ČESKOMORAVSKÁ
ZÁRUČNÍ A ROZVOJOVÁ
BANKA, a. s.

annual report

2010

In the Czech Republic, we represent a promotional bank aimed at contributing to the efficient development of national infrastructure and economic sectors that have been approved for public support according to the economic policies of the Czech Republic government and its regions.

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Chairman's introduction

Dear clients, business partners and shareholders,

The economic recovery we all were hoping for early last year became reality. The prognoses for continued economic development fluctuates, however, and one cannot overlook that within the European Union the level of economic recovery is notably varied. The stability of the financial system and further development of some EU countries' economies remains subject of speculation and heightened uncertainty. Even despite modest optimism, therefore, reasons remain for heightened prudence in all manner of financial market operations.

It was apparent during 2010 that measures of individual countries' governments were reflected in increased activity of specialised financial institutions, whose main aim is to help in overcoming a weakened availability of capital in areas where this problem had long existed and that are, therefore, continuously the subject of those governments' economic policies. The Czech Republic, too, reacted to impacts of the crisis in a manner similar to those of a number of other countries. With the aim of reviving economic growth, the extent of public funds flowing into the economy has increased, both as grants or guarantees and loan. Accelerated drawing from structural funds represented a significant component of those resources.

For CMZRB, 2010 marked a second year in a very challenging test of the Bank's capacity to perform. I am very pleased that we succeeded in reacting flexibly to the dynamically evolving demands made upon us during the year. Toward that end, the Bank was well-served especially by long experience, the active and responsible approach of the employees, and co-operation with our partners from the state administration and banking sector. These demands included, among others, ongoing adaptation of the national guarantee programme to the needs of entrepreneurs and to the extraordinary events that were the consequences of floods in spring and summer of last year. For the last two years, the Bank has provided about 50 % more guarantees than in the three previous years combined. It thus supported the access of clients in the enterprise and apartment house owners segments to loans in the amount of CZK 19.6 billion. A result of this sudden jump upward in business activity was significant growth in the managed portfolio of guarantees and loans, the amount of which surpassed CZK 30 billion at the end of last year.

I regard as very positive for future fulfilment of the Bank's mission the fact that the Bank dealt successfully with the impacts of the economic downturn in the form of increased credit risk within its existing transactions and with the associated creation of reserves. Moreover, shareholders' equity grew and all the key analytical indicators have been satisfying for an extended period. It enables to fulfil the Bank's functions both as a guarantor and a counterparty in the financial market in a trustworthy manner.

During 2011, the intensity of the Bank's operations will increase in relation to managing the established portfolio of guarantees and loans. We anticipate that the amount of preferential loans provided for small and medium-sized enterprises will further increase and the offer of guarantees for start-up enterprises will be innovated. The Bank's activities in the area of lending to municipalities will continue.

Nonetheless, I consider the main challenge for 2011 to be the Bank's active engagement into the first phase of preparations for the next programming period of EU structural funds. One of the clear signals the existing documentation has sent is that there is a goal to boost effectiveness of usage these funds through broader application of financial engineering instruments in the forms of loans, guarantees and risk capital. I am convinced that the Bank's experience to date, which is unique in the Czech Republic, will help in reacting to this new strategy in using public resources.

Ing. Ladislav Macka
Chairman of the Board of Directors

Company profile

The Government of the Czech Republic adopted a resolution on 23 October 1991 for the founding of a specialised banking institution to support small and medium-sized enterprises. This institution was entered into the Commercial Register in January 1992 under the name Českomoravská záruční a rozvojová banka, a. s. (hereinafter referred to as "CMZRB" or the "Bank").

The Bank's initial scope of business was directed only to implementing government programmes for the support of small and medium-sized enterprises. In subsequent years, the Bank's activity was extended to providing support in the housing area and to financing infrastructure development projects. CMZRB has a full banking licence, a foreign exchange licence, and a securities broker's licence issued under the relevant laws.

At present, CMZRB's main mission is to facilitate primarily small and medium-sized enterprises' access to financing through specialised banking products and, in accordance with the economic policy aims of the Government and the regions of the Czech Republic, to assist in developing other selected areas of the economy that require public support.

Throughout its entire time in operation, the Bank has co-operated closely with ministries, state funds, regions, banks, economic chambers and other representatives of the business community. The specific character of CMZRB's activities, the development of modern banking and communication technologies, and traditionally good co-operation with its partners allow the Bank to provide its clients with high quality banking services across the entire Czech Republic that positively impact those clients' development. Clients may use the services of the Bank's branches in Prague and in the regional centres of Brno, Hradec Králové, Ostrava and Pilsen. The Bank operates a regional office in České Budějovice for even better contact with its clients.

Shareholders of the Bank

Czech Republic (72.33 %)

- Ministry of Industry and Trade (24.25 %)
- Ministry for Regional Development (24.25 %)
- Ministry of Finance (23.83 %)

Česká spořitelna, a. s. (13 %)
Komerční banka, a. s. (13 %)
Československá obchodní banka, a. s. (1.67 %)

BANK'S OFFICES

Branch
Regional office

The Bank provides its clients with bank guarantees, preferential loans, and investment and financial services. Together with the State Housing Development Fund, the Bank actively participates in facilitating financing for the repair and modernisation of apartment houses. Financing projects to improve the quality of municipalities' infrastructure also constitutes an important part of the Bank's activities. With respect to the financial market, the Bank offers its clients a wide range of services and products, including special operations in securities investment.

The two most important client groups are small and medium-sized enterprises and apartment house owners, especially housing co-operatives and apartment owners associations. Other users of the Bank's services include municipalities, regional authorities, ministries and state funds.

Selected economic indicators

	Unit	2006	2007	2008	2009	2010
Total assets	CZK mil.	51,707	57,055	75,431	62,135	58,147
Liabilities	CZK mil.	46,890	52,185	70,309	56,686	52,455
Shareholders' equity	CZK mil.	4,817	4,870	5,122	5,449	5,692
Share capital	CZK mil.	2,132	2,132	2,132	2,132	2,132
Profit after tax	CZK mil.	738	795	802	815	854
Guarantee portfolio	CZK mil.	11,627	11,996	13,952	18,565	23,649
Capital adequacy	%	22.7	20.2	15.8	15.2	16.4
Average number of employees		250	239	230	220	219
Number of branches		5	5	5	5	5

Governing bodies

Board of Directors

Chairman	Ladislav Macka
Vice-Chairman	Pavel Weiss
Members	Jiří Jirásek
	Lubomír Rajdl
	Jan Ulip

Supervisory Board

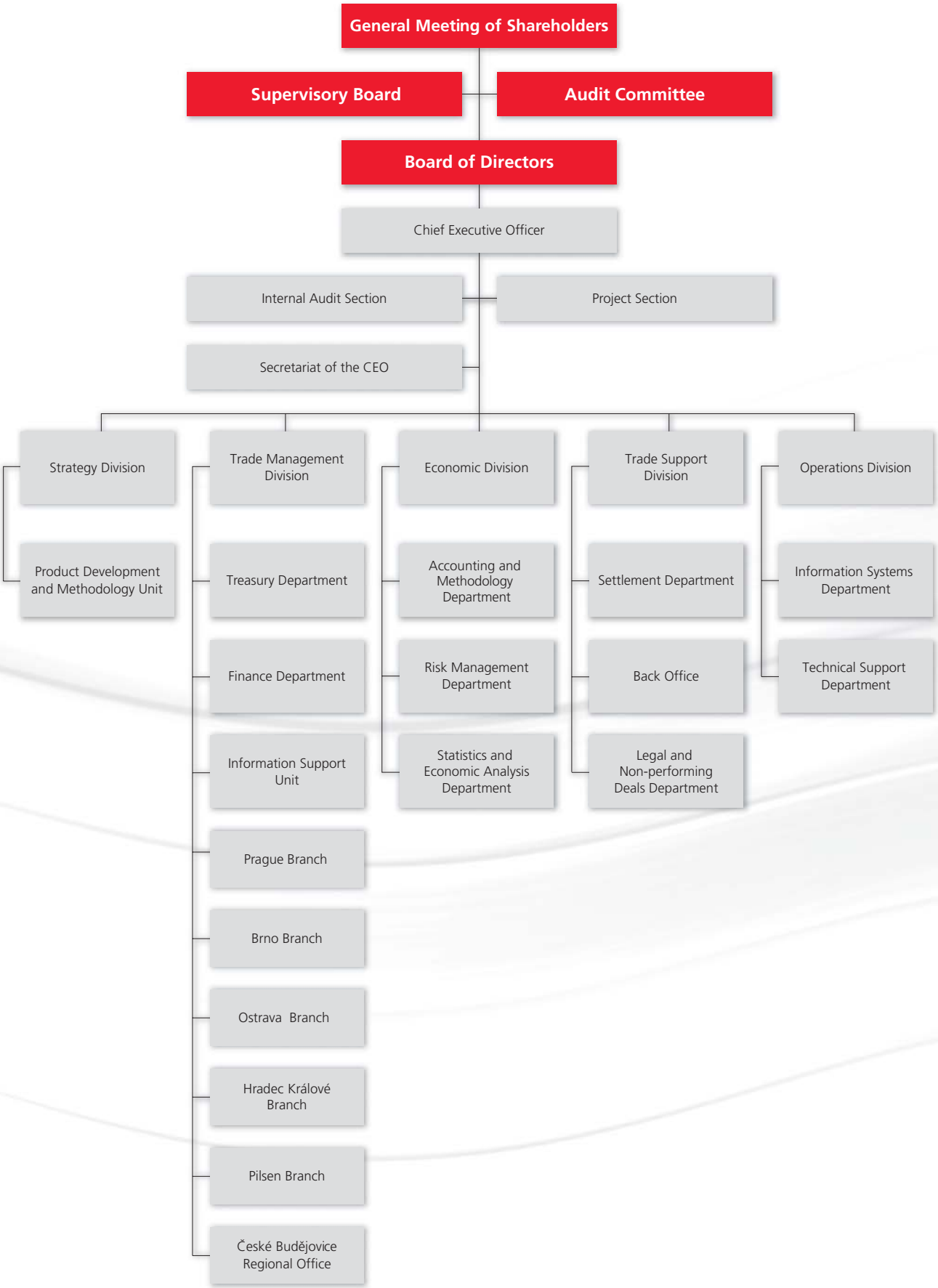
Chairman	Robert Szurman
Vice-Chairman	Josef Hájek (since 16 March 2010)
Members	Daniel Braun (since 7 December 2010)
	Josef Doruška (since 27 April 2010)
	Růžena Kabilková (since 27 April 2010)
	Ladislav Koděra (since 4 August 2010)
	Zdeněk Mareš (since 4 August 2010)
	Milan Novák
	Jana Šindelářová

During 2010, Martin Plachý ended his activities on the Supervisory Board (7 December 2010).

Audit Committee

Chairman	Milan Novák
Vice-Chairman	Josef Hájek
Members	Růžena Kabilková
	Robert Szurman

Bank's organisation chart



Report of the Board of Directors on the Bank's business activities and financial situation for 2010

annual report

2010

Economic environment and its impact on the Bank's performance

In contrast to the previous year, 2010 already showed signs of economic recovery which was associated especially with more favourable development in economies of the Czech Republic's main trading partners. Nevertheless, a general source of uncertainty and anxiety concerning future economic development was the rather strong prevalence of negative expectations as to a more lasting revival of economic growth and specific developments in the financial situations of some euro zone countries.

Due to its good starting position, the Czech Republic's banking sector remained stable, and this was confirmed also by ongoing stress tests conducted by the Czech National Bank. As expected, however, the impacts of the economic crisis have expressed themselves in a greater proportion of loans in default – especially for consumer loans, but for business loans as well. In particular, the number of individual entrepreneurs in bankruptcy increased, and the number of companies gone bankrupt was approximately at the level of 2009. As CMZRB's guarantee portfolio was directly connected with development of the guaranteed loan portfolio, and as had been expected, these development tendencies also carried over into a moderate overall increase in risk of the provided guarantees. A similar development manifested itself in the Bank's loan portfolio, as perspectives for further economic development in a number of companies are threatened by a decrease in demand due to limited public outlays or changes in the structure of the consumer shopping basket as a response to increases in some types of household expenses. Demand developments in their target markets abroad, and especially in Western Europe, will be very important for the businesses of some companies operating in the Czech Republic whose importance to overall economic growth and employment is quite significant, as well as for their ability to penetrate into new, non-European markets.

The enduring and heightened caution of banks when providing loans has been manifested especially among small and medium-sized enterprises, and most pronouncedly among those just starting out. Financing of working capital needs dominated the demand structure for new loans while electricity generating projects, and especially those using solar power, were very significantly represented in the demand for investment loans. These factors shaped the structure of the Bank's guarantee and loan portfolio last year and also influenced the course of the individual support programmes. Despite the considerable extent of funds available to finance working capital loan guarantees, strong demand for such guarantees forced their discontinuation already late in the first half of 2010. This was in contrast with the low drawing of funds from the guarantee programme for start-up entrepreneurs, which clearly confirmed the need to adjust the setting of the terms and conditions of that programme and for the guarantees it provides.

