sale assets	Finance lease receivables	Total
<b>Assets</b>				
Cash and cash equivalents (Note 7)	92,537,762	-	-	92,537,762
Mandatory reserve with Bank of Mongolia (Note 8)	9,780,500	-	-	9,780,500
Due from other banks (Note 9)	19,438,657	-	-	19,438,657
Loans and advances to customers (Note 10)	300,496,676	-	21,194,095	321,690,771
Investment securities available for sale (Note 11)	-	23,300	-	23,300
Other financial assets (Note 15)	747,958	-	-	747,958
<b>Total financial assets</b>	<b>423,001,553</b>	<b>23,300</b>	<b>21,194,095</b>	<b>444,218,948</b>

The following table provides a reconciliation of financial assets with the measurement categories at 31 December 2009. The amounts below are adjusted for effect of restatements or reclassifications.

In thousands of Mongolian Tugriks	Loans and receivables	Available-for-sale assets	Finance lease receivables	Total
<b>Assets</b>				
Cash and cash equivalents (Note 7)	72,309,165	-	-	72,309,165
Mandatory reserve with Bank of Mongolia (Note 8)	6,834,900	-	-	6,834,900
Due from other banks (Note 9)	20,641,544	-	-	20,641,544
Loans and advances to customers (Note 10)	180,814,004	-	13,149,323	193,963,327
Investment securities available for sale (Note 11)	-	3,191,051	-	3,191,051
Other financial assets (Note 15)	327,299	-	-	327,299
<b>Total financial assets</b>	<b>280,926,912</b>	<b>3,191,051</b>	<b>13,149,323</b>	<b>297,267,286</b>

As of 31 December 2010 and 31 December 2009 all of the Bank's financial liabilities were carried at amortised cost.

## ■ RELATED PARTY TRANSACTIONS

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Bank's Parent, Tenger Financial Group LLC, and shareholders exercising significant influence over the Parent are disclosed in Note 22. Balances and transactions with the Parent, its subsidiaries and associates, as well shareholders exercising significant influence over Parent's operations, are disclosed below.

In thousands of Mongolian Tugriks	Parent company	Subsidiaries of parent company	Associates of parent company	Shareholders of parent company	Key management
Loans and advances to customers (contractual interest rate: 2010: 0% - 12%)	-	883,951	-	-	584,890
Other assets	-	647	75,034	-	138,204
Customer accounts (contractual interest rate: 2010: 0.15% - 16%)	2,841,053	839,640	1,207,875	2,171,539	6,460
Other borrowed funds (contractual interest rate: 2010: 4.3% - 15.7%)	-	-	-	17,678,315	-
Deferred grants	-	-	-	2,315	-
Subordinated debt (contractual interest rate: 2010: 6.9%)	-	-	-	6,221,352	-

The income and expense items with related parties for 2010 were as follows:

In thousands of Mongolian Tugriks	Parent company	Subsidiaries of parent company	Associates of parent company	Shareholders of parent company	Key management
Interest income	12,215	90,265	23,155	-	32,466
Interest expense	(235,518)	(39,117)	(70,377)	(1,613,129)	(1,748)
Fee and commission income	-	5,999	1,172	-	-
Foreign exchange gains/(losses), net	176,965	(56,230)	(33,373)	1,572,447	(62,547)
Other operating income	-	12,000	-	-	-
Administrative and other operating expenses	-	(879,571)	(76,766)	-	(679,039)

Aggregate amounts lent to and repaid by related parties during 2010 were:

In thousands of Mongolian Tugriks	Parent company	Subsidiaries of parent company	Associates of parent company	Shareholders of parent company	Key management
Amounts lent to related parties during the year	1,236,461	738,729	849,784	-	282,763
Amounts repaid by related parties during the year	(1,236,461)	(738,729)	(1,571,204)	-	(145,196)

The amount of the Bank's investment in associates as of 31 December 2010 and 31 December 2009 is disclosed in Note 12. There were no material transactions with the Bank's associates during 2010 and 2009.

At 31 December 2009, the outstanding balances with related parties were as follows. The amounts presented below are adjusted for effect of restatements or reclassifications, where necessary.

In thousands of Mongolian Tugriks	Parent company	Subsidiaries of parent company	Associates of parent company	Shareholders of parent company	Key management
Loans and advances to customers (contractual interest rate: 2009: 0.0% - 18.0%)	-	938,083	-	-	459,480
Other assets	-	-	-	-	91,501
Customer accounts (contractual interest rate: 2009: 0.15% - 17.5%)	2,561,004	1,003,975	28,494	4,004,846	28,315
Other borrowed funds (contractual interest rate: 2009: 4.7% - 14.0%)	-	-	-	15,645,909	-
Deferred grants	-	-	-	2,659	-

The income and expense items with related parties for 2009 were as follows. The amounts presented below are adjusted for effect of restatements or reclassifications, where necessary.

