

Development of information technologies

The development of the global and Russian finance systems is affected not only by economic factors but also improving banking technologies, which, in turn, depend on the level of development of computer and telecommunications equipment.

In 2007, a project was implemented to provide technical support for the process of crediting small and medium-sized enterprises.

Within the framework of the retail banking development, a project named "Credit cards with a grace period" was implemented.

The project for implementing PSB-Retail is in its final stages. The system has been successfully introduced into all sales outlets in the Moscow area, and the largest branches in the other regions of Russia. All the new sales offices are already equipped with the new PSB-Retail system. The number of private individuals registered as users of the remote access systems exceeds 30,000.

The development of the Siebel CRM system of the Oracle Corporation has continued in the Corporate Block, and the functions of sales management and maintenance of a catalogue of the Bank's products have been implemented. The introduction of the system

in the Retail Block has been launched within the scope of collection activities' implementation.

Also in 2007, a project for setting up a Settlements Centre was launched and successfully implemented.

A tender has been made for the development of a reporting system for the internal analytical and managerial activities of the Bank. As the platform for this, the Bank selected a world-class solution mySAP ERP.

The first items selected for the implementation of the system are budget planning, cost accounting, fixed assets' and tangible assets' accounting, personnel reporting, and salary calculations.

The number of legal entities connected to the Bank's "PSB On-Line" Internet service system exceeded 22,000 businesses in 2007. PSB On-Line 'Internet-Client-Bank' system is continuing to develop actively, and represents the main system for corporate clients.

The classic 'Client-Bank' system continues to function alongside the PSB On-Line system; it is used by 2,000 of the Bank's clients who do not have access to the Internet technology in their daily work.

Risk management

The Bank is pursuing a reasonable policy in the area of risk management on the basis of setting justifiable limits on various types of risk, constantly monitoring operations and exercising control over abidance by the set limits. In November 2007, a Risk Management and Control Department was set up within the Bank, bringing together a team of highly-professional risk managers with work experi-

ence in leading western and Russian banks. For the purpose of effective asset-liability management, as well as liquidity risk management, Treasury Department was set up within the Bank and authorised to determine the rates for attracting and placing funds, set transfer rates and manage the Bank's derivative hedging portfolios.

Credit risk management

Credit risk management at Promsvyazbank comprises the following main areas: individual credit risk management, portfolio credit risk management, problem asset recovery and the methodological support for the credit risk management and the credit process as a whole. Several structural and independent sub-divisions are involved in the credit risk management process. This is due to the functional and administrative division of individual and portfolio credit risk management in the Bank, and also the segregation between different business lines.

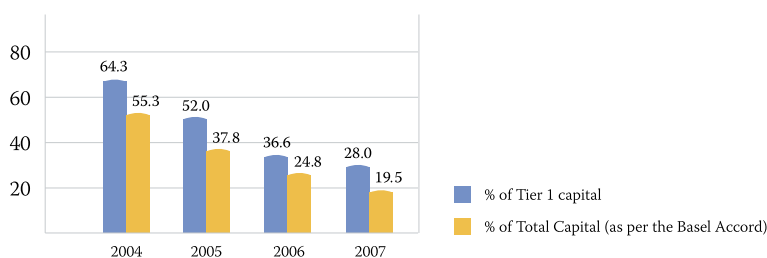
Individual credit risk management includes initial assessment and subsequent monitoring of the creditworthiness of individual borrowers, holdings, and security issuers; evaluation of the structure of the proposed transaction, the quality of the collateral, as well as monitoring of the payment discipline and the credit history of the borrower.

The value and state of the collateral is appraised and monitored, if necessary, by engaging independent appraisers and surveyor companies.

Portfolio credit risk management includes analysis of the credit risk concentration and the state of the Bank's assets carrying credit risk and provision of recommendations to the Bank's management for mitigating these risks. Decision-making limits, credit limits, limits on securities operations, risk concentration limits and other portfolio limits are subjected to calculation and observance control.