One of two factors influencing the course of the NEW PANEL programme to support the repairs of apartment houses were the government's state budget-savings measures, which precluded an increase of funds for this programme. Therefore, the realisation of one of its components – grants to cover interest costs – was interrupted. Nevertheless, funds to satisfy the increased demand for guarantees under this programme were secured, albeit with certain difficulties. The second factor influencing the course of the NEW PANEL programme was extension of the Green Savings programme for repairs of panel-block apartment houses. To ensure a co-ordinated approach in upholding the state aid rules t, it was initially necessary to respond by adjusting the Bank's internal procedures. However, this programme, too, was halted in late 2010, which may unfavourably influence the Bank's activities on this market in the coming year.

The loan market for municipalities was influenced by decreased demand in connection with its transfer to the term of office for new representative bodies established after the elections, as well as with an overall decrease in the municipalities' revenues due to impacts of the economic crisis.

The statement of the new government regarding a delay in establishing a date for the Czech Republic's entering into the euro zone was an important signal that for a number of years the situation on the Czech market and the development of the Czech currency will remain decisive for conduct of the Bank's business. During 2010, the Czech National Bank reduced the 2-week repo rate to 0.75 % per annum and held it at this low level for the remainder of the entire year. Heightened caution continued to prevail in trading on the money market, which was concentrated into trades with short maturities. Risk premiums on the Czech government bond market were gradually decreasing through the year. Overall, developments on the financial market positively influenced CMZRB's economic earnings in the past year.

Prompted by analyses as to the causes of the crisis which hit the financial sector in Europe changes were initiated in the regulatory framework for the operation of financial institutions. The Bank responded to these by adjusting its internal regulations as appropriate.

Bank's economic results

1) Unconsolidated data

Basic economic characteristics of the Bank, 2006 – 2010 Table 1

		Unit	2006	2007	2008	2009	2010
Total balance sheet		CZK mil.	51,707	57,055	75,431	62,135	58,147
Assets:	Deposits and loans in banks	CZK mil.	6,264	11,898	32,649	17,531	13,040
	Securities accepted by the Czech National Bank for refinancing	CZK mil.	7,057	8,511	10,166	14,178	16,584
	Debt securities	CZK mil.	5,411	7,101	6,281	6,275	7,235
	Payments from guarantees and other classified receivables	CZK mil.	3,345	3,002	2,826	2,849	3,874
Liabilities and equity:							
	Shareholders' equity	CZK mil.	4,817	4,870	5,122	5,449	5,692
	Liabilities	CZK mil.	46,890	52,185	70,309	56,686	52,455
	of which: reserves	CZK mil.	2,272	2,199	1,991	2,009	2,277
	funds to cover credit risks	CZK mil.	1,299	1,212	1,547	2,437	3,295
Off-balance sheet:							
	Guarantees granted	CZK mil.	11,627	11,996	13,952	18,565	23,649
Total revenues		CZK mil.	5,892	5,501	5,826	5,099	4,924
of which:	from securities and interbank operations	CZK mil.	780	858	1,394	1,012	828
	from operations with clients	CZK mil.	1,586	1,631	1,691	1,431	1,197
Total expenses		CZK mil.	5,154	4,706	5,024	4,284	4,070
of which:	net reserves and provisions	CZK mil.	287	142	-150	303	404
Profit after tax		CZK mil.	738	795	802	815	854
Capital adequacy		%	22.7	20.2	15.8	15.2	16.4

The Bank's business activities were favourably impacted in 2010 especially by advance drawing of funds from EU structural funds and by using other sources for supporting small and medium-sized enterprises under the government's anti-crisis measures. Moreover, there was high growth in the amount of new loan guarantees for repairs of apartment houses. Guarantee and loan transactions concluded totalled CZK 12.5 billion during 2010, and the total amount of the guarantee and loan transactions portfolio (net and less loans to state institutions increased by 22 % to CZK 30.5 billion.

Results in the financial area also were positive. The profit after tax in the amount of CZK 854 million represents an increase of CZK 39 million as compared to 2009. Profit per employee rose by 6.2 % and reached CZK 3.9 million. The return on average annual shareholders' equity reached 18.4 % and return on average annual assets[1] was 1.3 %. Shareholders' equity as of 31 December 2010 reflected growth by 4.5 % to reach CZK 5.7 billion. In 2010, 80 % of the 2009 after-tax profit (or CZK 652 million) was paid out to shareholders in dividends. These represented a 30.6 % return on the nominal value of the share.

As of the end of 2010, all known losses were fully covered by reserves and provisions in amounts corresponding to Czech and international standards, and the total balance of reserves and provisions for credit risk was CZK 3.8 billion, i.e. 12.5 % of the value of the guarantee and loan portfolio. Moreover, credit risks for certain types of guarantee products were covered by funds for credit risks provided by the programme originators. These funds grew during the year by CZK 858 million to a total of CZK 3.3 billion. As of the end of the year, moreover, the Bank had at its disposal reserve funds in shareholders' equity of CZK 1.15 billion.

[1] Calculations are made in accordance with the methodology established in the Czech National Bank's Official Information dated 26 October 2007 to Decree 123/2007 Coll., as amended, stipulating the prudential rules for banks, credit unions and securities dealers.

The overall balance sheet at the end of 2010 was 6.4 % smaller than in the previous year and netted to CZK 58.1 billion. This diminution was caused especially by a decrease in the amounts due to clients (–CZK 2.5 billion) and to banks (–CZK 2.2 billion). On the assets side, and corresponding to the changes in liabilities, there was in particular a decrease in amounts due from banks (–CZK 4.5 billion) and a reduction in loans to state institutions (–CZK 2.5 billion) along with an increase in the volume of securities (+CZK 3.4 billion). The balance sheet total does not include bank guarantees issued primarily for long-term investment loans and which comprise a significant part of the Bank's business activities and credit exposure. Their value had risen by 27 % to CZK 23.6 billion as of the end of 2010.

On the assets side, the Bank had at its disposal a portfolio of financial investments amounting to CZK 37 billion (63.4 % of net assets) and placed especially into bank deposits (22.4 % of net assets), government bonds, bonds of selected banks and companies, as well as zero-coupon government bonds (41 % of net assets). Loans provided to state institutions constituted an important net assets item (24 % of net assets), as did loans to other clients (11.7 % of net assets) reported in the item amounts due from customers. Non-earning assets comprised 0.7 % of the total balance sheet.

The funding sources on the liabilities and equityi side were provided primarily by amounts due to banks (33 % of liabilities and equity) and amounts due to clients (47 % of liabilities and equity), shareholders' equity (10 % of liabilities and equity), reserves (4 % of liabilities and equity), and temporary and other liabilities. Capital adequacy in relation to the risk-weighted assets in accordance with the Czech National Bank methodology was 16.4 % as of 31 December 2010.

Profit grew only moderately in 2010, even despite exceptionally high growth in the business volume (the portfolio of guarantee and loan transactions grew by 22 %) and positive developments in income from financial investments and operating costs. The reason for this development is especially the low profitability of the newly concluded transactions and higher net credit risk reserves. Despite the dynamic growth in business activity and an average inflation rate of 1.5 %, operating costs were successfully reduced by 2.5 %. The cost-income ratio decreased year on year from 21.6 % to 18.8 %.

Additional indicators of the Bank's financial performance, 2006–2010 Table 2

Indicator	Unit	2006	2007	2008	2009	2010
Total capital (Tier 1)	CZK '000	4,062,106	4,203,389	4,355,718	4,511,388	4,666 426
of which:						
- share capital	CZK '000	2,131,550	2,131,550	2,131,550	2,131,550	2,131,550
- compulsory reserve fund	CZK '000	800,000	800,000	800,000	800,000	800,000
- other profit allocations	CZK '000	350,000	350,000	350,000	350,000	350,000
- retained profit from previous years	CZK '000	802,450	943,652	1,095,241	1,249,745	1,406,286
- deductible items	CZK '000	-21 893	-21 814	-21 073	-19 907	-21 410
- of which: intangible fixed assets	CZK '000	-21 893	-21 814	-21 073	-19 907	-21 410
Additional capital (Tier 2)	CZK '000	0	0	0	0	0
Total capital to cover market risks (Tier 3)	CZK '000	0	0	0	0	0
Total capital	CZK '000	4,062,106	4,203,389	4,355,718	4,511,388	4,666,426
Capital requirements	CZK '000	1,429,718	1,666,670	2,211,711	2,376,281	2,273,135
of which:						
- specific interest rate risk	CZK '000	0	0	986	56,951	74,678
- specific equity risk	CZK '000	0	0	0	0	0
- settlement risk	CZK '000	0	0	0	0	0
- reverse repos and repos, securities borrowing and lending	CZK '000	0	110	304	3	323
- derivatives	CZK '000	5,706	5,765	10,368	8,236	5,668
- other trading portfolio instruments	CZK '000	0	0	0	21,844	33,938
- banking portfolio	CZK '000	1,405,658	1,625,456	1,880,443	1,970,495	1,831,701
- general interest rate risk	CZK '000	17,009	33,698	76,248	76,518	87,948
- trading portfolio exposure	CZK '000	0	0	9,959	0	
- equity risk	CZK '000	0	0	0	0	
- general equity risk	CZK '000	0	0	0	0	
- currency risk	CZK '000	1,345	1,641	2,622	6,887	7,512
- commodity risk	CZK '000	0	0	0	0	
- options	CZK '000	0	0	0	0	
- operational risk	CZK '000	0	0	230,781	235,347	231,367
Return on average assets (ROAA)[1]	%	1.31	1.63	1.20	1.24	1.34
Return on average equity (ROAE)[1]	%	18.49	19.01	18.51	18.15	18.39
Assets per employee[1]	CZK '000	209,341	239,727	332,296	279,887	265,510
Administrative costs per employee[1]	CZK '000	1,256	1,306	1,369	1,364	1,385
Net profit per employee[1]	CZK '000	2,988	3,341	3,533	3,670	3,899

2) Consolidated data

The Bank's consolidated profit after tax (i.e. including the 49 % share in the single associated company MUFIS a. s.) is CZK 9 million higher, amounting to CZK 863 million. Upon including the holding's share in the associated company's shareholders' equity, the Bank's equity rises by CZK 91 million to CZK 5,784 million. The total assets increase by the same CZK 91 million to CZK 58,238 million.

[1] Calculations are made in accordance with the methodology established in the Czech National Bank's Official Information dated 26 October 2007 to Decree 123/2007 Coll., as amended, stipulating the prudential rules for banks, credit unions and securities dealers.

1/ Products

In 2010, the Bank provided the following products:

a) Guarantees

- Guarantees for bank loans up to 80 % of the loan principal with an increasing level of liability that depends on the time when the call for exercising the guarantee is submitted (hereinafter just "gradual guarantees") provided under the GUARANTEE (guarantee for investment loans) and GUARANTEE (preferential guarantees for loans) programmes for small and medium-sized enterprises;
- guarantees for bank loans provided by a simplified procedure and with a limited guaranteed amount for a portfolio of guaranteed loans (hereinafter just "portfolio guarantees") provided under the GUARANTEE (guarantees for investment loans) programme for small and medium-sized enterprises for loans up to CZK 5 million and up to 70 % of the loan principal;
- portfolio guarantees for bank loans provided under the GUARANTEE (preferential guarantees for loans) programme for small and medium-sized enterprises for loans up to CZK 20 million and up to 70 % of the loan principal;
- guarantees for bank loans to owners or co-owners of apartment houses up to 80 % of the loan principal provided under the PANEL and NEW PANEL programmes to support the repair and modernisation of apartment houses;
- portfolio guarantees for bank loans to owners or co-owners of apartment houses up to 80 % of the loan principal provided under the PANEL and NEW PANEL programmes to support the repair and modernisation of apartment houses; and
- guarantees for tender bids for small and medium-sized enterprises in amounts of CZK 100,000 to CZK 5 million.

b) Loans

- Subordinated capital-project loans under the PROGRESS programme for small and medium-sized enterprises in amounts up to CZK 20 million, with a fixed interest rate of 3 % p.a., with maturity up to 7 years and grace period up to 3 years;
- regional loans for small and medium-sized enterprises in the South Bohemia Region in amounts up to CZK 1 million, with a fixed interest rate of 5 % p.a. and maturity up to 5 years under the Programme of Preferential Regional Loans for Micro- and Small Enterprises in the South Bohemia Region;
- long-term loans under the MUNICIPALITY 2 programme to maintain and develop infrastructure owned by a municipality or association of municipalities and thereby to improve inhabitants' quality of life, in amounts from CZK 8 million to CZK 250 million, with fixed interest rates, maturity up to 15 years and grace period up to 3 years;
- long-term loans under the MUFIS 2 programme to finance investments in infrastructure owned by municipalities or associations of municipalities in amounts up to CZK 30 million, with fixed interest rate, maturity up to 10 years and grace period up to 2 years;
- long-term loans funded by the Regional Development Fund for municipalities or associations of municipalities (with the exception of Prague) to co-finance projects for improving local infrastructure for business and non-business purposes in amounts up to CZK 30 million, with a preferential fixed interest rate, maturity up to 10 years and grace period up to 3 years;
- loans in the form of participation in a syndicated loan for using renewable energy sources.

c) Grants to cover interest costs

Grants to cover interest costs of loans to owners or co-owners of apartment houses under the PANEL programme to support the repair of panel-block apartment houses and the NEW PANEL programme to support the repair of apartment houses in the amount of 2 % to 4 % p.a. of the assisted part of the loan.