In thousands of Mongolian Tugriks	Parent company	Subsidiaries of parent company	Associates of parent company	Shareholders of parent company	Key management
Interest income	-	68,325	73,817	-	25,505
Interest expense	(200,408)	(22,345)	-	(1,996,210)	(1,599)
Fee and commission income	-	8,971	-	-	-
Foreign exchange gains/(losses), net	(209,589)	32,888	(71,430)	1,504,331	57,423
Grant income	-	-	-	4,262	-
Grant expense	-	-	-	(4,262)	-
Administrative and other operating expenses	-	(726,022)	-	-	(318,441)

Aggregate amounts lent to and repaid by related parties during 2009 were as follows. The amounts presented below are adjusted for effect of restatements or reclassifications, where necessary.

In thousands of Mongolian Tugriks	Parent company	Subsidiaries of parent company	Associates of parent company	Shareholders of parent company	Key management
Amounts lent to related parties during the year	-	-	721,420	-	287,671
Amounts repaid by related parties during the year	-	-	-	-	(91,640)

Key management compensations are presented below:

In thousands of Mongolian Tugriks	2010	2009
Salaries	393,616	203,231
Bonuses	157,508	55,223
State pension and social security costs	60,624	28,430
Total	611,747	286,884

#### ■ EVENTS AFTER THE END OF THE REPORTING PERIOD

**Share issue.** On 31 March 2011, the Bank issued 2,877,764 ordinary shares at an issue price of MNT 5,212 per share. Nominal value of each share is MNT 1,000. As a result of share issue, share capital and share premium have increased in the amount of MNT 2,877,764 thousand and MNT 12,122,236 thousand, respectively.

**Changes in management.** As of 1 January 2011 a new CEO of the Bank was appointed. The previous CEO became CEO of the Parent, Tenger Financial Group LLC.

Management is not aware of other events that occurred after the end of reporting period until 22 April 2011, which would have impacted on these financial statements.

*The current success of the Bank could not be realized without the supports from many partnering organisations including SME Development Fund, Employment Generation Fund, Development Solutions, Oyu Tolgoi, Mongolian Millennium Challenge Account, as well as international and bilateral organizations, including World Bank, ADB, UNDP BEEP, Habitat for Humanity, Women's World Banking, FMO, USAID, JICA, GTZ, WFF, Vittana, Kiva and last but not least the SEEP network.*





Partnership for progress

# Annex:

## Corporate Social Responsibility: A Glossary of Basic Terms

### ■ CODE OF CONDUCT

A code of conduct is a set of rules and regulations, guidelines and management principles governing the way in which the employees of a company are expected to behave. It encapsulates a company's core values, which should form part of the fabric of its day-to-day activities. In other words, a code of conduct lays down the required standard of behavior for the company as a whole.

### ■ COMPLIANCE

Compliance – as the name suggests – refers to the systems and procedures within a company to ensure that it is in compliance with the applicable guidelines and statutory requirements. Companies should have a dedicated Compliance unit or designated officer for this purpose, responsible for checking that they are adhering to the relevant Mongolian and international regulations and legislation in respect of insider trading and money laundering, for instance.

### ■ CORPORATE CITIZENSHIP

Corporate citizenship is the term used to describe the relationship between a company and its local environment. It covers the philanthropic activities of a company and its employees, as well as sponsorship, which is of mutual benefit.

### ■ CORPORATE GOVERNANCE

Corporate governance sets out the framework for the transparent management and monitoring of a company. The recommendations of the Mongolian Corporate Governance Code<sup>4</sup>, mainly designed

for listed companies, serve to create transparency and underpin confidence that a company is being managed in a responsible manner. In particular, they afford protection to the shareholders of a company.

### ■ CORPORATE RESPONSIBILITY

Corporate responsibility describes the extent to which a company is aware of – and lives up to – its responsibilities in those areas where its activities have an impact on society, the employees of that company, the environment and the business landscape. In other words, corporate responsibility embodies a corporate philosophy based on transparency, ethical behavior and respect for the various stakeholders. It is an umbrella term, encompassing sustainability, corporate governance and corporate citizenship.

### ■ CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility covers all company's activities and programs designed to better preserve and protect the society in which we live for future generations, in the context of sustainable development. It is a key element of corporate responsibility.

### ■ GLOBAL COMPACT

The Global Compact is an initiative of the United Nations. Companies that sign up to the Global Compact undertake to advance ten universal principles in the areas of human rights, labour, the environment and anti-corruption.

#### ■ GLOBAL REPORTING INITIATIVE

The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution, whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines.

#### ■ INFORMATION DISCLOSURE (also Public Disclosure)

The process of providing information to the affected local communities and other stakeholders that is timely, accessible, understandable, and in the appropriate local languages. For companies with potential adverse impacts, information on the purpose, nature and scale of the company, and any potential risks to and potential impacts on such local communities should be included.

#### ■ SOCIAL AND ENVIRONMENTAL ASSESSMENT

The process of evaluating and addressing potential social and environmental impacts and risks of a company and identifying any mitigation or corrective measures that will enable the company to meet the requirements of the Performance Standards, applicable domestic laws and local regulations, and any additional priorities and objectives for social or environmental performance identified by the client.

#### ■ SOCIAL AND ENVIRONMENTAL IMPACT ASSESSMENT

The Social and Environmental Impact Assessment report focuses on the significant issues of a company and predict and assesses the company's likely positive and negative impacts, in quantitative terms to the extent possible. Examines global, transboundary, and

cumulative impacts as appropriate. Impact assessment includes baseline data, alternatives analysis and management program.