Within the scope of both the individual and the portfolio management, an important place belongs to the management of related-party credit risk. The Bank has set limits, and monitors the aggregate credit exposure to related parties, as well as limits for each affiliated entity as a proportion of the Bank's capital.

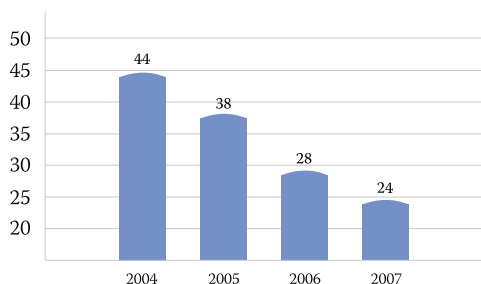
Dynamics of the aggregate credit exposure to related parties as % of capital



Methodological support for the credit risk management and the credit process as a whole consists in elaboration of internal documents connected with organisation of the credit process, in development of methodologies for assessing creditworthiness, procedures for impairment loss provisioning and other credit risk management documents.

For the purpose of introducing credit risk management culture and principles based on best world practices and the recommendations of the Basel Committee on Banking Supervision, the Bank is building models for an internal rating-based approach to borrowers and securities issuers, calculating the probability of default and loss given default, taking into account the proceeds from a possible realization of collateral. In 2007, the process was launched of building a unified, centralised system for assigning credit ratings and calculating the probability of default of corporate borrowers and issuers; credit default statistics are being gathered and analysed for the purpose of further calibration of the credit rating models. Special attention is paid to measures aimed at diversification of the Bank's credit exposure to the largest borrowers.

The share of the 20 biggest borrowers in the loan portfolio (%)



In order not to hold back the Bank's lending activities, credit powers are being expanded and delegated to different levels of decision-making. At the same time, for the purpose

of keeping reasonable control over the risks, a multi-level system for the division of powers between the bodies involved in credit decision-making has been introduced and is in operation in the Bank: the Credit Committee of the Bank, the Small Credit Committee, credit committees of branches, the Credit Committee for small and medium-sized business, the Credit Committee for the Retail Business, and the two-tier Institution of Personal Limits. Each collegial and individual body has restrictions on the amounts for which they may take decisions, as well as on other credit parameters.

**CREDIT RISK MANAGEMENT
IN SME LENDING**

Within the scope of the Programme for SME lending the general terms and conditions for extending loans have been determined, the basic requirements to the borrowers have been set, and the general criteria for approving credit transactions have been developed. The Programme also establishes the methodology for evaluating creditworthiness and collateral, the requirements on credit documentation, the procedure for monitoring limits and recovery of impaired and non-performing loans. Credit risk management with respect to SME is based on a combination of rating-based approaches and standard credit analysis, and includes regular re-evaluation of the creditworthiness of borrowers.

**CREDIT RISK MANAGEMENT
IN RETAIL LENDING**

In 2007, the Bank substantially improved its scoring models used and introduced new methods of statistical analysis for the retail loan portfolios. The process of considering applications is based on standard procedures. Decisions to extend retail loans are taken by the heads of branches or sub-branches of the Bank on the basis of the results of checks on the data included in the loan application, scorecard validation of the borrower, determining the credit risk level and in consideration of the information available on the customer's credit history.

For each retail programme, the Department for Retail Business Development sets limits, which are approved by the Bank's Credit Committee on the basis of the business development plan and current volumes of existing loan portfolios for each of the retail lending programmes. Within the general limits, specific limits are set for each branch and each sub-branch of the Bank. For the purpose of retail credit risk management, use is made, on the one hand, of specific methods for analysing development of arrears (so-called "vintage analysis"), and other statistical methods and, on the other hand, existing scoring models are regularly calibrated on the basis of data provided by the credit history database and the Bank's own accumulated default statistics.