2/ Support to small and medium-sized enterprises

a) Overall results

The Bank provided support to small and medium-sized enterprises ("SMEs") especially as agreed with the Ministry of Industry and Trade.

By means of the Operational Programme Enterprise and Innovations (hereinafter just "OPEI") that is co-funded by EU structural funds, mainly investment-oriented projects in manufacturing and construction were supported, as were projects in a number of other sectors.

As part of the National Anti-Crisis Plan, an independent guarantee programme was financed from state budget funds. This programme made it easier for most small and medium-sized enterprises to obtain bank loans especially for acquiring inventories. In the second half of 2010, also under this programme, bank loan guarantees for small and medium-sized enterprises were provided in order to implement projects in areas of Moravia and North Bohemia afflicted by natural disaster.

Based on an agreement with South Bohemia Region, preferential loans were provided to small enterprises under the Programme of Preferential Loans for Micro- and Small Enterprises in the South Bohemia Region.

In 2010, small and medium-sized enterprises submitted a total of 2,288 applications for support in the form of guarantees for loans or subordinated loans (see Table 3). Of that number, 1,318 applications were approved and 515 applications were rejected because they either did not meet programme criteria or represented risks too high for the project to receive financing. A total of 340 applicants withdrew their applications during processing. The remaining 115 applications were not resolved in 2010 and will continue into the following year.

Applications for support and their settlement — Table 3

Indicator		**2006**	**2007**	**2008**	**2009**	**2010**
Total applications submitted	number	2,532	3,164	2,531	1,288	2,288
Approved	number	2,075	1,745	1,900	922	1,318
Rejected or withdrawn	number	198	265	586	184	855
Carried into following year	number	259	1,154	45	182	115

The major part of loans and guarantees provided was directed to small enterprises with up to 49 employees (see Table 4).

Supported projects divided according to sizes of enterprises — Table 4

	Guarantees (excluding bids to public tenders)				Loans			
	number		amount		number		amount	
Number of employees		**%**	**CZK mil.**	**%**		**%**	**CZK mil.**	**%**
0 to 9	567	46.3	2,869.3	43.5	60	63.8	412.9	65.6
10 to 49	423	34.6	1,681.2	25.5	25	26.6	126.1	20.0
50 to 249	234	19.1	2,042.9	31.0	9	9.6	90.4	14.4
Total	**1,224**	**100.0**	**6,593.4**	**100.0**	**94**	**100.0**	**629.4**	**100.0**

b) Guarantees

The Bank provided 1,224 guarantees in a total amount of CZK 6,593 million based on guarantee agreements concluded in 2010. The guarantees supported loans of CZK 10,070 million (see Table 5).

Based on a commitment to extend the liability period, the Bank extended this period through appendices to guarantee agreements for 422 guarantees amounting to CZK 2,352 million, which allowed the enterprises to continue drawing loans to finance working capital needs.

In addition to guarantees for bank loans, 302 guarantees were provided for bids to public tenders totalling CZK 219 million.

Guarantees issued (excluding bids to public tenders) and loans guaranteed — Table 5

Indicator		2006	2007	2008	2009	2010
Guarantees issued	number	459	482	1,043	878	1,224
Amount of guarantees issued	CZK mil.	2,951	1,925	3,529	6,369	6,593
Amount of loans guaranteed	CZK mil.	5,145	2,959	5,094	9,550	10,070
Average guarantee rate	%	57	65	69	67	65

Guarantees for investment loans under OPEI programmes were issued in a total amount of CZK 2,562 million to 321 businesses. Of this amount, 188 guarantees totalling CZK 416 million were provided through a simplified procedure.

Guarantees within the national programme were provided in a total amount of CZK 4,031 million, i.e. 46 % of the total amount of guarantees issued. These guarantees were used to secure 903 loans totalling CZK 5,800 million. The simplified guarantee application procedure was used by 865 applicants.

The largest portion of guarantees was used to support projects located in the South Moravia Region (see Table 6).

Regional structure of the volume of guarantees
(in % of contracted value of guarantees issued) — Table 6

Region		2006	2007	2008	2009	2010
Praha (Capital City of Prague)	%	5.1	8.5	0.4	1.7	5.6
Středočeský (Central Bohemia)	%	8.6	4.6	5.3	8.5	8.2
Jihočeský (South Bohemia)	%	1.8	4.9	4.1	3.5	4.9
Plzeňský (Pilsen)	%	10.2	7.2	6.5	8.4	7.0
Karlovarský (Karlovy Vary)	%	1.6	0.6	0.7	0.9	1.4
Ústecký (Ústí nad Labem)	%	2.8	5.9	7.2	3.1	2.1
Liberecký (Liberec)	%	10.5	1.4	6.0	6.1	9.7
Královéhradecký (Hradec Králové)	%	6.8	1.5	3.1	8.7	10.0
Pardubický (Pardubice)	%	4.5	10.5	8.9	9.0	3.8
Vysočina (Bohemian–Moravian Highlands)	%	6.5	4.4	5.2	7.0	4.7
Jihomoravský (South Moravia)	%	10.7	9.5	9.0	15.8	15.2
Olomoucký (Olomouc)	%	8.1	8.0	12.5	12.9	8.3
Zlínský (Zlín)	%	10.3	6.6	6.8	5.3	7.1
Moravskoslezský (Moravia–Silesia)	%	12.5	26.4	24.4	9.1	12.0
Total	**%**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The breakdown of guarantees according to the main groups of economic activities upon which the supported projects focused was significantly influenced in 2010 by the setting of conditions for the support programmes. The largest number of guarantees was provided to projects in manufacturing. The largest volume of guarantees was represented by loans for electricity production and distribution, and especially from renewable energy sources (see Table 7).

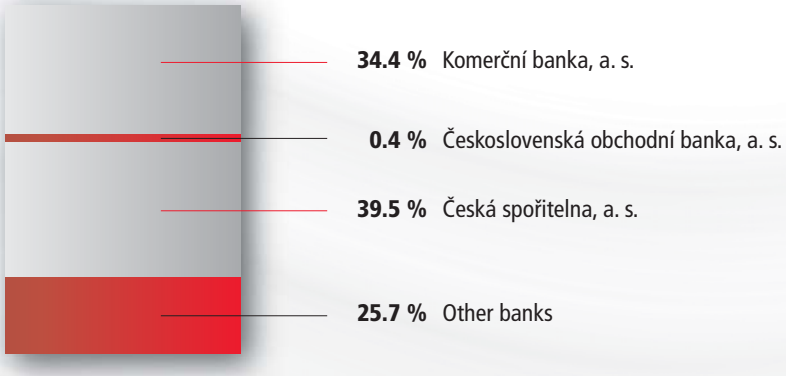
Sector structure of guarantees provided
(in % of contracted value of newly issued loans) Table 7

Sector		
Manufacturing (CZ NACE 10–33)	%	29.7
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	27.6
Construction (CZ NACE 41–43)	%	10.5
Wholesale and retail trade; repair of motor vehicles and motorcycles (CZ NACE 45–47)	%	26.2
Accommodation and food service activities (CZ NACE 55–56)	%	1.2
Other service activities (CZ NACE 05–09,36–39,49–53,58–75,77–82,84–88,90–99)	%	4.8
Total	%	**100.0**

During 2010, the majority of guarantee transactions was made with CMZRB's shareholding banks. As in previous years, Česká spořitelna, a. s. and Komerční banka, a. s., were the most substantial partners in this area. Among other banks, Raiffeisenbank a. s., (9.6 %) and GE Money Bank, a. s., (6.5 %) had the greatest shares in guarantee transactions (see Graph 1).

Graph 1

Percentage breakdown of guarantee transactions by lending banks (2010)



c) Loans

The Bank provided a total of 94 loans during 2010 for small and medium-sized enterprises amounting to CZK 629 million (see Table 8).

Preferential loans provided Table 8

Indicator		2006	2007	2008	2009	2010
Loans provided	number	745	182	105	44	94
Amount of loans provided	CZK mil.	1,502	931	286	209	629
Average loan amount	CZK mil.	2.0	5.1	2.7	4.7	6.7

Preferential loans were provided as:

- Subordinated loans under the OPEI PROGRESS programme. The number of loans provided was 89 and these totalled CZK 625 million.
- Reduced-interest loans under the South Bohemia Regional Programme. The number of loans provided was 5 and these totalled CZK 4 million.

The largest proportion of loans was used by entrepreneurs in the Pilsen Region (see Table 9).

Regional structure of the volume of loans provided
(in % of contracted value of newly issued loans) Table 9

Region		2006	2007	2008	2009	2010
Praha (Capital City of Prague)	%	4.7	1.8	1.3	0.0	0.0
Středočeský (Central Bohemia)	%	5.7	7.2	16.4	9.3	5.0
Jihočeský (South Bohemia)	%	6.1	7.9	7.7	13.6	9.8
Plzeňský (Pilsen)	%	13.5	18.5	19.4	33.4	16.0
Karlovarský (Karlovy Vary)	%	3.5	3.8	2.4	9.6	3.6
Ústecký (Ústí nad Labem)	%	5.7	0.5	3.4	1.7	8.2
Liberecký (Liberec)	%	0.9	3.9	2.3	2.9	0.0
Královéhradecký (Hradec Králové)	%	5.6	15.9	6.2	3.2	1.1
Pardubický (Pardubice)	%	8.6	6.0	10.2	4.5	6.2
Vysočina (Bohemian–Moravian Highlands)	%	5.1	4.4	6.1	2.4	11.2
Jihomoravský (South Moravia)	%	14.6	14.0	1.3	12.6	8.3
Olomoucký (Olomouc)	%	6.5	5.9	3.7	1.2	7.7
Zlínský (Zlín)	%	8.2	4.5	10.4	4.7	8.5
Moravskoslezský (Moravia–Silesia)	%	11.5	5.8	9.3	1.0	14.4
Total	**%**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The setting of conditions for the PROGRESS programme and the general investment climate were major factors contributing to the large proportion of projects supported in manufacturing and electricity supply (see Table 10).

Sector structure of the volume of loans provided
(in % of contracted value of newly issued loans) Table 10

Sector		
Manufacturing (CZ NACE 10–33)	%	24.4
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	63.4
Construction (CZ NACE 41–43)	%	7.0
Wholesale and retail trade; repair of motor vehicles and motorcycles (CZ NACE 45–47)	%	0.0
Accommodation and food service activities (CZ NACE 55–56)	%	0.2
Other service activities (CZ NACE 05–09,36–39,49–53,58–75,77–82,84–88,90–99)	%	5.0
Total	**%**	**100.0**

3/ Assistance for repairing apartment houses

Using funds provided by the State Housing Development Fund, CZK 1,804 million was provided in 2010 on the basis of contracts concluded with recipients in the forms of grants and guarantees to assist in repairing apartment houses. For the period since 2001, that sum aggregates to CZK 13,554 million.

Under the programme, owners and co-owners of apartment houses were provided with support in the forms of:

- guarantees for bank loans, and
- grants to cover interest costs of bank loans.

The assistance was directed to loans to be used by housing co-operatives, apartment owners associations and other individuals (see Table 11) to finance repairs of apartment houses.

Projects supported by guarantees or interest grants, by recipients — Table 11

Indicator			2006	2007	2008	2009	2010
Projects supported		number	1,338	2,345	2,301	2,346	1,715
Recipients:	housing co-operatives	%	57.0	43.9	42.2	42.6	30.4
	municipalities	%	0.6	0.7	0.2	0.3	1.9
	owners associations	%	42.3	55.0	56.5	57.0	67.5
	individuals	%	0.1	0.0	1.1	0.0	0.1
	legal entities	%	0.1	0.2	0.0	0.1	0.1

a) Guarantees

In 2010, the Bank issued 351 guarantees totalling CZK 1,759 million (of which 31 were portfolio guarantees amounting to CZK 113 million) to help applicants obtain loans for financing repairs to apartment houses. The assisted loans totalled CZK 2,411 million (see Table 12). The number of guarantees provided to apartment owners associations exceeded two thirds of all those provided.