#### ■ SOCIAL AND ENVIRONMENTAL MANAGEMENT SYSTEM

The Social and Environmental Management System includes the organizational structure, responsibilities, policies, procedures and practices, and resources, and is essential for successfully implementing the company-specific management program developed through the social and environmental assessment of its operational impact. A good management system enables continuous improvement of the company's social and environmental performance, and can lead to improved economic, financial, social and environmental outcomes.

#### ■ SOCIAL AND/OR ENVIRONMENTAL AUDITS REPORT

Report focuses on (i) compliance of existing facilities and operations with relevant laws and regulations, and applicable International Finance Corporation (IFC) Performance Standards; and (ii) the nature and extent of significant adverse environmental impacts.

#### ■ SUSTAINABILITY

Sustainability is a holistic concept, based on an ecologically compatible, socially just and economically effective approach to development. That means using resources carefully, responsibly and efficiently – with a view to the here and now and generations to come ■

# Corporate Social Responsibility: Glossary of Terms

## Code of conduct

A code of conduct is a set of rules and regulations, guidelines and management principles governing the way in which the employees of a company are expected to behave. It encapsulates a company's core values, which should form part of the fabric of its day-to-day activities. In other words, a code of conduct lays down the required standard of behavior for the company as a whole.

## Compliance

Compliance - as the name suggests - refers to the systems and procedures within a company to ensure that it is in compliance with the applicable guidelines and statutory requirements. Companies should have a dedicated Compliance unit or designated officer for this purpose, responsible for checking that they are adhering to the relevant Mongolian and international regulations and legislation in respect of insider trading and money laundering, for instance.

## Corporate citizenship

Corporate citizenship is the term used to describe the relationship between a company and its local environment. It covers the philanthropic activities of a company and its employees, as well as sponsorship, which is of mutual benefit.

## Corporate governance

Corporate governance sets out the framework for the transparent management and monitoring of a company. The recommendations of the Mongolian Corporate Governance Code\*, mainly designed for listed companies, serve to create transparency and underpin confidence that a company is being managed in a responsible manner. In particular, they afford protection to the shareholders of a company.

## Corporate responsibility

Corporate responsibility describes the extent to which a company is aware of - and lives up to - its responsibilities in those areas where its activities have an impact on society, the employees of that company, the environment and the business landscape. In other words, corporate responsibility embodies a corporate philosophy based on transparency, ethical behavior and respect for the various stakeholders. It is an umbrella term, encompassing sustainability, corporate governance and corporate citizenship.

## Corporate social responsibility

Corporate social responsibility covers all company's activities and programs designed to better preserve and protect the society in which we live for future generations, in the context of sustainable development. It is a key element of corporate responsibility.

## Global Compact

The Global Compact is an initiative of the United Nations. Companies that sign up to the Global Compact undertake to advance ten universal principles in the areas of human rights, labour, the environment and anti-corruption.

## Global Reporting Initiative

The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution, whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. Information Disclosure (also Public Disclosure)

The process of providing information to the affected local communities and other stakeholders that is timely, accessible, understandable, and in the appropriate local languages. For companies with potential adverse impacts, information on the purpose, nature and scale of the company, and any potential risks to and potential impacts on such local communities should be included.

## Social and Environmental Assessment

The process of evaluating and addressing potential social and environmental impacts and risks of a company and identifying any mitigation or corrective measures that will enable the company to meet the requirements of the Performance Standards, applicable domestic laws and local regulations, and any additional priorities and objectives for social or environmental performance identified by the client.

## Social and Environmental Impact Assessment

The Social and Environmental Impact Assessment report focuses on the significant issues of a company and predict and assesses the company's likely positive and negative impacts, in quantitative terms to the extent possible. Examines global, transboundary, and cumulative impacts as appropriate. Impact assessment includes baseline data, alternatives analysis and management program.

## Social and Environmental Management System

The Social and Environmental Management System includes the organizational structure, responsibilities, policies, procedures and practices, and resources, and is essential for successfully implementing the company-specific management program developed through the social and environmental assessment of its operational impact. A good management system enables continuous improvement of the company's social and environmental performance, and can lead to improved economic, financial, social and environmental outcomes.

## Social and/or Environmental Audits Report

Report focuses on (i) compliance of existing facilities and operations with relevant laws and regulations, and applicable International Finance Corporation (IFC) Performance Standards; and (ii) the nature and extent of significant adverse environmental impacts.

## Sustainability

Sustainability is a holistic concept, based on an ecologically compatible, socially just and economically effective approach to development. That means using resources carefully, responsibly and efficiently – with a view to the here and now and generations to come ■

## Microfinance Client Protection Principles

XacBank has endorsed the Microfinance Client Protection Principles, initiated by the Center for Financial Inclusion and promoted by the Smart Campaign\* in 2009. These principles are at core of the Bank's business operations and will be further implemented to strengthen its trust-building with the clients and customers in terms of being transparent in the pricing, terms and conditions of all financial products.

**Avoidance of Over-Indebtedness.** Providers will take reasonable steps to ensure that credit will be extended only if borrowers have demonstrated an adequate ability to repay and loans will not put borrowers at significant risk of over-indebtedness. Similarly, providers will take adequate care that noncredit, financial products (such as insurance) extended to low-income clients are appropriate.