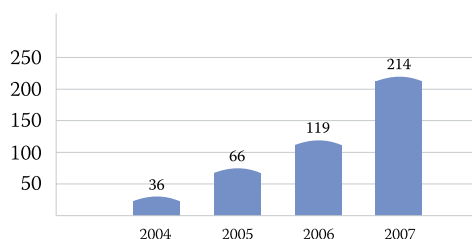
The Bank regularly monitors retail loan portfolios, including daily monitoring of volumes of current and overdue loans, weekly monitoring of the share of non-performing loans, and monthly and quarterly calculation and review of the allowance for impairment losses. In the event of arrears emerging, a multi-stage collection procedure comes into play in the Bank.

PROBLEM ASSET RECOVERY

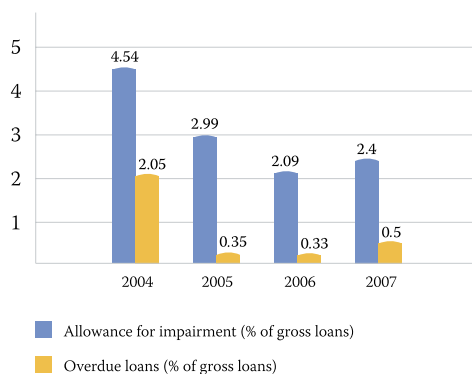
The Bank has its own special Service for recovering problem assets, the main tasks of which consist in: preventing property losses to the Bank and minimising losses from the appearance of problem assets. At the same time, considerable attention is focused on identifying borrower problems at a stage when it is still possible to prevent arrears. The Service also organises and carries out work with regard to court enforcement proceedings and foreclosure in relation to debtors.

Issues relating to the Bank's problem debt recovery are considered by the Problem Assets Committee. In spite of the active loan portfolio growth, thanks to the application of the latest methods for measuring, evaluating, monitoring and limiting risks, work with impaired and non-performing assets and improvement of the information systems, the effective credit risk management system allows Promsvyazbank to maintain a high quality of its credit exposure.

Dynamics of loans (billion roubles)



Dynamics of overdue loans and allowance for impairment (%)



CREDIT RISK MANAGEMENT IN OPERATIONS WITH COUNTERPARTY BANKS

The key instrument for understanding the credit risk level is the internal credit risk rating model built on the basis of the latest approaches to assessing the financial stability of banking counterparties, in consideration of a large number of quantitative and qualitative indicators. In order to restrict the credit risk, limits are set for counterparty banks and regularly reviewed with respect to individual instruments. Regular monitoring of the counterparties' credit quality and a moderately conservative policy in setting limits allow Promsvyazbank to minimise losses from interbank market operations.

Country risk management

Cross-border economic activities have been a key focus for Promsvyazbank, both in servicing its customers and in performing its own operations. A thorough analysis of macro-economic indicators and development trends, assessment of the regulatory base and business practices in individual countries ensure com-

fortable co-operation with foreign companies. Country limits are reasonable restrictions allowing to minimise the risks of failure to perform on the part of the Bank's partners as a consequence of economic, political or social disruption in their home countries.

Market risk management

Given the considerable instability and substantial heteroscedasticity of the Russian financial markets, market risk management is acquiring decisive significance. A whole complex of measures has been developed in the Bank for reducing the impact of market factors on the size of capital by hedging positions and limiting potential losses on trading portfolios. All market risk management decisions are taken by a standing collegial body — the Asset and Liability Management Committee.

The latest approaches, taken into account the practice of the leading global financial institutions, are used to manage the various types of market risk (currency risk, equity risk and interest rate risk).

The currency risk exposure of the Bank is calculated as the aggregate of all the open FX positions and is managed in accordance with the requirements of the Bank of Russia. To manage currency risk, Promsvyazbank uses the Value-at-Risk (VaR) methodology. The VaR indicator is calculated on a daily basis for the Bank's overall currency position, taking into account the volatility of individual currencies and the correlations between them. For the purpose of managing the currency risk, use is also made of derivative-based hedging strategies.