Guarantees issued and loans guaranteed — Table 12

Indicator		2006	2007	2008	2009	2010
Guarantees issued	number	302	328	200	188	351
Amount of guarantees issued	CZK mil.	1,255	1,281	985	952	1,759
Amount of loans guaranteed	CZK mil.	1,941	2,158	1,532	1,352	2,411
Average guarantee rate	%	65	59	64	70	73

b) Grants covering interest costs

In 2010, the State Housing Development Fund decided on providing 953 grants totalling CZK 1 billion. Together with grant applications the approval of which already had been decided at the end of 2009, this allowed to conclude 1,364 contracts to provide grants covering interest costs totalling CZK 1,595 million in 2010. The decrease in the total amount of grants issued was influenced by the State Housing Development Fund's failing during 2010 to increase the limit of funds designated for interest cost grants. For this reason, accepting further applications was temporarily suspended in August 2010.

Grants covering interest costs — Table 13

Indicator		2006	2007	2008	2009	2010
Grants provided	number	1,036	2,017	2,101	2,158	1,364
Amount of grants	CZK mil.	1,587	3,271	2,484	2,364	1,595

4/ Municipal projects finance

a) Loans under the MUNICIPALITY 2 programme

The MUNICIPALITY 2 programme, which followed up the successful predecessor MUNICIPALITY programme, was launched in mid-2009 using resources obtained from the Council of Europe Development Bank. Loans provided by this Bank are designated for purchase or reconstruction of property owned by municipalities. This mainly concerns municipalities' technical infrastructure, school and pre-school facilities, cultural and sport facilities, and local streets and their lighting. In 2010, the Bank provided 8 loans totalling CZK 210 million.

b) Loans under the MUFIS 2 programme

The MUFIS 2 programme was launched in October 2009 and enables municipalities to obtain loans for similar infrastructure projects as under the MUNICIAPLITY 2 programme, albeit in lower amounts and with shorter repayment terms. The loans are provided from the so-called Common Loan Fund that has been newly established using funds from CMZRB and its associated company Municipální finanční společnost.

In 2010, the Bank provided 6 loans totalling CZK 29 million.

c) Loans from the Regional Development Fund

In June 2010, lending from the Regional Development Fund was re-established after its being suspended for approximately a year. In an agreement with the Ministry for Regional Development from October 2010, the scope of projects provided loans was extended to sport, cultural and educational facilities, including their equipment, as well as to improvements of parks and free-time areas. The first loan contracts are expected to be concluded in early 2011.

5/ Trading on financial markets

During 2010, the Bank concluded transactions on the money and capital markets in order to manage its liquidity, manage the money and capital market instruments portfolio, and refinance the loan programme for supporting small and medium-sized enterprises.

In managing its portfolio of money and capital market instruments, the Bank continued its conservative investment strategy. The Bank was oriented exclusively to purchasing government bonds, treasury bills, and bonds of a selected group of issuers with the highest credit ratings.

6/ Other lending activities

As a financial manager for infrastructure programmes, the Bank secured financing for these programmes totalling CZK 8 billion in 2010. This amount included funds obtained from the European Investment Bank, Council of Europe Development Bank, funds from the state budget and from the State Fund for Transport Infrastructure, as well as the investors' own sources.

The Bank used the aforementioned funds to finance a total of 4 projects and programmes directed primarily to transport infrastructure and for which CZK 5.7 billion was provided. As in previous years, these were in particular highway structures included in the Czech Motorways Project B and the project for constructing the south-western section of a beltway around Prague.

In 2010, the main part of financing was completed for the Masaryk University Campus Construction Project in Brno – Bohunice. The amount of CZK 0.5 billion drawn in 2010 was obtained from a loan taken on by the Czech Republic for this project from the European Investment Bank, from state budget funds (Ministry of Education, Youth and Sports), and from funds of Masaryk University itself.

The Bank continued in financing water sector infrastructure. Under a project to construct and renovate infrastructure of water supply and sewerage, a total of CZK 1.7 billion was realised for funding over 300 water sector infrastructure projects. Apart from these activities, the Bank also provided administration for paying a part of the interest from commercial loans. For these purposes, the Bank paid almost CZK 18 million to more than 60 participants in water sector infrastructure projects. The Bank in 2010 also provided payment operations for a programme to prevent flood damage, where the volume of funds used came to CZK 1.9 billion.

Using funds acquired in a loan from the German development bank Kreditanstalt für Wiederaufbau, the Bank participated in providing syndicated loans for projects in renewable energy sources. The undertakings within these contractual relationships totalled CZK 649 million.

External communications

Considering the scope of activities and funds designated for support, the Ministry of Industry and Trade was the Bank's main partner in 2010. The co-operation was concentrated in three areas. The first concerned ongoing changes in the national guarantees programme and its adjustment to entrepreneurs' current needs. This primarily concerned utilisation of the programme for supporting entrepreneurs in areas afflicted by natural disaster during 2010. A co-ordinated approach ensured that the additional resources provided for this purpose were fully utilised and funds were sufficient to process all those applications submitted.

The second equally important area where the Bank was very intensively communicating with the Ministry of Industry and Trade was in implementing the OPEI loan and guarantee programmes. Apart from operative questions related to ensuring smooth financing of these programmes, other important points of the co-operation were to prepare an extension of the call for applicants under the PROGRESS loan programme and to specify the rules for operation of the guarantee fund so that they conform with the methodological and interpretative recommendation of the European Commission under preparation and relating to using structural fund resources as loans and guarantees. The Bank has made use of the experience acquired from managing the loan and guarantee fund in preparing documents provided to the Ministry of Finance and Ministry for Regional Development for preparing the statement and comments to the proposals of the pertinent European Commission recommendation.

In 2010, also under the patronage of the Ministry of Industry and Trade, the closing phase was underway in preparing documents to close out the Operational Programme Industry and Enterprise in its part related to the START and CREDIT loan programmes, which had operated during 2004–2006.

The development of the NEW PANEL programme for repairs of apartment houses and the concurrently operating Green Savings Programme for thermal insulation of apartment houses, which is managed by the State Environmental Fund, required the Bank and the State Housing Development Fund together to react rapidly during 2010 to a change in conditions and to secure and co-ordinate the methods of providing the subsidies. One of the decisive areas was to determine optimal methods concerning the rules of providing public support.

During 2010, the Bank continued in communicating with other central state authorities and several regions. The Bank's main objective was to work out the method of preparing town development funds using structural funds resources. The development in this area has reached a stage where there now exists a real opportunity to move forward in fulfilling the Bank's development goals and its mission.

Co-operation with the Council of Europe Development Bank enabled the Bank also to ensure funds in 2010 for the MUNICIPALITY 2 programme. Positive, too, is the receipt of a loan in the amount of EUR 30 million from Kreditanstalt für Wiederaufbau for co-financing projects oriented toward energy production from renewable sources.

As a member of the European Association of Mutual Guarantee Societies (AECM), the Bank was involved in preparing opinions and topics for the European Commission in relation to using guarantees as one of the measures against the decreased availability of loans for small and medium-sized enterprises. Thanks in part to the long-standing contacts with members of the Club of development banks (ISLTC), there continued to be exchange of experience and co-operation with foreign partners in long-term project financing.

The Bank's co-operation with trade associations, commercial banks, and other entities was ongoing, thereby expanding the applicants' awareness as to the various types of support. In this way, knowledge as to the current needs and problems of the individual applicant target groups and beneficiaries of support also was obtained. The Bank took this as suggestions for improving the services it provides or passed this information on to the partners responsible for setting the conditions of the provided support.

Goals for further development

The year 2010 concluded a two-year period in many ways exceptional. In the past two years, both the resources earmarked as part of the National Anti-Crisis Plan and those of the structural funds designated for guarantees were in considerable extent directed to the present needs of entrepreneurs. This will influence the extent and structure of newly issued guarantees in 2011 and beyond. These guarantees will be primarily directed to acquiring investment-focused loans. The announcement of a new call for guarantee applications under the START and GUARANTEE programmes, along with related changes in the conditions of the programmes and guarantee products, will extend the scope of supported projects and boost the effectiveness of guarantees as quick and affordable security especially for smaller loans. Micro-enterprises being established will feel these positive changes the most, inasmuch as guarantees will make it easier for them to obtain working capital loans in order to develop those enterprises.

The available sources will allow the Bank to increase the scope of preferential loans under the PROGRESS programme during 2010. In this area, the Bank will focus on co-financing development projects in co-operation with commercial banks. This programme, too, will expand its area of operations into some additional sectors that were not supported last year.

Implementation of the NEW PANEL programme will be influenced both by the possibilities to finance grants for payment of interest and also by future development of the Green Savings programme, which will undoubtedly influence loans demand for these types of projects. In the area of support to housing, the Bank will therefore focus on providing guarantees and on high-quality management of the extensive portfolio of grants for payment of interest costs. The Bank will administer their payment, and will operatively react to possible changes in the economic environment in co-operation with the State Housing Development Fund.

In view of the extent of resources at its disposal, the Bank will also in 2011 have the possibility to remain at a stabilised level regarding its offer of long-term loans for financing investments that contribute to maintaining and developing infrastructure of municipalities while enhancing their inhabitants' quality of life.

As of 2011, the Bank enters a new period from the viewpoint of preparing its strategic goals for further development and fulfilling its mission in the economy. This will be characterised especially by the Bank's participating most actively and broadly in the conceptual deliberations, and stepwise also in the first phases of the implementing steps, toward increasing the proportion of resources from structural funds, which will be used in the forms of loans, guarantees and other types of financial instruments.

Already in 2011, the Bank will endeavour to use its long-standing experience with providing support in the form of preferential loans in another area which is being prepared for the use of this instrument. This concerns the town development funds, the establishment of which should further extend the use of this instrument as an effective way of financing projects which are components of towns' integrated development plans or others of their strategic development documents. The Bank will continue in actively communicating the offer of its technical and knowledge potential in connection with possible newly arising needs of the state authorities.

In order to achieve its objectives in the areas of its business activities and financial performance, the Bank will need to continue in using the potential offered by the information technologies at its disposal in the best possible way. At the same time, however, it will be essential to ensure a high level of reliability in the operation of these technologies and to draw upon experience acquired during their application to enhance the efficiency of individual processes and utilise the capacity of the Bank's employees. By progressive steps throughout 2011, the Bank will pursue this long-term development course. One of its key elements will be a fundamental increase in the capacity and functionality of the Bank's accounting system and the associated changes in the corresponding information systems.

Report of the Supervisory Board of Českomoravská záruční a rozvojová banka, a.s.

During 2010, the Supervisory Board regularly carried out its duties as defined by law and the Articles of Association of Českomoravská záruční a rozvojová banka, a. s. In its capacity as the Bank's oversight body, the Supervisory Board monitored the work of the Board of Directors in discharging its duties, conducting the Bank's business activities and financial management, and executing its strategic policy. The Supervisory Board was regularly informed about the Bank's activities, its financial situation and other essential matters.

Having examined the unconsolidated and consolidated financial statements for the year ended 31 December 2010, and on the basis of the external auditor's report, the Supervisory Board states that the accounting records and books were kept in a transparent manner and in compliance with the generally binding accounting regulations for banks as well as with the Articles of Association of the Bank. The accounting records and books reflect the Bank's actual financial situation in all important respects.

PricewaterhouseCoopers Audit, s.r.o., performed an audit of the unconsolidated and consolidated financial statements and confirmed that the financial statements provide a true and fair view of the financial position of Českomoravská záruční a rozvojová banka, a. s., as of 31 December 2010 and of its operations for this year, in accordance with Czech accounting standards. The Supervisory Board acknowledged the Auditor's report by consent.

Based upon the facts stated above and pursuant to the Articles of Association of Českomoravská záruční a rozvojová banka, a. s., the Supervisory Board recommends that the General Meeting approves the unconsolidated and consolidated financial statements of Českomoravská záruční a rozvojová banka, a. s., for the year ended 31 December 2010, as well as the proposed profit distribution for 2010, the Bank's long-term development strategy through 2013, and the amendment to the Bank's Articles of Association.

The Supervisory Board reviewed without comment the Report of the Board of Directors on the Bank's Business Activities and Financial Situation for 2010. It likewise examined the Report of the Board of Directors on Relations between Related Entities for 2010 and remarks that it took note of that Report without comment.

Prague, 15 March 2011

On behalf of the Supervisory Board of Českomoravská záruční a rozvojová banka, a. s.:

Robert Szurman
Supervisory Board Chairman

Statutory declaration

Českomoravská záruční a rozvojová banka, a.s., declares that all information and data presented in this annual report are true and complete. Moreover, the Bank confirms that this document contains all facts that may be of importance for investors' decisions.

Furthermore, Českomoravská záruční a rozvojová banka, a.s., declares that as of the date of processing the annual report no negative changes in the financial situation or any other changes had occurred that would influence the accurate and correct assessment as to the financial position of Českomoravská záruční a rozvojová banka, a.s.