**Transparent Pricing.** The pricing, terms, and conditions of financial products (including interest charges, insurance premiums, all fees, etc.) will be transparent and will be adequately disclosed in a form understandable to clients.

**Appropriate Collections Practices.** Debt collection practices of providers will not be abusive or coercive.

**Ethical Staff Behavior.** Staff of financial service providers will comply with high ethical standards in their interaction with microfinance clients and such providers will ensure that adequate safeguards are in place to detect and correct corruption or mistreatment of clients.

**Mechanisms for Redress of Grievances.** Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients.

**Privacy of Client Data.** The privacy of individual client data will be respected, and such data cannot be used for other purposes without the express permission of the client (while recognizing that providers of financial services can play an important role in helping clients achieve the benefits of establishing credit histories).

*XacBank proved its reputation as a leading microfinance institution in the World by being ranked at 99<sup>th</sup> out of 721 MFIs on Microfinance Information eXchange (MIX).*

*XacBank continues to strengthen ties with microfinance institutions abroad-a tour of the Bank was organized for 15 CEOs from Republic of China, which provided the Bank an opportunity to share its experience in the field.*

# Holding company shareholders



Number of shares: 917,556  
Ownership: 10%

Founded in 1991, the European Bank for Reconstruction and Development (EBRD) uses the tools of investment to help build market economies and democracies in 27 countries from Central Europe to Central Asia. The EBRD is owned by 61 countries and two intergovernmental institutions. Despite its public sector shareholders, it invests mainly in private enterprises, usually together with commercial partners. The EBRD provides project financing for banks, industries and businesses, both new ventures and investments in existing companies. It also works with publicly owned companies to support privatization, restructuring state-owned firms and improvement of municipal services.

[www.ebrd.com](http://www.ebrd.com)



Number of shares: 2,302,659  
Ownership: 25.1%

EIT (Employee Investment Trust) Capital Management is a special purpose company, which is jointly owned by coworkers and capitalized with the shares that they currently hold in the Bank and the Group. Through this process co-workers set up a truly sustainable mechanism to align the Group's interest with those of its employees and at the same time ensure a proper participation of these shareholders in the strategy of the organization while ensuring protection of their legal rights as minority stakeholders. This entity has voting and transfer rights and allows the Group to deal with 1 shareholder, alleviating the need to work separately with each individual shareholder.

[www.eit.mn](http://www.eit.mn)



Number of shares: 1,243,624  
Ownership: 13.56%

The International Finance Corporation (IFC) is a member of the World Bank Group. IFC fosters sustainable economic growth in developing countries by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments. IFC helps companies and financial institutions in emerging markets create jobs, generate tax revenues, improve corporate governance and environmental performance, and contribute to their local communities. The goal is to improve lives, especially for the people who most need the benefits of growth. IFC invests in enterprises majority-owned by the private sector throughout most developing countries in the world.

[www.ifc.org](http://www.ifc.org)



Number of shares: 1,254,180  
Ownership: 13.67%

Mercy Corps provides international humanitarian aid and development charitable organization that focuses on emergency relief services, economic development and civil society, founded in 1979 as Save the Refugees Fund. Mercy Corps works amid disasters, conflicts, chronic poverty and instability to unleash the potential of people who can win against nearly impossible odds. Since 1979, Mercy Corps has provided \$1.3 billion in assistance to people in 100 nations. Supported by headquarters offices in North America and Europe, the agency's unified global programs employ 3,400 staff worldwide and reach nearly 14.4 million people in more than 35 countries.

[www.mercycorps.org](http://www.mercycorps.org)



Number of shares: 264,141  
Ownership: 2.88%

Open Society Forum (OSF) is a non-for-profit public benefit foundation established pursuant to the Non-Governmental Organization Law of Mongolia, as a successor to the Mongolian Foundation for Open Society (Soros Foundation). The OSF is providing a venue of for public engagement in the policy formulation and implementation monitoring processes, broad public access to information resources about policies, laws, and regulations, physical and virtual space for high-quality research and analysis in the fields of economic growth, social development and democratic governance policy.

[www.forum.mn](http://www.forum.mn)



Number of shares: 150,153  
Ownership: 1.64%

The Rotary Club of Ulaanbaatar was the first Rotary Club in Mongolia. The Club was admitted to Rotary on January 10, 1996, and chartered on May 13, 1996. Rotary is short for Rotary International - a worldwide association of local clubs for men and women in business or the professions who provide humanitarian service to the community at local, national and international level, encourage high ethical standards in all vocations, work for goodwill and peace in the world. Rotary was founded in 1905 and now has over 1.3 million members in more than 30,000 clubs in 185 countries and geographical regions.

[www.rotarymongolia.org](http://www.rotarymongolia.org)



**BlueOrchard**

Number of shares: 1,528,173  
Ownership: 16.66%

BlueOrchard Private Equity Fund (PEF), specialising in the equity investment and management in microfinance institutions, acting as an investment vehicle targeting microfinance institutions at a local, regional or international levels.