The equity risk of the Bank, as an active professional player on the Russian stock

market, is assessed with respect to the entire trading book of shares/ADR/GDR. As its target trading assets, the Bank chooses, as a rule, highly liquid shares in Russian Tier 1 companies included in calculation of the main stock indexes. In managing equity risk, account is taken of the fact that the Russian stock market is distinguished by high volatility and an instrument yield distribution that differs substantial from the normal (Gaussian) distribution. For the purpose of equity risk management, Promsvyazbank uses the Value-at-Risk methodology. The VaR indicator is calculated on a daily basis for the Bank's overall position, taking into account the volatility of individual equity instruments and the correlations between them.

The interest rate risk of the Bank on securities' trading portfolios, Eurobonds and liquid promissory notes is measures in accordance with modern risk management standards. As its target trading assets, the Bank chooses, as a rule, high-quality and sufficiently liquid debt instruments of Russian companies and banks, as well as state and subsovereign debt instruments. For the purpose of interest rate risk management, Promsvyazbank uses the PVBP indicator (Price Value Basis Point), constituting the change in the price of the portfolio given a minimum change in market yields. The PVBP indicator is calculated on a daily basis for all debt instrument portfolios.

Liquidity risk management

A system has been set up within the Bank for effective and responsive liquidity risk management. The procedures for and main requirements on liquidity management are determined, limits on permitted levels of liquid and

highly liquid assets are set, as well as liquidity gap limits. In managing liquidity, use is made of modern methods of stress-testing, economic forecasting and statistical analysis.

Operating risk management

A methodology has been developed in Promsvyazbank for assessing operating risk and information is gathered throughout the Bank on operating risk events for registration in the analytical database. An approach has been developed for determining the key

risk indicators, thus making it possible to monitor the level of operating risk in the key structural subdivisions efficiently and to forecast the probability of operating risk events occurring throughout the Bank.

Internal audit and control

In order to ensure observance of the regulatory and legal acts, accuracy of the financial reporting, the efficiency of the Bank's activities, abidance by the rights and legitimate interests of the Bank's depositors, creditors and other counterparties, Promsvyazbank has built up an effective internal control system. The Bank's internal control system includes checks designed for timely identification of failures to observe internal policies and procedures, a system of approval and delegation of authorities, checks on observance of limits and subsequent control over elimination of any violations revealed. The effectiveness of the internal control system is assessed by the Internal Audit and Control Department (IACD), which is accountable to the Board of Directors.

IACD performs internal audits of the Bank's activities and gives recommendations for improving them, and assists the Bank's management bodies in providing for its efficient functioning. The internal audit is performed on all structural subdivisions of the Bank, including branches, as well as all operations carried out by the Bank.

According to the results of audits, acts and reports are drawn up indicating shortcomings and recommendations are made for eliminating them. The staff of the audited subdivisions submit reports to IACD setting out the measures called on to eliminate the shortcomings identified and precluding their recurrence.

In 2007, IACD conducted 38 audits of the head office and branches of the bank. On their basis, amendments were introduced into a number of internal documents, software is being worked up and the organisational structure of branches improved to exclude conflicts of interests in performance of banking operations.

For the purpose of increasing the effectiveness of the internal control, it is planned to set up regional subdivisions of IACD in the largest branches of the Bank, thereby allowing effective measures to be taken to reduce the risks undertaken by the Bank and exercise constant control over elimination of any violations identified.



Tula. 1870



Tula. 1872

Anti-money laundering

Promsvyazbank's system for combating legalisation of criminally-derived proceeds is structured in accordance with the requirements of the Russian Federal Law, dated 07 August 2001, "On Combating Legalisation of Criminally-Derived Proceeds and Financing of Terrorism" (hereinafter referred to as the Law 115-FZ), the recommendations of the Bank of Russia and the recommendations of the Financial Action Task Force (FATF).

The Bank's system for combating legalisation of criminally-derived proceeds and financing of terrorism (hereinafter referred to as the System) is aimed at:

- excluding the possibility of the Bank's products and services being drawn into schemes and operations of criminal structures for money-laundering purposes;
- minimising the Bank's reputational and financial-legal risks in connection with possible attempts to use it for operations connected with money-laundering and financing of terrorism;
- helping to improve the results of the Bank's activities and its stable operation in the future.