Prague, 25 March 2011

Signed on behalf of the Board of Directors:

Ladislav Macka
Chairman of the Board of Directors

Pavel Weiss
Vice-Chairman of the Board of Directors

Independent auditor´s report to shareholders of Českomoravská záruční a rozvojová banka, a.s.

annual report

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Independent auditor's report

to the shareholders of Českomoravská záruční a rozvojová banka, a.s.

We have audited the accompanying financial statements of Českomoravská záruční a rozvojová banka, a.s., identification number 44848943, with registered office at Jeruzalémská 964/4, Praha 1 ("the Bank"), which comprise the balance sheet as at 31 December 2010, the statements of income, comprehensive income, changes in equity and cash flows for the year then ended and notes, including a summary of significant accounting policies ("the separate financial statements").

Board of Directors' Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal controls as the Board of Directors 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 the Act on Auditors of the Czech Republic, International Standards on Auditing and the related application guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

PricewaterhouseCoopers Audit, s.r.o., Kateřinská 40/466, 120 00 Prague 2, Czech Republic
Phone: +420 251 151 111, fax: +420 251 156 111, www.pwc.com/cz

Shareholders of Českomoravská záruční a rozvojová banka, a.s.
Independent auditor's report

Auditor's Responsibility (continued)

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 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 preparation of the financial statements that give a true and fair view 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 internal control. An audit also includes evaluating the appropriateness of the 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 financial statements give a true and fair view of the financial position of the Bank as at 31 December 2010, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

25 March 2011

PricewaterhouseCoopers Audit, s.r.o.
represented by partner

Petr Kříž
Statutory Auditor, Licence No. 1140

Financial statements for the year ended 31 December 2010 prepared in accordance with IFRS as adopted by the EU

annual report

2010

Income statement

	Note	Year ended 31 December 2010 CZKm	Year ended 31 December 2009 CZKm
Interest and similar income		2,026	2,443
Interest and similar expenses		(997)	(1,448)
Net interest income	**3.1**	**1,029**	**995**
Fee and commission income		848	689
Fee and commission expenses		(10)	(6)
Net fee and commission income	**3.2**	**838**	**683**
Income from financial operations	3.3	264	165
Expense on financial operations	3.3	(415)	(332)
Administrative expenses	3.4	(343)	(352)
Increase in loan impairment and write-offs	3.5	(136)	(263)
(Increase)/decrease in provisions for guarantees and other provisions	3.6	(192)	47
Other operating income		1	-
Operating profit		**1,046**	**943**
Share of profit of associates accounted for using the equity method	3.15	9	9
Profit before income tax		**1,055**	**952**
Income tax expense	3.7	(199)	(135)
Profit for the year		**856**	**817**

Statement of comprehensive income

	Note	Year ended 31 December 2010 CZKm	Year ended 31 December 2009 CZKm
Profit for the year		**856**	**817**
Other comprehensive income			
Net gains on available-for-sale financial assets, before tax		59	198
Income tax relating to components of the comprehensive income	3.7	(11)	(38)
Other comprehensive income for the year, net of tax		48	160
Total comprehensive income for the year, net of tax		**904**	**977**

Balance sheet

	Note	31 December 2010 CZKm	31 December 2009 CZKm
Assets			
Cash and balances with central banks	3.8	10,586	17,586
Loans and advances to banks	3.9	2,538	808
Financial assets held for trading			
- Debt securities	3.10	324	559
- Trading derivatives	4.2.2	65	104
Debt securities designated at fair value	3.10	1,274	558
Hedging derivatives	4.2.2	39	16
Loans and advances to customers	3.11	20,776	22,806
Investment securities available for sale	3.12	17,116	14,122
of which: assets pledged as collateral		1,860	739
Investment securities held to maturity	3.13	5,105	5,214
Deferred income tax assets	3.7	41	45
Investment in associate	3.15	92	83
Intangible assets		21	20
Property and equipment	3.16	171	185
Other assets	3.14	91	112
Total assets		**58,239**	**62,218**
Liabilities			
Amounts due to banks	3.17	18,908	21,102
Amounts due to customers	3.18	27,076	29,594
Financial liabilities held for trading	4.3		
- Short sales		198	0
- Trading derivatives		106	85
Hedging derivatives	4.2.2	890	1,095
Current income tax liabilities	3.7	60	41
Provisions	3.6	2,277	2,009
Other liabilities	3.19	2,947	2,767
Total liabilities		**52,462**	**56,693**
Shareholders' equity			
Share capital	3.20	2,132	2,132
Statutory and other reserves		1,150	1,150
Revaluation reserve		150	102
Retained earnings		2,345	2,141
Total shareholders' equity		**5,777**	**5,525**
Total liabilities and shareholders' equity		**58,239**	**62,218**

The accompanying notes are an integral part of these financial statements.

These financial statements were prepared by the Bank and approved by the Board of Directors of the Bank on 24 March 2011.

Ing. Ladislav Macka
Chairman of the Board

Ing. Jan Ulip
Member of the Board

Statement of changes in equity

	Share capital CZKm	Statutory and other reserves CZKm	Revaluation reserve CZKm	Retained earnings CZKm	Total CZKm
Balance at 1 January 2009	**2,132**	**1,150**	**(57)**	**1,965**	**5,190**
Total comprehensive income	-	-	159	818	977
Dividends relating to 2008	-	-	-	(642)	(642)
Balance at 31 December 2009	**2,132**	**1,150**	**102**	**2,141**	**5,525**
Total comprehensive income	-	-	48	856	904
Dividends relating to 2009	-	-	-	(652)	(652)
Balance at 31 December 2010	**2,132**	**1,150**	**150**	**2,345**	**5,777**

Statement of cash flows

	Note	2010 CZKm	2009 CZKm
Profit before income tax		1,055	952
Adjustments for non-cash transactions			
Loans impairment and write-offs and provisions for guarantees		307	218
Depreciation and amortisation		33	41
Impairment of available-for-sale debt securities		(4)	16
Share of profit of associates		(9)	(9)
Change in fair values and foreign exchange differences		(322)	(335)
Other non-cash items		17	33
Net interest income		(1,029)	(995)
Fee and commission income		(848)	(689)
		(800)	(768)
(Increase)/decrease in operating assets			
Loans and advances to banks		(84)	3,171
Loans and advances to customers		1,821	2,344
Other assets		(426)	(900)
Increase/(decrease) in operating liabilities			
Amounts due to banks		(1,774)	402
Amounts due to customers		(2,498)	(14,498)
Other liabilities		(171)	191
Interest received		1,967	2,559
Interest paid		(961)	(1,420)
Fee and commission received		991	1,319
Net cash flow from operating activities before income tax and payments under guarantee calls		(1,935)	(7,600)
Payments made under guarantee calls		(210)	(99)
Income taxes paid		(146)	(138)
Net cash flow from operating activities		**(2,291)**	**(7,837)**
Cash flows from investing activities			
Purchases of securities		(17,447)	(12,036)
Sales of securities and proceeds from matured securities		14,673	8,992
Purchase of tangible and intangible assets		(36)	(64)
Proceeds from the sale of tangible assets		-	1
Net cash flow from investing activities		(2,810)	(3,107)
Cash flows from financing activities			
Dividends paid		(251)	(248)
Net cash flow from financing activities		**(251)**	**(248)**
Net increase/ (decrease) in cash and cash equivalents		**(5,352)**	**(11,192)**
Cash and cash equivalents at the beginning of the year	**3.21**	**18,188**	**29,380**
Cash and cash equivalents at the end of the year	**3.21**	**12,836**	**18,188**

Notes to the financial statements for the year ended 31 December 2010

annual report

2010

Notes to the financial statements for the year ended 31 December 2010

1/ General information

Českomoravská záruční a rozvojová banka, akciová společnost (henceforth the "Bank" or "ČMZRB") was formed as a joint stock company pursuant to the Czech Commercial Code and was incorporated in 1992. The Bank's registered office is located at Jeruzalémská 964/4, Prague 1, Czech Republic. The Bank has five branches in the Czech Republic (in Brno, Hradec Králové, Ostrava, Pilsen and Prague) and one regional office in České Budějovice.

The Bank's activities are focused on supporting small and medium-sized businesses in the Czech Republic by providing preferential loans (Note 2 d), preferential guarantees (Note 2 j) and issuing infrastructure loans to municipalities and their legal associations, as well as water sector entities with municipal capital share (Note 2 b). The Bank's loan portfolio includes also loans to the Ministry of Finance provided in connection with infrastructure programmes (Note 3.11). The Bank also acts as an agent disbursing Czech government agency's funds as subsidy of interest costs to the block of flats' owners that meet specified criteria (Note 2 f). The purpose-bound funds are made available to Bank by the Czech state and international financial institutions. In some cases the Bank participates on programme funding.

These financial statements include the Bank and its associated undertaking Municipální finanční společnost a.s. (see Note 3.15) (together the "Group").

2/ Summary of significant accounting policies

(a) Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS'). The financial statements comprise the income statement and statement of comprehensive income presented as two separate statements, the balance sheet, the statement of changes in equity, the statement of cash flows and the notes.

The financial statements have been prepared under the historical cost convention, except for available-for-sale financial assets, financial assets held at fair value through profit or loss and all derivative contracts that have been measured at fair value.

The accompanying financial statements are based on the accounting records, together with appropriate adjustments and reclassifications necessary for fair presentation in accordance with IFRS.

The financial statements are presented in CZK, which is the Bank's functional and presentation currency. The figures shown in the financial statements are stated in CZK million.

Cash and cash equivalents in the statement of cash flows include highly liquid investments. Note 3.21 shows in which item of the balance sheet cash and cash equivalents are included.

The cash flows from operating activities are determined by using the indirect method. Profit before tax in the statement of cash flows is therefore adjusted by non-cash items, such as measurement gains or losses, changes in provisions, as well as changes from receivables and liabilities. In addition, all income and expenses from cash transactions that are attributable to investing or financing activities are eliminated. Interest received or paid is classified as operating cash flows.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Bank's financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2 p.

New Standards, Amendments and Interpretations applied in 2010

Application of the new accounting standards, interpretations and amendments to standards presented below does not have any significant impact on these financial statements:

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. This amendment has been endorsed by the European Union on 26 November 2009.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 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. This amendment has been endorsed by the European Union on 27 November 2009.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; 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 interests") 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. This amendment has been endorsed by the European Union on 3 June 2009.

IFRS 3, Business Combinations (revised January 2008; 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. This amendment has been endorsed by the European Union on 3 June 2009.

Notes to the financial statements for the year ended 31 December 2010

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. This amendment has been endorsed by the European Union on 23 March 2010.

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. This amendment has been endorsed by the European Union on 15 September 2009.

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 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 2008, are effective for annual periods beginning on or after 1 July 2009. This amendment has been endorsed by the European Union on 23 March 2010.

New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Bank's accounting period beginning on 1 January 2011 or later periods and which the Bank has not early adopted. Listed below are those new standards and interpretations or their amendments that could be relevant to the operations of the Bank or have not yet been analysed by the Bank to confirm that they would have no impact on its financial statements:

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. This amendment has been endorsed by the European Union on 23 December 2009.

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. This amendment has been endorsed by the European Union on19 July 2010.

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. This interpretation has been endorsed by the European Union on 23 July 2010.

Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14 (effective for annual periods beginning on or after 1 January 2011). This amendment will have a limited impact as it 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. This amendment has been endorsed by the European Union on 19 July 2010.

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.

The Bank is currently considering the implications of the standard. This new standard has not been endorsed by the European Union yet.

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. This amendment has not been endorsed yet by the EU.

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 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 2008) 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 2008); 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; and IFRIC 13 was amended to clarify measurement of fair value of award credits. These amendments have been endorsed by the European Union on 18 February 2011.

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. This amendment has not been endorsed yet by the EU.

Unless otherwise disclosed above, the amendments or standards are not expected to have a significant effect on financial statements of the Bank.

(b) Treatment of associated undertakings

Investments in associated undertakings are accounted for using the equity method of accounting and are initially recognised at cost. These are undertakings in which the Bank has between 20 percent and 50 percent of the voting rights, and over which the Bank exercises significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Equity accounting involves recognizing the Bank's share of the associate's profit or loss for the period in the profit or loss. The Bank's interest in the associate is carried in the balance sheet at an amount that reflects its share of net assets of the associate.

For summarised financial information on the associate Municipální finanční společnost a.s. accounted for using the equity method, see Note 3.15.

(c) Foreign Currencies

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions (Czech National Bank official rate).

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

All foreign exchange gains and losses recognised in the income statement are presented net in the income statement within 'Income from financial operations' or 'Expense on financial operations'.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available for sale, a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount, except impairment, are recognised in other comprehensive income.

(d) Financial assets and liabilities

In accordance with IAS 39, all financial assets and liabilities – which include derivative financial instruments – have to be recognised in the balance sheet and measured in accordance with their assigned category.