[www.blueorchard.org](http://www.blueorchard.org)

**Triodos Bank**

Number of shares: 685,993  
Ownership: 7.48%

Triodos-Doen Foundation, founded by Triodos Bank and DOEN Foundation in 1994, aims to develop microfinance into a full-fledged and integral part of the financial sector in developing countries. The creation of an inclusive financial sector, a sector where the majority of people have access to financial services, will provide a sustainable basis for a balanced social-economic development. In its vision microfinance institutions distinguish themselves from other financial institutions through a specific identity and sustainable profile which includes not only a focus on the profitability of the institution but also on the social aspects, which are an almost inherent part of their mission, and on the potential impact of their business and credit operations on the environment and natural living conditions.

[www.triodos.com](http://www.triodos.com)

**Triodos Fair Share Fund**

Number of shares: 685,996  
Ownership: 7.48%

Triodos Investment Management LLC, established in 2002 in the Netherlands, is one of the first and very few social-ethical funds worldwide that offers the opportunity to invest in microfinance institutions to the general public. The fund initially concentrates on the private investors market in the Netherlands. Triodos Fair Share Fund is one of the three microfinance funds managed by Triodos Investment Management B.V., part of the Triodos Bank N.V., and invests in microfinance institutions in developing countries, Central Asia and Eastern Europe. The objective of the fund is to give low-income people in these countries access to financial services by contributing to a sustainable inclusive financial sector.

[www.triodos.nl](http://www.triodos.nl)



Number of shares: 100,000  
Ownership: 1.09%

Mongolian Women's Federation is an NGO that continues the heritage and the deeds of its predecessor organisation established in 1924, with a renewed aim to serve for the women's rights and improvement of their social status in Mongolia.

[www.mwf.mn](http://www.mwf.mn)

# International investors

MNT in thousands

## FMO

Finance for Development

MNT 18,947,742

The Netherlands Development Finance Company, development bank, founded by the Dutch government and business community in 1970 as the successor of the Netherlands Overseas Financing Association (NOF). At present, FMO is firmly rooted in some 40 or more developing countries and countries in transition and provides financing in the form of equity investments and loans to enterprises and financial institutions.

7 Year Term Loan  
[www.fmo.nl](http://www.fmo.nl)



## BlueOrchard Finance s.a.

Microfinance Investment Advisors

MNT 8,368,606

BlueOrchard Finance, a Swiss company, specialising in the management of microfinance investment products, assists banks and financial intermediaries who wish to invest in the microfinance industry by offering a comprehensive package of services. Acting as a fund of funds, it invests in a broad array of Apex debt investment vehicles targeting microfinance institutions at a local, regional or international level.

5 Year Term Loan  
[www.blueorchard.org](http://www.blueorchard.org)

## Morgan Stanley

MNT 5,825,000

Founded in 1935, Morgan Stanley (NYSE: MS) is a leading global financial services firm providing a wide range of investment banking, securities, investment management and wealth management services. The Firm's employees serve clients worldwide including corporations, governments, institutions and individuals from more than 600 offices in 33 countries.

5 Year Term Loan  
[www.morganstanley.com](http://www.morganstanley.com)



MNT 1,974,547

Kreditanstalt fuer Wiederaufbau (KfW) Bankengruppe, established in 1948, is a state-owned development bank designed to assist developing countries and the German economy. It provides funds for housing, infrastructure, environmental protection and preservation, and venture capital. KfW is involved in funding telecommunications, transportation, energy infrastructure, and industrial projects around the world.

10 Year Term Loan  
[www.kfw.de](http://www.kfw.de)

## Deutsche Bank



DB-Global Commercial Microfinance Consortium

MNT 4,672,000

Deutsche Bank Aktiengesellschaft provides investment banking products and services. It was founded in 1870 and is a leading global investment bank with a strong and profitable private clients franchise. The bank is a leader in Germany and Europe, and growing in North America, Asia and key emerging markets with 1,889 facilities worldwide.

5 Year Term Loan  
[www.deutsche-bank.de](http://www.deutsche-bank.de)

## CREDIT SUISSE

MNT 8,531,499

Credit Suisse Group, founded in 1856, headquartered in Zurich, operates as a financial services company worldwide. It provides companies, institutional clients and high-net-worth private clients worldwide, as well as retail clients in Switzerland, with advisory services, comprehensive solutions, and innovative products in over 50 countries.

2 Year Term Loan  
[www.credit-suisse.com](http://www.credit-suisse.com)

## Calvert Foundation

MNT 1,529,899

Calvert Foundation, a nonprofit organization, is an industry leader in community investment. It was launched in 1995 as a separate organization with the support of the Ford, MacArthur and Mott Foundations. Its goal is to maximize the flow of capital to disadvantaged communities in order to foster a more equitable and sustainable society.

5 Year Term Loan  
[www.calvertfoundation.org](http://www.calvertfoundation.org)



MNT 14,992,966

Developing World Markets is an asset manager and investment bank dedicated to making socially positive investments in order to promote sustainable economic and social development on a global scale. We believe that the private sector and capital markets can and should be utilized to create positive economic and social change, and are often the most effective catalysts for doing so.

[www.dwm.com](http://www.dwm.com)



MNT 5,825,646

Oikocredit is a unique cooperative society, which encourages investors to invest their funds in a socially responsible manner. It is one of the few ethical investment funds, which finances development projects in the South benefiting disadvantaged and marginalised people. Today more than 75% of our outstanding capital goes to financial intermediaries, the MFIs.