Compliance rules have been elaborated and implemented in the Bank and agreed with the Central Bank of the Russian Federation. The Rules include:

- a programme for identifying and investigating the Bank's customers and beneficiaries of operations, which encompasses, among other things, specific procedures for checking on potential customers of the Bank, thereby preventing contractual relations being established with customers that provide incorrect identification data or are not located at their legal entity official addresses;
- checks on whether customers, including potential ones, are on the list of persons concerning which there is information on their involvement in terrorist activities and financing of terrorism;

- timely identification and registration of operations subject to mandatory control, as well as those that meet the criteria of suspicious operations, provision of information on these to the relevant authority of the Russian Federation — the Federal Service for Financial Monitoring;
- a programme of continuous training of bank staff in aspects of combating legalisation of criminally-derived proceeds.

Within the scope of the programme, in 2007 training seminars were held for authorised staff on financial monitoring in the Moscow area branch network, as well as staff of all branches. In December 2007, a remote check was made on the knowledge of the customer service staff and authorised staff with respect to financial monitoring.

Over 2007, in accordance with the requirements of the Federal Law "On Combating Legalisation of Criminally Derived Proceeds and Financing of Terrorism", the Bank forwarded 80,130 notifications with respect to operations to the Federal Service for Financial Monitoring, including 38,256 operations subject to mandatory control and 41,874 unusual operations.

On the basis of the results of anti-money laundering control, 505 potential customers were refused bank account contracts on the grounds specified by the effective legislation and 97 customers were refused performance of payment operations from existing accounts.

The tasks for the near future include expansion of the functional capacities of the specialised software used in the Bank for the purpose of combating legalisation of criminally-derived proceeds, an increase in the reliability of the systems and programmes identifying operations and a change in the procedure for exchange of data between the head office and branches of the Bank.

Corporate governance system

Key principles

The Bank's corporate governance system is based on management bodies of various levels: the General Meeting of Shareholders, Board of Directors, President and Management Board of the Bank.

In its activities, the Bank abides strictly by the requirements of the Russian legislation and supervisory bodies with respect to activities of management bodies, protection of the rights of shareholders and other stakeholders, control over financial and business activities, and disclosure of information on the financial results and various aspects of the Bank's activities. Considerable importance is given to the recommendations of the Central Bank of the Russian Federation and the Federal Service for Financial Markets and to the corporate governance principles formulated by the Organisation for Economic Co-operation and Development (OECD) and the Basel Committee on Banking Supervision.

The Bank's corporate governance standards are frequently remarked by participants of the financial markets. According to the results of a study carried out by the Euromoney magazine in 2007, Promsvyazbank was, for the third time running, included among the best banks on the developing markets of Europe in the sphere of corporate governance. The study was based on a traditional annual financial institution survey, in which the respondents are asked to identify the most successful and promising banks with respect to corporate governance.

The Bank consistently abides by the principle of raising the level of information transparency. It regularly publishes its financial reporting data according to both Russian and international reporting standards, holds conference-calls and issues press releases on the most significant events in the life of the Bank. The Bank's website presents, in both Russian and English, information not only about the broad range of services offered, but also additional information about the Bank itself that might be of interest to both customers and investors. Considerable attention is devoted to providing analytical information on the situation on the financial markets: the Bank publishes daily and weekly overviews of the stock markets, as well as a quarterly bulletin for investors.

The Bank's information policy is confirmed by the results of an independent study performed by the rating agency Standard&Poor's: in 2007, Promsvyazbank held 8th place in the rating of information transparency among Russian banks, while in 2006 and 2005 it was only in 14th and 24th place, respectively.

For the purpose of further development of the corporate governance system of the Bank, at the close of 2007 a resolution was adopted to set up a Corporate Governance Department to introduce the best international and Russian corporate governance practices for the purpose of raising the efficiency of the Bank's activities and its investment appeal.