Financial assets

The Bank allocates financial assets to the following IAS 39 categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its financial instruments at initial recognition.

(a) Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. Bank's financial assets held for trading consist of debt instruments. These financial assets are recognised in the balance sheet as 'Financial assets held for trading'.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income

statement and are reported as ‘Income from financial operations’ or ‘Expense on financial operations’. Interest income on financial assets held for trading are included in 'Interest and similar income'. The instruments are derecognised when the rights to receive cash flows have expired or the Bank has transferred substantially all the risks and rewards of ownership and the transfer qualifies for derecognising.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consists of debt host and an embedded derivative that must otherwise be separated.

To reduce accounting mismatch, the fair value option is applied to certain debt securities that are hedged with cross-currency interest rate swaps but for which the hedge accounting conditions of IAS 39 are not fulfilled. The aim is to recognize the changes in the fair value of the security together with change in the fair value of the derivatives in the income statement.

Financial assets for which the fair value option is applied are recognised in the balance sheet as 'Financial assets designated at fair value'. Fair value changes relating to financial assets designated at fair value through profit or loss are recognised in 'Net gains on financial instruments designated at fair value through profit or loss’.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Bank includes in this category principally Loans originated by the Bank by providing money directly to a borrower.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Loans and receivables are reported in the balance sheet as loans and advances to banks or customers or as investment securities.

Interest on loans is included in the income statement and is reported as 'Interest and similar income'.

Preferential loans provided by the Bank

The Czech government and the Bank created various scheme to provide zero interest, low interest rate and subordinated loans to Czech enterprises that meet specified conditions (economic sectors supported by the Czech government or the European Union). The Bank participates partially on the funding of these loans, however, recognizes the full amount due from final recipient on its balance sheet in Loans and advances to customers. To compensate to the Bank for the below-market interest rate, the Bank receives from the funding partner the fees for managing the scheme, credit risk fee and the market interest rate agreed on a yearly basis for the Bank’s share on funding. Overall amount of these fees is recognized as interest income.

Based on the arrangements, the Bank is effectively able to transfer part of credit risk on these loans to the government (subject to certain limits). Such arrangement represent in substance a guarantee issued by the government. Once the loans are written-off due to credit quality deterioration in accordance with the Bank’s rules, the funds deposited

by the government for the provision of these loans (included in Amounts due to state institutions - see Note 3.18) are settled against this amount. The financial guarantee received is not separately recognized as a receivable and is being effectively part of the funds provided by the government.

Following collection of the receivable or its settlement against the programme funding when deemed uncollectible, the receivable is derecognized, the loss exceeding the contractually agreed portion of credit risk, if any, covered by the government in respect of loans with the programme would be settled by the Bank.

(c) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity, other than those that the Bank designates as available for sale and those that meet the definition of loans and receivables.

These financial assets are initially recognised at fair value including directly attributable and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method.

Interest on held-to-maturity investments is included in the income statement and reported as 'Interest and similar income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the investment and recognised in the income statement as 'Net gains/(losses) on financial operations'. No provisions on held-to-maturity investments had to be recognised either in 2010 or 2009.

(d) Available-for-sale financial assets

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognised at fair value plus transaction costs and measured subsequently at fair value with gains and losses being recognised in the statement of comprehensive income, except for impairment losses, until the financial asset is derecognised. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the statement of comprehensive income is recognised in the income statement.

However, interest calculated using the effective interest method, and foreign currency gains and losses on Bank's bonds classified as available for sale are recognised in the income statement.

(e) Recognition

The Bank uses settlement date accounting for regular way contracts when recording financial asset transactions. The settlement (collection) date is the day on which the financial instrument is delivered (cash payment). When settlement date accounting is applied, the financial asset is recognised on the day of receipt of a financial instrument (sending of cash) and derecognised on the day of its provision (collection of cash). In case of a portfolio of financial assets measured at fair value, changes in the fair value of the financial assets are recognized from the purchase trade date to the sale trade date. Accrued interest on debt financial assets is recognised from the purchase settlement date to the sale settlement date.

All loans and receivables are recognised when funds are provided to customers. Loans and receivables are derecognised when fully repaid by the borrower or written-off.

The Bank settles and derecognises financial liabilities at the date on which all related risks and costs attributable to the specific liability are transferred or settled.

Financial assets that are transferred to a third party but do not qualify for derecognition are presented in the balance sheet as 'Assets pledged as collateral', if the transferee has the right to sell or repledge them.

Financial liabilities

The Bank's holding in financial liabilities is comprised by financial liabilities at fair value through profit or loss (financial liabilities held for trading, i.e. financial derivatives and short sales), financial liabilities at amortised cost and hedging derivatives.

(a) Financial liabilities at fair value through profit or loss

In the Bank's case, this category comprises only financial derivatives held for trading and short sales. The Bank recognizes its financial derivatives in the category held for trading unless they are designated and effective as hedging instruments. These instruments are recognised in the balance sheet as 'Financial liabilities held for trading'.

Gains and losses arising from changes in fair value of financial liabilities classified as held for trading are included in the income statement and are reported as 'Net gains/(losses) on financial operations'.

(b) Other liabilities measured at amortised cost

Financial liabilities that are not classified as at fair value through profit or loss fall into this category and are measured at amortised cost. Financial liabilities measured at amortised cost are principally deposits and loans from banks or customers.

Determination of fair value

The best evidence of fair value are quoted prices in an active market. If the market for a financial instrument is not active, the entity establishes the fair value by using a valuation technique.

The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same and discounted cash flow analysis.

The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.

For more complex instruments, the Bank uses developed valuation models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market. All the inputs to these models are market observable.

The fair value of over-the-counter (OTC) derivatives is determined using valuation methods that are commonly accepted in the financial markets, such as present value techniques and option pricing models. The fair value of foreign exchange forwards is generally based on current forward exchange rates.

For the categorization of the financial instruments carried at fair value see Note 5.

Derecognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

Collateral (bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Bank retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

Reclassification of the financial assets

The Bank may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or available-for-sale categories if the Bank has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification. The Bank has not performed any of the reclassification or any type of other reclassifications between categories of the financial assets in 2010 or 2009.

(e) Offsetting financial instruments

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

(f) Interest and fee income and expenses

Interest income and expense are recognised in the profit and loss account for all interest bearing instruments on an accruals basis using the effective interest rate. Loan origination fees are included in the effective interest rate and are therefore reported in ‘Interest income’. Other fees and commissions are recognised in the period to which they relate on an accruals basis. Interest income includes interest income for all fixed income instruments.

As part of its activities, the Bank acts as an agent disbursing government's funds as subsidy of interest costs of the loans provided by the Czech state agency to the debtors that meet specified criteria. Therefore, the grant is not recognized on the balance sheet of the Bank. The Bank's services are: (i) it is a payment agent and (ii) the Bank processes paperwork, e.g. subsidy agreements on behalf of the government. The Bank obtains remuneration for the services provided of the agreed percentage of funds disbursed. This remuneration from the government partner is recognized as earned as it is calculated on annual basis based on the agreed contract with the provider of the assistance.

(g) Impairment of financial assets

(a) Assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The Bank regularly assesses its loan portfolio for impairment. As part of this analysis, the Bank splits all loans into two categories: non-performing loans, i.e., a larger than insignificant part of the principal and interest is past due for more than 90 days, and performing loans. If there is any objective evidence that a loan may be impaired (deterioration of a debtor's financial health, payment default, etc), the amortised cost of the loan is reduced through a provision to its estimated recoverable value. The recognition, use and release of provisions are accounted for on a monthly basis always by reference to the loan balances at the month-end. The provision is reduced if objective reasons for loan impairment cease to exist. In such cases, the original amount is reversed and a required provision is released. Provisions are used when loans are sold or written off. Provisions are released to income when the reasons for maintaining the provision cease to exist (for example, when the loan is repaid).

The Bank makes an estimate of realised losses on an individual basis for individually significant loans and on a portfolio basis for individually insignificant loans by reference to historical experience.

Management of the Bank uses estimates based on historical experience of losses on loans that have similar risk characteristics (that is, on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). 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. The methods and assumptions adopted in estimating amounts and the timing of future cash flows are regularly reviewed to reduce differences between the estimated and actual data.

The Bank writes off loss loans when it can be reasonably anticipated that clients will be unable to fulfil their obligations to the Bank in respect of these loans. Subsequent recoveries are credited to the income statement in the line 'Decrease/ increase in loan impairment and write-offs'.

For further information on credit risk refer to Note 4.1.

(b) Available for sale financial assets

The Bank performs regular assessments to determine whether available for sale financial assets suffered impairment. When a decline in the fair value of an available-for-sale financial asset has been recognised in other comprehensive income and there is objective evidence that the asset is impaired, the carrying amount of the impaired security is decreased directly and at the same time the cumulative loss that had been recognised in other comprehensive income is reclassified from equity to profit or loss line 'Net gains/ (losses) on financial operations' as a reclassification adjustment even though the financial asset has not been derecognised. The amount of this loss reflects the difference between the cost (less the repayments of principal and amortisation, if any) and the current fair value, reflecting previous impairment losses recognised in expenses.

(h) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in Due to banks or Due to customers, as appropriate.

Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

(i) Derivative financial instruments and hedging

In the normal course of business, the Bank enters into contracts for derivative financial instruments which represent a financial instrument that requires none or a very low initial investment. The derivative financial instruments used include interest rate and currency forwards and swaps. These financial instruments are held by the Bank in order to hedge interest rate risk and currency exposures associated with its transactions.

Derivative financial instruments are initially recognised at fair value and are subsequently remeasured to their fair value. Fair values are obtained from the discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

On the date a derivative contract is entered into, the Bank designates certain derivatives as an accounting hedge of the fair value of a recognised asset or liability (fair value hedge). Hedge accounting is used for derivatives and the hedged items designated in this way provided that certain criteria are met.

The Bank's criteria for a derivative instrument to be accounted for as an accounting hedge include:

(a) They meet the Bank's risk management strategy,
(b) At the inception of the hedge, the hedging relationship is formally documented, the documentation identifies the hedged item and the hedging instrument, defines the risk that is being hedged and the approach to establishing and documenting whether the hedge is effective, and
(c) The hedge is effective, that is, if, at inception and throughout the period, changes in the fair value of the hedged item are almost fully offset by changes in the fair value of the hedging instrument and the results are within a range of 80 percent to 125 percent.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk are recorded in profit or loss along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective element of the hedge is charged directly to profit or loss in line 'Income from financial operations' or 'Expense on financial operations'.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under 'Income from financial operations' or 'Expense on financial operations'.

(j) Provisions and financial guarantees obligations

Provisions for legal claims are recognised when the Bank has a present legal 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.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

Financial guarantee contracts

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

Bank provides two main types of financial guarantees:

- the financial guarantees to the small and medium enterprises in various preferential guarantee programmes in cooperation with the Czech state, and
- the financial guarantees in PANEL programme launched by the State Fund of Housing Development ("SFRB") in support of reconstruction and refurbishment of specific block of flats with the aim to improve their quality and lifetime.

Under the agreements concluded between the Bank and the Czech state or the Bank and SFRB, the Bank issues preferential financial guarantees for loans provided by third party banks. The difference between the full market price of the guarantee and the fee paid by client is funded by the Czech state (intermediating in some cases the programmes of the European Union) or by SFRB. The Bank immediately deducts such support funded by the Czech state whole in advance from the customer's bank account as its fee for the issued financial guarantee and these fees received are recognised in the income statement over the life of the guarantee. The terms and conditions of the financial guarantee contracts with related parties are described in Note 3.24.

In addition, the government refunds to the Bank losses on financial guarantees issued under the schemes up to the amount agreed in the contract between the Bank and the Czech state. For these purposes the amounts are deposited within special bank account for each guarantee provided and recognized as Amounts due to state institutions (see Note 3.18).

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for future premiums is recognised. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance with IAS 18, and the best estimate of the amount required to settle the guarantee (i.e. the amount determined in accordance with IAS 37 Provisions, Contingent liabilities and Contingent assets). Provisions for guarantees are made for estimated losses above the amounts deposited by the Czech state. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of the Bank's management. Risk category method applied by the Bank is considering the likelihood that an outflow will be required in settlement by considering the class of obligations (i.e. those arising from a certain type of the financial guarantees) as a whole. A provision is therefore recognised even if the likelihood of an outflow with respect to any specific item included in the same class of obligations may be small.

(k) Property, plant and equipment and intangible assets

Tangible and intangible assets are stated at historical cost less the accumulated depreciation and accumulated impairment losses. Fixed assets are depreciated through the accumulated depreciation charge. Depreciation is calculated on a straight line basis in order to write off the cost of each asset to their residual value over its estimated useful economic life. Assets in the course of construction are not depreciated.