3-4 Year Term Loan  
[www.oikocredit.org](http://www.oikocredit.org)



MNT 10,293,030

The Dexia Micro-Credit Fund, created in 1998 by Dexia Banque Internationale, is the first commercial investment fund designed to refinance microfinance institutions specialised in financial services to small companies in emerging markets. It is active in 27 developing countries in Latin America, Asia and Eastern Europe, and finances 78 institutions, which serve well over one million microentrepreneurs.

2-3 Year Term Loan  
[www.blueorchard.org](http://www.blueorchard.org)



MNT 8,986,618

Triple Jump, fund management company, founded in 2006 as a result of management team spin off from Oxfam Novib, aims to provide financial services for MFIs in all phases of their development. Its mission is to contribute to the sustainable development of emerging market economies by facilitating investment in micro and small enterprises.

2-3 Year Term Loan  
[www.oxfamnovib.nl](http://www.oxfamnovib.nl)



MNT 5,699,896

The European Bank for Reconstruction and Development (EBRD) uses the tools of investment to help build market economies and democracies in 27 transition countries. It provides project financing for banks, industries and businesses. It also works with publicly owned companies to support privatization, restructuring state-owned firms and improvement of municipal services.

4 Year Term Loan  
[www.ebrd.com](http://www.ebrd.com)

## Triodos Microfinance Fund

MNT 5,939,571

Triodos SICAV - Triodos Microfinance Fund aims to increase access to financial services for the working poor in developing countries by providing loans and equity to microfinance institutions (MFIs), while achieving an attractive financial return for investors. Triodos Investment Management acts as investment manager of the fund.

[www.triodos.nl](http://www.triodos.nl)



MNT 3,754,920

The International Finance Corporation (IFC) is a member of the World Bank Group. It fosters sustainable economic growth in developing countries by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments.

5 Year Term Loan  
[www.ifc.org](http://www.ifc.org)

## Triodos Fair Share Fund

MNT 3,191,012

Triodos-Fair Share Fund, founded by Triodos Bank and DOEN Foundation in 1994, aims to develop microfinance into a full-fledged and integral part of the inclusive financial sector in developing countries, where the majority of people will have access to financial services, and provide a sustainable basis for a balanced socio-economic development.

4 Year Term Loan  
[www.triodos.com](http://www.triodos.com)



MNT 1,533,990

Kiva is a non-profit organization with a mission to connect people through lending to alleviate poverty. Leveraging the internet and a worldwide network of microfinance institutions, Kiva lets individuals lend as little as \$25 to help create opportunity around the world.

[www.kiva.org](http://www.kiva.org)



Established in 1966, we are a major source of development financing for the Asia and Pacific region. With more than \$17.5 billion in approved financing, and 2,800 employees from 59 countries, ADB - in partnership with member governments, independent specialists and other financial institutions - is focused on delivering projects that create economic and development impact.

[www.adb.org/Mongolia](http://www.adb.org/Mongolia)



MNT 5,789,499

The mission of the Vision Microfinance Fund is to offer exposure to investors interested in microfinance. The fund has a double bottom line strategy, on the one hand maximizing its risk return profile for the benefit of the investor, and on the other hand maximizing the social outreach in breadth and depth to micro, small and medium enterprises in emerging and least developed economies.

[www.visionmicrofinance.com](http://www.visionmicrofinance.com)



MNT 1,243,820

Oyu Tolgoi's key priorities in developing the mine responsibly are: the environment, the health and safety of its employees, sustainable development, world class technology and behaving with integrity. Oyu Tolgoi works closely with local communities, respects laws and customs and will ensure a fair share of benefits and opportunities for the Mongolian people.

[www.ot.mn](http://www.ot.mn)



MNT 1,454,563

The Finethic initiative is designed to ally finance with ethics. Through microfinance, it uses finance as a tool to serve the disadvantaged.

[www.finethic.org](http://www.finethic.org)



MoFA works with an aim to support the regional and rural development providing economical growth and to provide the favourable environment of stable development in the agricultural sector.

[www.mofa.gov.mn](http://www.mofa.gov.mn)

# Sustainable Development Partners



## Microfinance Development Fund (MDF), World Bank

Aims to expand the outreach of microfinance services in rural areas. The Bank disburses MDF's loan through its branches in Darhan Uul, Orhon, Bulgan, Zavhan, Govi Altay, Dornogovi and Suhbaatar aymags. The Bank has disbursed, through its Darhan-Uul, Orhon, Zavhan, Khentiy, Dundgovi, and Suhbaatar aymag center branches, total loans of MNT 1,828.1 million to 900 microentrepreneurs, 32 herders and 238 individuals living under the poverty-line.

Started in November 2002



## Rural Poverty Alleviation Program (RPAP), IFAD

Aims to reduce the poverty of poor rural people and households. The Bank cooperates with RPAP in Arhangay, Huvsgul, Bulgan and Hentiy aymags. The Bank disburses low-interest loans to low-income households, herders and poor households in soums, as well as to women groups jointly with the Mongolian Women Federation. The Bank disbursed low-interest, reduced-collateral loans of MNT 185.1 million of amount up to MNT 1 million to 168 low-income poor women groups, and disbursed a total amount of MNT 1,598.6 million loans to 1531 persons in 2009.