Change in the Bank's ownership structure

In 2007, in order to make the Bank's equity capital structure more transparent, the overall ownership structure was simplified. As a result of transactions concluded on the secondary market, the company "Promsvyaz Capital B.V.", beneficially owned by Alexey N. Ananiev and Dmitry N. Ananiev, in-

creased its ownership interest in the authorised equity capital of the Bank from 10.3793 to 84.6799%. At the same time, the ownership interest of the minority Bank shareholder "Commerzbank Auslandsbanken Holding AG" remained unchanged at 15.3201%.

Board of Directors

In 2007, the numerical strength of the Board of Directors of the Bank was increased to 6 and, as of 31 December, 2007, its members were as follows:

Alexey Nikolaevich Ananiev (1964) — member of the Board of Directors from 2001, Chairman of the Consulting Council of LLC “Technoserv A/S”. Since 2006 — Chairman of the Board of Directors.

Alexander Anatolievich Levkovskiy (1972) — President of Promsvyazbank and Chairman of the Management Board from 2001.

Nikolay Ivanovich Zyatkov (1950) — member of the Board of Directors from 2003, Executive Director and Editor-in-Chief of CJSC “Argumenty i Fakty”.

Maxim Gennadievich Litvinov (1970) — member of the Board of Directors from June 2007, Director for Investments of the Strategic Development Department of CJSC “Promsvyazcapital”.

Sergey Sergeevich Kharitonov (1966) — member of the Board of Directors from November 2006, Senior Deputy Chairman of the Consulting Council of LLC “Technoserv A/S”.

Pavel Stepanovich Khokhryakov (1972) — member of the Board of Directors of the Bank from June of 2007, since 2004 — President of CJSC “Promsvyazcapital”.

Management Board

In 2007, the numerical strength of the Management Board of the Bank was increased to 8 and, as of 31 December, 2007, its members were as follows:

Alexander Anatolievich Levkovskiy (1972) — President of Promsvyazbank and Chairman of the Management Board since 2001, member of the Management Board since 1996.

Dmitry Sergeevich Sennikov (1957) — member of the Management Board since 1995, First Vice-President of the Bank since 2004.

Artem Georgievich Konstandyan (1974) — member of the Management Board since 2005, First Vice-President of the Bank.

Alexey Anatolievich Krasnov (1958) — member of the Management Board since 2005, Senior Vice-President — Head of the Branch Network Block.

Irina Viktorovna Morozova (1963) — member of the Management Board since 2000, Chief Accountant of the Bank — Director of the Financial Accounting and Reporting Department.

Alexandra Yurievna Volchenko (1976) — member of the Management Board since 2007, Vice-President — Head of the Finance and Risk Management block.

Alexey Valentinovich Fedotkin (1976) — member of the Management Board since 2007, Vice-President — Head of the Corporate Block.

Natalia Vladimirovna Neverkevich (1974) — member of the Management Board since 2007, Director of the Internal Audit and Control Department.

Committees of the Management Board

For the purpose of considering issues and adopting resolutions in relation to the Bank's day-to-day activities, the Bank holds regular meetings of various committees:

Credit Committee — determines the conditions for lending and the list of standard credit products offered by the Bank, sets risk limits per borrower (in accordance with their classification) and by branch, approves loans, makes decision on placement of credit resources and considers restructuring schemes for problem loans.

Small Credit Committee — fulfils the same functions as the Credit Committee but is restricted to taking decisions on loans not exceeding a set limit.

Asset and Liability Committee (ALCO) — exercises control over liquidity management and formation of the requisite level of liquidity and the Bank's standard thereon, approves procedures for determining the Bank's policy in relation to financial risks and supporting a justified and controlled (on a daily basis) level of market risk, liquidity and capital adequacy.

Problem Assets Committee — the Committee's activities are geared to preventing

material losses for the Bank, minimising losses incurred thereby and the risks run by the Bank in conducting its business.

Retail Banking Problem Assets Committee — the Committee's activities are geared to preventing material losses for the Bank, minimising losses incurred thereby and the risks run by the Bank in conducting its retail business.

Tariff Committee — provides for pursuit by the Bank of a unified tariff policy.

Budget Committee — provides for current management of the budget process in the Bank, as well as timely and accurate formation of the planned budgets for the Bank's structural subdivisions.