The estimated useful economic lives are set out below:	
Machinery and equipment, computers, vehicles, software	4 years
Fixtures, fittings and equipment	10 years
Buildings and structures	30 years

The Bank periodically tests its assets for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount. Where assets are identified as being surplus to the Bank's requirements, management of the Bank determines a provision for asset impairment. In respect of the assets owned by the Bank, the provision is assessed by reference to a fair value based on third party valuation reports adjusted downwards for an estimate of associated sale costs. Leasehold assets are provisioned by reference to the net present value of future costs and the residual value of any technical improvements.

Repairs and renewals are charged directly to the income statement when the expenditure is incurred.

(l) Employee benefits

The Bank governs through internal guidelines provision of employee benefits. Some benefits are provided regularly to all employees (e.g. additional pension insurance); others are provided in relation to the actual need of an employee (e.g. loans).

Contributions are made to the government's retirement benefit scheme at the statutory rates in force during the year based on gross salary payments. The cost of social security payments is charged to the income statement in the same period as the related salary cost.

(m) Current and deferred income tax

Tax is calculated in accordance with the provisions of the relevant legislation of the Czech Republic based on the profit determined in accordance with the Czech Accounting Standards.

Deferred income tax is provided using the balance sheet liability method for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred income tax is determined using tax rates effective in the periods in which the temporary tax difference is expected to be realised. The principal temporary differences arise from specific allowances for loan losses and provisions for the guarantees and unrealised gains and losses from available for sale financial assets. Deferred tax assets in respect of tax losses carried forward and other temporary differences are recognised to the extent that it is probable that future taxable profit will be available against which the tax assets can be utilised.

Current and deferred tax are recognised as an expense or income in the income statement, except for the deferred tax effects related to fair value re-measurement of available-for-sale investments. As the fair value re-measurement is recognised in other comprehensive income, deferred tax is also recognised in the other comprehensive income and subsequently reclassified to the income statement together with the gain or loss on derecognition.

Notes to the financial statements for the year ended 31 December 2010

(n) Share capital

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's general meeting of shareholders. Dividends for the year that are proposed or declared after the balance sheet date are disclosed in the subsequent events note.

(o) Subsequent Events

The effects of events which occurred between the balance sheet date and the date when the financial statements were authorised for issue are reflected in the financial statements in the event that these events provide further evidence of conditions which existed at the balance sheet date.

Where significant events occur subsequent to the balance sheet date prior to authorising the financial statements for issue which are indicative of conditions which arose subsequent to the balance sheet date, the effects of these events are disclosed but do not result in adjustments in the financial statements.

(p) Key Bank's management judgments and estimates

The presentation of financial statements in conformity with IFRS requires management of the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the reporting date and the reported amounts of revenues and expenses during the reporting period. These estimates, which specifically relate to the impairment of financial assets and provisions arising from the provided financial guarantees, are based on the information available as of the date of preparation of the financial statements and actual results could differ from those estimates.

Impairment losses on loans to customers and provisions for financial guarantees

Management uses estimates based on historical loss experience for assets and financial guarantees with credit risk characteristics 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. Should the estimated percentages of the impairment provisions divert from the current management estimate by +/-1 %, the impairment loss is to be estimated CZK 71,000,000 higher/lower.

Deferred income taxes

The deferred tax assets recognised at 31 December 2010 and 31 December 2009 have been based on the best management estimate of the recovery of the deferred tax asset over a five year horizon. In the event of changes to the assumptions underlying these estimates, the tax assets recognised may be adjusted. Were the actual final outcome (on the judgement areas) to differ by 10 % from management's estimates, the Bank would need to increase the deferred income tax asset by CZK 6 million if favourable; or decrease the deferred tax asset by the same amount if unfavourable.

Impact of the global economic crisis

The global economic crisis, its acceleration and resulting market turbulence increase the risk that the actual results and outcomes may significantly differ from these estimates. Key areas with a potential for significant differences between the actual results and the estimates principally include loan provisioning and provisions for the guarantees. Information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are disclosed in individual notes as appropriate.

Management of the Bank has determined these estimates and assumptions by reference to the relevant information available to it.

3/ Additional information to balance sheet and income statement items

3.1. Interest income

CZKm	2010	2009
Interest income on loans and advances to banks	113	303
Interest income on loans and advances to customers	427	491
Interest on loans granted to the Czech state	772	940
Interest on debt securities	714	709
- held for trading	12	7
- designated at fair value through profit or loss	37	12
- available for sale	462	514
- held to maturity	203	176
Interest income	**2,026**	**2,443**
Interest on amounts due to banks	(585)	(782)
Interest on deposits due to customers	(38)	(81)
Interest on deposits from the Czech state	(298)	(498)
Interest from unwinding discounts on provisions (Note 3.6)	(76)	(87)
Interest expenses	**(997)**	**(1,448)**
Net interest income	**1,029**	**995**

3.2. Fee and commission income

CZKm	2010	2009
Fees from financial guarantees	749	563
Credit related fees and commissions	41	57
Fees and commissions from payment transactions	58	69
Fee and commission income	**848**	**689**
Fee and commission expense from trading activities	(10)	(6)
Fee and commission expense	**(10)**	**(6)**
Net fee and commission income	**838**	**683**

3.3 Income and expenses from financial operation

CZKm	2010	2009
Gains and (losses) on securities	69	28
- available for sale	53	19
- amounts reclassified from other comprehensive income at sale of securities	48	5
- impairment losses on available for sale securities	4	(16)
- changes in fair value of the hedged available for sale securities	1	30
- changes in fair value of the held for trading securities	9	(7)
- changes in fair value of the securities designated at fair value through profit or loss	3	16
- gain/ (loss) from sale of held to maturity securities	3	-
- gain/ (loss) from revaluation of short sales	1	-
Net gain/(loss) on derivatives held for trading	(108)	(51)
Net losses on hedging derivatives	(307)	(257)
Exchange differences (including also exchange differences on available for sale and held to maturity securities)	195	113
Total income and expenses on financial operations	**(151)**	**(167)**

Net losses on hedging instruments of CZK 307,000,000 (2009: CZK 257,000,000) are due to high hedge accounting effectiveness almost fully compensated in the income statement in lines "Exchange differences" in case of the foreign currency risk hedging and in "Interest income" and "Interest expense" in case of interest rate risk hedging. The overall accounting hedge ineffectiveness amounts to CZK 0 in 2010 (2009: CZK 1 million in 2009).

3.4. Administrative expenses

CZKm	2010	2009
Wages, salaries and bonuses	(164)	(165)
Social security costs	(49)	(45)
of which: state pension scheme contributions	(36)	(32)
Total personnel expenses	**(213)**	**(210)**
General administrative expenses	(130)	(142)
Total administrative expenses	**(343)**	**(352)**

Wages, salaries and key management compensations:

CZKm	2010	2009
Wages and salaries of the Bank's employees	(104)	(108)
Key management personnel compensation	(44)	(43)
- wages and salaries of the Bank's management	(36)	(36)
- compensations to Board of Directors members	(6)	(6)
- compensations to Supervisory Board members	(1)	(1)
- compensation to Audit committee	(1)	-
Other employees' expenses	(9)	(8)
Directors' fees	(1)	(1)
Social fund expenditures	(6)	(5)
Total wages, salaries and bonuses	**(164)**	**(165)**

Staff Analysis

	2010	2009
Number of members of the Supervisory Board	9	9
Average number of the Bank's management	23	23
- of which: number of members of the Board of Directors	5	5
Average total number of Bank's employees	**198**	**197**

Other administrative expenses comprise:

CZKm	2010	2009
General administrative expenses	(79)	(81)
Rental charges	(11)	(11)
Audit, legal and tax advisory services	(7)	(9)
Depreciation and amortisation	(33)	(41)
Total other administrative expenses	**(130)**	**(142)**

3.5. Increase in loan impairment and write-offs

Overall charge for the loan impairment can be analyzed as follows:

31 December 2010

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions to loan impairment allowances	(108)	(19)	(127)
Receivables written-off during the year not fully provided for	(8)	-	(8)
Additions to allowances to other assets	(1)	-	(1)
Total increase in loan impairment allowances and write-offs	**(117)**	**(19)**	**(136)**

31 December 2009

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions to loan impairment allowances	(205)	(37)	(242)
Receivables written-off during the year not fully provided for	(20)	-	(20)
Income received on claims previously written off	(1)	-	(1)
Total increase in loan impairment allowances and write-offs	**(226)**	**(37)**	**(263)**

Reconciliation of the allowance account for impairment:

Year ended 31 December 2010

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2010	**1,280**	**213**	**1,493**
Additions to impairment allowances	112	19	131
Use of the allowances for write-offs	(48)	-	(48)
Balance at 31 December 2010	**1,344**	**232**	**1,576**

Year ended 31 December 2009

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2009	**1,121**	**176**	**1,297**
Additions to impairment allowances	206	37	243
Use of the allowances for write-offs	(47)	-	(47)
Balance at 31 December 2009	**1,280**	**213**	**1,493**

3.6. Provisions for guarantees and other provisions

The balance of provisions for guarantees and other provisions comprises:

CZKm	31 December 2010	31 December 2009
Provisions for guarantees (Note 3.22)	2,115	1,984
Provisions for loan commitments (Note 3.22)	39	25
Other provisions	123	-
Total provisions	**2,277**	**2,009**

Reconciliation of the provisions for guarantees and other provisions:

CZKm	2010	2009
Balance at 1 January	**2,009**	**1,969**
Increase/(decrease) in provisions for guarantees and loan commitments	104	(47)
Increase in other provisions	88	-
Interest expense from unwinding of discounts	76	87
Balance at 31 December	**2,277**	**2,009**

3.7. Income taxes

CZKm	2010	2009
Profit before income tax	**1,055**	**952**
Theoretical tax calculated at a statutory income tax rate 2010: 19 % (2009: 20 %)	200	190
Non-taxable income from securities – permanent difference	9	(15)
Effect of non-recognized contingent deferred tax asset	(12)	(42)
Other permanent items	2	2
Income tax expense as reported in the income statement	**199**	**135**
- current	206	179
- deferred	(7)	(44)
Income tax paid during the year	146	138
Current income tax asset/(liability) at 31 December	(60)	(41)
Effective tax rate	**19 %**	**14 %**

Deferred taxation

The recognised deferred tax asset can be analysed as follows:

CZKm	31 December 2010	31 December 2009
Provisions for guarantees	42	64
Other provisions	34	5
Deferred tax recognised in other comprehensive income for revaluation of available for sale securities	(35)	(24)
Total deferred tax asset	**41**	**45**
Deferred tax asset balance at 1 January	**45**	**39**
Movement through income statement	7	44
Movement in deferred tax recognised in other comprehensive income for revaluation of available for sale assets	(11)	(38)
Deferred tax asset balance at 31 December	**41**	**45**

The deferred tax asset is calculated at the statutory income tax rate of 19 % (31 December 2009: 19 %), which is a statutory income tax rate enacted for the period, when the Bank anticipates realising the temporary differences.

An additional contingent deferred tax asset of CZK 100,000,000 as at 31 December 2010 (31 December 2009: CZK 95,000,000) has not been recognised as it is not probable that it will be utilized in the future given the structure of the provided financial guarantees, and existing tax rules.

3.8. Cash and balances with central banks

CZKm	31 December 2010	31 December 2009
Obligatory minimum reserves	76	854
Cash in hand	8	9
Amounts due under reverse repo transactions	10,502	16,723
Total cash in hand and balances with central banks	**10,586**	**17,586**

Obligatory minimum reserves represent mandatory deposits with the Czech National Bank.

3.9. Loans and advances to banks

CZKm	31 December 2010	31 December 2009
Current accounts with other banks	3	4
Term deposits with banks	413	298
Amounts due under reverse repo transactions	1,834	300
Included in cash and cash equivalents (Note 3.21.)	2,250	602
Other amounts due from banks	82	-
Unquoted bank bonds classified as loans	206	206
Total loans and advances to banks	**2,538**	**808**

All the amounts due from banks are unimpaired exposures before due date and no provisions are recognized. As the majority of the balances are collateralized exposures with local Czech banks under reverse repo transactions, the credit quality of the balances is not further analyzed in these financial statements.

3.10. Securities at fair value through profit or loss

CZKm	31 December 2010	31 December 2009
Government bonds	324	559
Total securities held for trading	**324**	**559**
Government bonds - domestic	154	112
Government bonds - foreign	318	-
Bonds issued by financial institutions in the Czech Republic	501	134
Bonds issued by other entities in the Czech Republic	301	312
Total securities designated at fair value through profit or loss	**1,274**	**558**
Total securities at fair value through profit or loss	**1,598**	**1,117**

3.11. Loans and advances to customers

CZKm	31 December 2010	31 December 2009
Loans to private legal entities and individuals	7,068	6,626
Loans to the Ministry of Finance of the Czech Republic and other government entities	13,959	16,462
Loans to municipalities	1,172	1,209
Unquoted debt securities	150	-
Gross amounts due from customers	**22,349**	**24,297**
Provisions for loans to customers (Note 3.5)	(1,573)	(1,491)
Net amounts due from customers	**20,776**	**22,806**

Loans to the Ministry of Finance represent principally the loans provided in connection with infrastructure programmes which were transferred to the Bank from Konsolidační banka Praha on 31 December 2000. These programmes are principally targeted at funding the construction of the highway network, repairs of international roads, removal of flood damage and water sector investments. The funding of these programmes was provided by the European Investment Bank (Note 3.17) and is denominated also in EUR. The Bank entered into fix-to-fix cross currency swap hedge accounting transaction to cover the associated foreign currency risk (Note 4.2.2).