Started in June 2003



## Employment Generation Support Fund (EGSF), Ministry of Social Welfare and Labor

XacBank disburses the Employment creation loan of Employment Generation Support Fund by Ministry of Social Welfare and Labor to individuals and entrepreneurs who want to create new jobs or retain existing jobs, in all aymags and districts. In 2009, total loans of MNT941.6 million to 136 unemployed individuals, 241 organizations, informal sector workers and herders, out of which 12 are disabled and 118 were ger-district area residents.

Started in May 2002



## European Bank for Reconstruction and Development

### Research study on "influence of microloans on the poverty reduction"

Jointly with the EBRD and Mongolian Women Federation a research study has been conducted since 2007. Under this project women groups in Arhangai, Bulgan, Hentiy and Huvsgul aymags received a low-interest loans without collateral. Group members are required to have group saving or common asset. Total loans of MNT 163.5 million were disbursed to 321 low-income women during 2008.

Started in 2007



## Rural Agribusiness Support Program (RASP), Mercy Corps Mongolia

The project's aim is to help expanding agribusinesses in central and southern Mongolia. The program is implemented in Dornogovi, Umnogovi, Dundgovi, Bayanhongor, Arhangay, Zavhan, Suhbaatar and Hovd aymags. In 2009, Bank disbursed MNT660.0 million to 252 herders and agribusinesses.

Started in March 2004



## Enterprise Mongolia Project, UNDP

Attempts to support entrepreneurial initiatives aimed at stimulating local economic development by creating national and global brand products. The project loans disbursed in Hovd, Zavhan, Huvsgul, Hentiy, Selenge, Ovorhangay, Bayan Ulgii aymags, and Han-Uul and Suhbaatar districts. Total loans of MNT110 million were disbursed to 18 business clients during 2008.

Started in May 2006



## Ger Initiative, CHF International

The project seeks to improve the quality of life for low and medium-income families in the peri-urban areas through supporting business development services and increasing development opportunities. The project is implemented in Ulaanbaatar city, Darhan-Uul, Orhon, Dornod, Selenge, Bayan Ulgii, Tuv and Bulgan aymags. In 2009, the Bank has disbursed MNT235.7 million to 181 borrowers.

Started in June 2003



## Support for Micro Business, ADRA, Mongolia

Project aims at supporting low-income and socially vulnerable ger-district residents in the capital city who have limited access to financial services to start micro businesses. Total loans of MNT90.7 million were disbursed to 113 business clients during 2009.

Started in August 2007



## "Self Help Groups", ADRA, Mongolia

Under the project the Self help groups voluntarily formed by the low-income rural micro businesses and those who are interested in micro business development will have financial and non-financial services. Group loans will be disbursed in Selenge, Zavhan, Huvsgul and Bayanhongor aymags through bank branches or mobile banking services as well as through Franchised Saving and Credit Cooperatives.

Started in July 2008



## Two Step Loan Project (TSL), JBIC

Two Step Loan Project (TSL) by Japan Bank for International Cooperation, aims to promote development of small and medium-sized businesses by introducing environmentally friendly technologies. TSL implemented in all aymags and capital districts of Mongolia.

Started in 2007



## SME Support Fund Project, Government of Mongolia

SME support fund project supports small and medium-sized businesses to access low-interest rate loans to promote purchase of productive equipment and required working capital.

Started in 2006



## Regional Economic Development Project, GTZ

Regional Economic Development Project of GTZ aims to support regional economic processes, including institutional framework conditions. The project is implemented in Darhan, Orhon and Bulgan aymags. Total loans of MNT800 million were disbursed to 9 business clients during 2009.

Started in May 2007



## Credit Lines for Veterinary Businesses, VET NET

This project enables qualified veterinarians and veterinary technicians in the designated aymags, soum and bag-based veterinary businesses to obtain subsequent loans from XacBank to buy veterinary drugs and equipment for use in their practices. Total loans of MNT 11.9 million were disbursed to 10 livestock veterinarians during 2009.

Started in January 2007



## Index Based Livestock Insurance project, World Bank

The Index-based Livestock Insurance Project for Mongolia aims to ascertain the viability of index-based livestock insurance in Mongolia to reduce the impact of livestock mortality for herders. Currently, herders in Uvs, Bayanhongor and Hentiy aymags are covered by this insurance. Total loans of MNT25.4 million were disbursed to 23 herders during 2009.

Started in March 2006



## Joint lending to SMEs supplying to Oyu Tolgoi Ltd

XacBank signed an agreement with Oyu Tolgoi Ltd to jointly support SMEs supplying to the mining development in Umnugovi province. The Bank received project loan fund worth USD1 million to provide discounted fee loans to local suppliers.

Started in 2011



## "Mongolian dream" Project

The project's aim is to house the low and middle income young families, and contribute to the reduction of air and soil pollution in ger districts. Since 2007 mortgage loans with discount rate provided to borrowers who lives in the micro district "Rising Sun", constructed under the project.