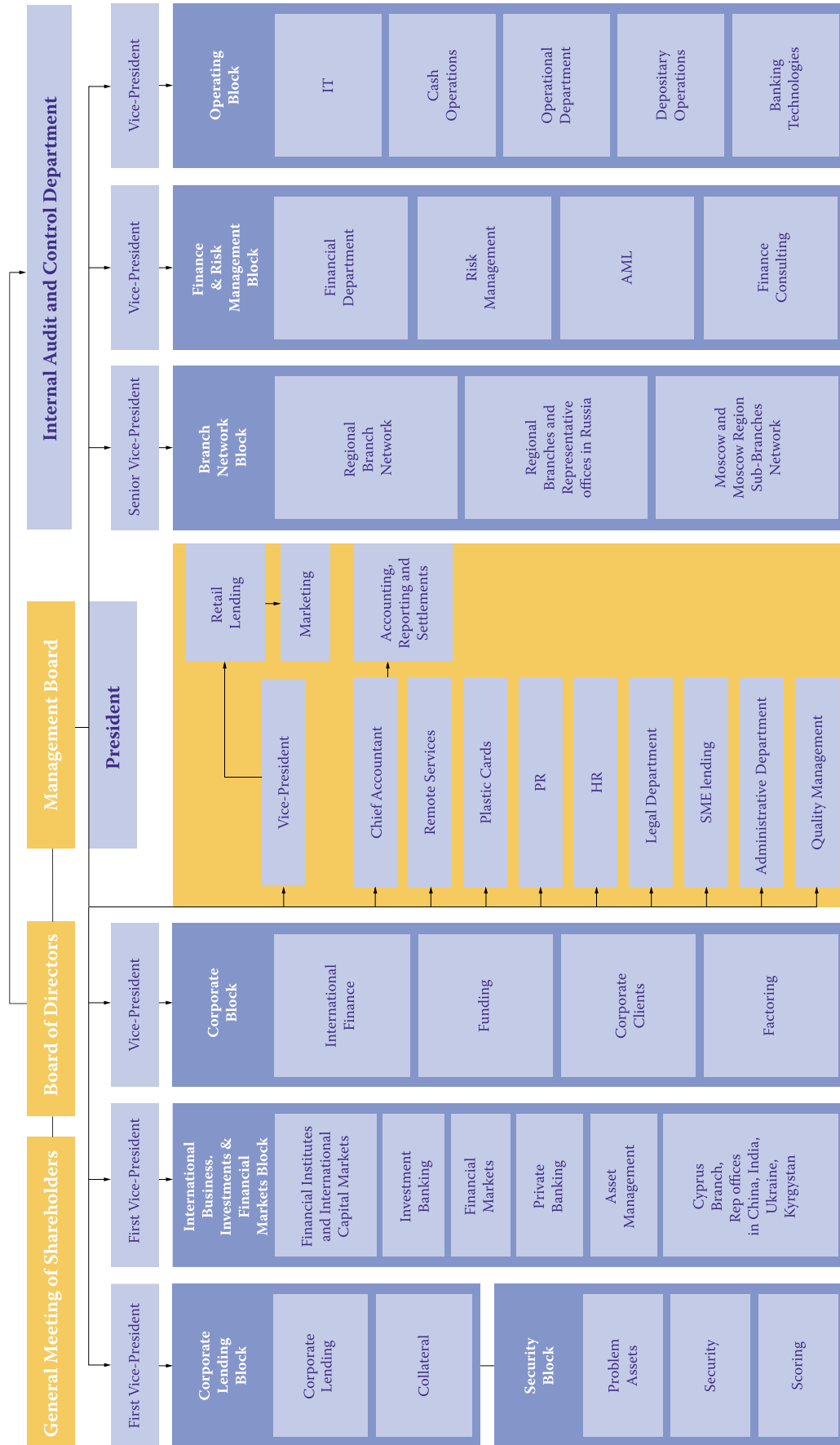
Technological Committee — ensures improvement and development of banking technologies.

Business Development Committee — manages development implementation of the Bank's business strategy for the purpose of raising competitiveness and yield.

Organisational structure

The Bank's dynamics development is manifested in a constant change and updating of its organisational structure, called on to comply fully with the Bank's current requirements. The consolidated organisational structure of the Bank as of 31 December, 2007 is presented below.

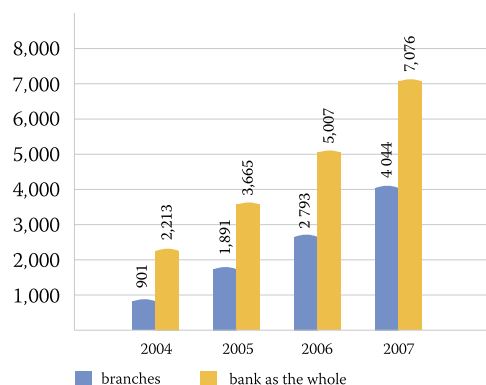
One of the main advantages of the new organisational structure of the Bank is introduction of elements of matrix management, allowing an increase in the interaction between and efficiency of the activities of different Bank subdivisions.



Organisational development and human resources

Promsvyazbank is at the stage of rapid growth and development. In 2007, new spheres of business appeared and, correspondingly, new subdivisions: the department for private capital management and the department for small and medium-sized business and others. For the purpose of arranging system-wide work to improve customer services, a quality management service was set up. Also in 2007, a strategic development department was created, with its functions including strategic planning issues. The Bank's staff numbers grew by 40% over 2007 and, by the end of the year, totalled 7,076.

Bank staff number changes 2004 — 2007



The growth and development of the Bank and the appearance of new business spheres necessitate optimisation of management processes. In the autumn of 2007, the administrative and functional management system was reorganised. The new structure consists of the following blocks: corporate (attracting and supporting corporate customers); corporate lending (servicing of corporate lending and collateral); finance and risk management; branch network development; international business, investments and financial markets; security and problem assets. The new structure is called on to ensure that the Bank's subdivisions fulfil their tasks more efficiently.

Growth of the Bank and development of new spheres of activity mean that the Bank

has to engage highly qualified specialists. The Bank's high status, its systemic approach to work with personnel, its ambitious and interesting tasks all mean that, in spite of the fierce competition on the human resources market, it is able to attract highly qualified experts in various spheres.

The professional community has also appraised the appeal of the Bank as an employer, by awarding it the national business prize "Captains of Russian business" in the category "Best employers", as well as the prize "Attractive employer" of the Research Centre portal superjob.ru.

In addition to engaging professionals from the market, the Bank also encourages career growth of its existing staff. In 2007, a unified system of the internal recruitment was introduced, allowing staff to realise their potential within the Bank.

The Bank also supports young specialist by arranging internships every year for students of higher educational institutions, such as the Finance Academy, the Bauman Technical University, the Graduate School of Economics, the Plekhanov Russian Economics Academy, and so on.

A professional, well-trained team is the foundation of our competitive advantage and guarantees our future prosperity. For this reason, the Bank focuses on training and development of its staff by sending them on study courses and inviting them to take part in internal corporate trainings and seminars. In 2007, 4,023 staff members studied under a variety of programmes.

The Bank also pays close attention to orientation of new members of the team. In addition to orientation course and study on-the-job, new staff are familiarised with the history and achievements of the Bank, our mission and corporate values, main spheres of activity and structure. To this end, in 2007 the Bank began holding orientation seminars called "Welcome to Promsvyazbank!"

The Bank strives to maintain its reputation as an attractive employer. The Bank's salary system and benefits package helps to attract the best specialists on the market. In order to keep our staff salaries in line with the market,

the Bank takes part in an annual review of salaries in financial sector companies.

The benefits provided to all the Bank's employees include voluntary medical insurance and other benefits are also provided.

Our Bank faces large-scale goals and it is continuing to grow and develop. In 2008,

the focus of HR work will be on introduction of a system for mass selection for entry positions, development of a system of basic professional training of managers, improvement of the remuneration system and establishment of a Corporate University.