Started in 2007



## Habitat for humanity mongolia affordable housing programme

XacBank in partnership with Habitat for Humanity Mongolia, a charitable organisation, will help 300 low-income families to have solid and affordable housing in Ulaanbaatar, Darkhan, Erdenet and Arvaikheer. HFH Mongolia's role is to work with the families in building or renovating their houses while XacBank will provide financing and loan servicing.

Started in 2008



## Supporting organic farming

In 2010, XacBank and MNCCI, Petrovis, Max Group and Energy Resources LLC implemented the second phase for "Organic Mongolia" project. The partnering organisations raised a total of MNT350 million in fund to which XacBank invested MNT200 million. The program disbursed MNT356 million to 126 farmers in support of their farming businesses.

Started in 2010

# Correspondent Banks

Country: Currency	SWIFT code	Account number
 <b>NATIONAL BANK FINANCIAL</b> Canada: USD National Bank of Canada, Montreal	BNDCCAMM INT	10246824000200101
 <b>中国农业银行</b> <small>AGRICULTURAL BANK OF CHINA</small> China: CNY, USD Agricultural Bank of China Inner Mongolia Branch, Erlian City	ABOCCNBJ050	05710101040022045 (CNY) 05710114012000055 (USD)
 <b>HypoVereinsbank</b> Germany: EUR Bayerische Hypo - und Vereinsbank AG, Munich	HYVE DE MM	69 109 012 (IBAN: DE13 7002 0270 0069 109012)
 <b>Postbank</b> Deutsche Postbank Friedrich-Ebert-Allee 114-126, 53113 Bonn, Germany	PBNKDEFF	755772 607
 <b>SMBC</b> <small>SUMITOMO MITSUI BANKING CORPORATION</small> Japan: JPY, USD Sumitomo Mitsui Banking Corporation, Tokyo	SMBC JP JT	4347 (JPY) 3625 (USD)
<b>KB</b>  Korea: USD Kookmin Bank, Seoul	CZNB KR SE	772-8-USD-01-3
 <b>SBERBANK</b> Russia: EUR, GBP, RUB, USD Sberbank (Savings Bank of the Russian Federation), Moscow	SABR RU MM	30111978700000000536 (EUR) 30111826700000000536 (GBP) 30231810900000000536 (RUB) 30111840100000000536 (USD)
<b>HSBC</b>  United States: USD HSBC Bank USA N.A., New York	MRMD US 33	CHIPS ABA: 0108 Fed Wire Routing Code: 021001088 000-144860
<b>Deutsche Bank</b>  Deutsche Bank Trust Co. Americas 60 Wall St.-28th Fl. New York, NY 10005, USA	BKTRUS 33	04434754
 <b>WACHOVIA</b> United States: USD Wachovia Bank 60 Wall St.-28th Fl. New York, NY 10005, USA	PNBPUS3NDNYC	2000191006555



## About this annual report

### ■ INTRODUCTION

The Annual Report 2010 is the fourth report that integrates XacBank's financial and operational performance reports with sustainability information concerning all major activities. The Bank's enriched Vision and Mission, restated in the report, includes our firm commitments to a triple-bottom line banking within the framework of the Global Reporting Initiative (GRI) № on good corporate governance, economic, social and environmental performance, as built around the 3Ps: the Planet, People and Profit. The report covers the period from 1 January to 31 December 2010 inclusive. XacBank's previous annual report was published in Sep 2010 and covered calendar year 2009. This report is based on the same basic principles as the 2009 annual report, including sustainability reporting and transparent disclosure of public information. Any changes to the methods of calculation used, if any, will be stated in the text.

### ■ SUSTAINABILITY REPORTING PRINCIPLES

The relevant sections of this annual report cover the corporate social responsibility (CSR) activities of the Bank. XacBank joined the Global Reporting Initiative's (GRI) platform for sustainability reporting in January 2007. The GRI framework is widely recognized and well tested by hundreds of companies around the world. In order to make our CSR reporting even more complete, relevant and comparable, the Bank has prepared the content of this report in accordance with the Global Reporting Initiative's G3 Guidelines, published in October 2006. The Bank also used the GRI Financial Services Sector Supplements, which is specifically relevant to financial services sector, both on Social Performance published in November 2002 and on Environmental Performance published in March 2005. For more detailed information about our application of the G3 Guidelines, please see the GRI index.

The Bank joined the United Nations (UN) Global Compact2 in October 2007. The GRI Guidelines' principles and performance indicators correspond to the requests contained in the UN Global Compact's mandatory annual Communication on Progress (COP), regarding its ten universally accepted principles in the core areas of human rights, labour, the environment and anti-corruption. This annual report provides an index to the Bank's performance with cross-references to relevant GRI indicators. Thus, the Bank has aligned its Global Compact reporting with the G3 Guidelines.

### ■ GRI CONTENT INDEX

Global Reporting Initiative (GRI) guidelines provide an internationally consistent format for information about a company's performance, particularly with regard to social and environmental issues. XacBank produced this annual report using the latest GRI - Sustainability Reporting Guidelines, Version 3.0. The guidelines together with the references in the annual report can be found online via [www.xacbank.mn/annualreports](http://www.xacbank.mn/annualreports). ■

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Banquiers Sans Frontrieres



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