Set out below is the currency structure of the outstanding infrastructure loan principal amounts on the side of assets and liabilities (Note 3.17):

	31 December 2010		31 December 2009	
	Assets	Liabilities	Assets	Liabilities
	CZKm	CZKm	CZKm	CZKm
CZK – principal	8,415	6,421	10,365	7,191
CZK – accrued interest	153	4	174	6
EUR – principal	5,547	7,107	5,886	8,510
EUR – accrued interest	3	96	4	113
USD – principal	-	-	6	6
Fair value hedge remeasurement	(474)	(690)	(18)	(299)
Total	**13,644**	**12,938**	**16,417**	**15,527**

The IFRS 7 disclosures per classes of the loans and advances to customers are made in the credit risk section in Note 4.1 and reconciliation of changes in the allowance account during the period for each class of the loans and advances to customers is disclosed in Note 3.5.

3.12. Securities available for sale

Available for sale securities comprise:

CZKm	31 December 2010	31 December 2009
Fixed income debt securities	7,234	5,655
Variable yield debt securities	5,903	5,700
Treasury bills (zero coupon)	3,979	2,767
Total debt securities available for sale	**17,116**	**14,122**

As of 31 December 2010, the available for sale portfolio included securities at a fair value of CZK 17,116,000,000 (2009: CZK 13,853,000,000) that were publicly traded on stock exchanges and securities at a fair value of CZK 0 (2009: CZK 269,000,000) that were not publicly traded securities. Available for sale securities are denominated in various currencies and the currency risk is hedged (see Note 4.3).

Available for sale securities at fair value of CZK 1,860,000,000 (2009: CZK 739,000,000) were pledged as collateral to third parties in sale and repurchase agreements to provide security over the money borrowed. These assets have been reclassified as pledged assets on the face of the balance sheet as the borrower possessing the collateral has the right to re-pledge it or sell, however also has an obligation to return it.

Debt securities available for sale comprise:

CZKm	31 December 2010	31 December 2009
Debt securities available for sale issued by:		
- State institutions in the Czech Republic	14,240	10,099
- Financial institutions in the Czech Republic	1,300	1,076
- Other entities in the Czech Republic	158	451
- Foreign financial institutions	1,079	2,150
- Other foreign entities	339	346
Total debt securities available for sale	**17,116**	**14,122**

3.13. Securities held to maturity

Held to maturity securities, analysed by issuer, comprise:

CZKm	31 December 2010	31 December 2009
State institutions in the Czech Republic	4,050	5,092
Other entities in the Czech Republic	1,055	122
Total debt securities held to maturity	**5,105**	**5,214**

Held to maturity securities are denominated in various currencies (see also Note 4.3). Held to maturity securities comprise only securities generating fixed income.

3.14. Other assets

CZKm	31 December 2010	31 December 2009
Financial assets		
Accrued income	66	89
Receivables from unsettled transactions with securities	1	8
Non-financial assets		
Prepaid expenses	13	5
Other	14	12
Total other assets, gross	**94**	**114**
Impairment provisions	(3)	(2)
Total other assets, net	**91**	**112**

3.15. Investments in associate

The financial statements include an investment in the associate, Municipální finanční společnost a.s., accounted for using the equity method, with its registered office address at Jeruzalémská 4, Prague 1 ('MUFIS'), key details of which are set out below.

The Bank formed MUFIS, a wholly owned subsidiary with share capital of CZK 1,000,000 in 1994. In 1995, the Bank disposed of 51 percent of the issued share capital, and holds a 49 percent investment in MUFIS at 31 December 2010 and 31 December 2009.

Shareholders' structure	31 December 2010	31 December 2009
ČMZRB	49 %	49 %
Ministry of Finance	49 %	49 %
Association of Czech Municipalities	2 %	2 %

MUFIS acts as the official broker and administrator of long-term funding obtained on the basis of an agreement with USAID from private US investors. This funding is designed to finance the infrastructure projects of municipalities. The ultimate beneficiaries were provided with the funding following an assessment of their business plans, through a selected number of commercial banks which act as MUFIS's debtors. Following preparatory negotiations with US investors and Czech institutions, MUFIS began to implement the programme in early 1995. As of 31 December 2010, MUFIS works with programme funding amounting to USD 5,000,000. The Bank signed on 27 August 2009 with MUFIS an agreement on the cooperation within area of financing infrastructure projects for municipalities in the Czech Republic.

Summary financial information in CZKm	Equity	The Bank's share on equity	Total assets	Profit after tax	The Bank's share of profit
At 31 December 2010 and for the year then ended	187	92	299	18	9
At 31 December 2009 and for the year then ended	170	83	351	18	9

3.16. Property, plant and equipment

CZKm	Land	Buildings	Equipment and fittings	Assets under construction	Total
At 1 January 2009					
Acquisition cost	10	303	160	2	475
Accumulated depreciation	-	(130)	(151)	-	(281)
Net book value	**10**	**173**	**9**	**2**	**194**
Year ended 31 December 2009					
Opening net book value	10	173	9	2	194
Additions	-	1	16	15	32
Disposals	-	-	-	(17)	(17)
Depreciation charge	-	(12)	(12)	-	(24)
Closing net book value	**10**	**162**	**13**	**-**	**185**
At 31 December 2009					
Acquisition cost	10	304	124	-	438
Accumulated depreciation	-	(142)	(111)	-	(253)
Net book value	**10**	**162**	**13**	**-**	**185**
Year ended 31 December 2010					
Opening net book value	10	162	13	-	185
Additions	-	-	6	6	12
Disposals	-	-	-	(6)	(6)
Depreciation charge	-	(11)	(9)	-	(20)
Closing net book value	**10**	**151**	**10**	**-**	**171**
At 31 December 2010					
Acquisition cost	10	304	125	-	439
Accumulated depreciation	-	(153)	(115)	-	(268)
Net book value	**10**	**151**	**10**	**-**	**171**

3.17. Amounts due to bank

CZKm	31 December 2010	31 December 2009
Due to other banks	17,651	18,761
Received term deposits from other banks	1,257	2,341
Amounts due to banks	**18,908**	**21,102**

Amounts due to other banks includes principally the payables to the development banks (European Investment Bank, Kreditanstalt für Wiederaufbau, Nordic Investment Bank and Council of Europe Bank) of CZK 14,597,000,000 at 31 December 2010 (31 December 2009: CZK 17,319,000,000), majority of which represents a funding for infrastructure loans described in Note 3.11.

3.18. Amounts due to customers

Amounts due to customers, by type of deposit, comprise:

CZKm	31 December 2010	31 December 2009
Current accounts	7,382	7,714
Term deposits	12,253	14,948
Repo operations with the Ministry of Finance	5,136	4,762
Security deposits	24	31
Other payables to clients	2,281	2,139
Total	**27,076**	**29,594**

Amounts due to customers, by type of customer, comprise:

CZKm	31 December 2010	31 December 2009
Amounts owed to state institutions	23,494	25,832
Amounts owed to local government institutions	44	38
Payables to other customers	3,538	3,724
Total amounts due to customers	**27,076**	**29,594**

The 'Amounts owed to state institutions' line includes, inter alia, payables comprising funding and funds to cover risks attached to the guarantee support programmes provided by the Bank (Note 2 d and 2 j):

CZKm	31 December 2010	31 December 2009
Funding from the providers of the individual support programmes not yet returned	2,228	2,057
Funds deposited by the programme partners to cover risks attached to providing the financial guarantees	3,295	2,437

3.19. Accruals and other liabilities

CZKm	31 December 2010	31 December 2009
Payable to employees	39	40
Deferred income	2,205	2,062
- financial guarantees premium deferred income	2,170	2,025
- other deferred income	35	37
Accrued expenses (financial liability)	26	27
Amount payable to Ministry for Regional Development with respect to intermediation of the support programme (financial liability)	231	206
Dividends declared and payable (Note 3.20)	401	394
Other	45	38
Total accruals and other liabilities	**2,947**	**2,767**

3.20. Equity and profit allocation

Share capital

	31 December 2010	31 December 2009
8,900 shares with a nominal value of CZK 239,500	2,132	2,132

The shares are registered and issued in book-entry form.

The Bank's shareholders and their ownership interests as of 31 December 2010 and 2009 are set out below:

Shareholder	2010 %	2009 %
Ministry of Industry and Trade	24.25	24.25
Ministry for Regional Development	24.25	24.25
Ministry of Finance	23.83	23.83
Czech state total shareholding	**72,33**	**72,33**
Komerční banka, a.s.	13.00	13.00
Česká spořitelna, a.s.	13.00	13.00
Československá obchodní banka, a.s.	1.67	1.67
Other shareholders (Banks)	**27,67**	**27,67**
Total	**100.00**	**100.00**

Profit Allocation

The statutory net profit of the Bank as recognized in accordance with Czech accounting standards for the year ended 31 December 2010 is proposed to be allocated and net profit for 2009 of the Bank was allocated as follows:

CZKm	2010	2009
Allocated to retained earnings	171	163
Dividends payable/paid	683	652
Net profit per statutory financial statements	**854**	**815**

Following the decision of the general meeting of the Bank, dividends payable to the Ministry of Industry and Trade, Ministry for Regional Development and Ministry of Finance from 2009 net profit in the total amount of CZK 401,000,000 were paid on 4 January 2011 (2009: CZK 394,000,000, paid on 5 January 2010) and are included as Dividends declared and payable in Accruals and other liabilities (Note 3.19).

Revaluation reserve

The revaluation reserve shows the effects from the fair value measurement of financial instruments of the category available for sale after deduction of deferred taxes. Any gains or losses are not recognised in the consolidated income statement until the asset has been sold or impaired.

Retained earnings and statutory and other reserves

Retained earnings consist of undistributed profits from previous years. Statutory reserve consists of CZK 800,000,000, which has to be set aside in accordance with national law and internally created revenue reserve of CZK 350,000,000.

3.21. Cash and cash equivalents

CZKm	31 December 2010	31 December 2009
Cash and balances with central banks (Note 3.8.)	10,586	17,586
Loans and advances to banks (Note 3.9.)	2,250	602
Total	**12,836**	**18,188**

Cash and cash equivalents comprise balances with less than three months' original maturity, including cash in hand, deposits held at call with banks and other short-term highly liquid investments.

In the 2009 financial statements the Bank did not classify reverse repo transactions with central bank and other banks as cash and cash equivalents. The amounts as at 31 December 2009 and 31 December 2008 were CZK 17,321,000,000 and CZK 29,272,000,000 respectively. In the 2010 financial statements these balances have been classified as cash and cash equivalents. Conversely, short term Treasury Bills with original maturity of 3 months and above of CZK 799,000,000 on 31 December 2009 (2008: CZK 2,489,000,000) were excluded from the cash and cash equivalents in these financial statements. As a result the decrease in cash and cash equivalents in 2009 presented in the financial statements is CZK 11,192,000,000. The decrease previously reported for 2009 was CZK 931,000,000.

3.22. Financial guarantees and loan commitments

Commitments to extend loans and financial guarantees for loans to third parties expose the Bank to credit risk and loss in the event that the client fails to comply with contractual conditions.

CZKm	31 December 2010	31 December 2009
Total issued financial guarantees	23,649	18,564
Loan commitments issued to clients	2,154	1,724
Total financial guarantees and loan commitments	**25,803**	**20,288**

In conducting repo and reverse repo transactions, the Bank uses government bonds. Receivables from reverse repo transactions are included in amounts due from banks (Note 3.9). Payables from repo transactions are included in amounts due to customers (Note 3.18). The securities received under reverse repo transactions are not recognized on the balance sheet, but the Bank has the right to re-pledge it or sell, however it also has an obligation to return it. Fair value of the securities held under reverse repo transactions was CZK 12,131,000,000 at 31 December 2010 (31 December 2009: CZK 16,835,000,000).

3.23. Legal contingencies

On 21 February 2002, the Bank was named as a defendant in a legal dispute initiated by AO Invest, spol. s r. o., in respect of compensation of a damage of CZK 238,000,000. The plaintiff alleges that the claimed damage was incurred with regard to the mediated purchase of 1,050 bonds of ZPS, a. s. The legal dispute was halted due to AO Invest, spol. s r. o., being declared bankrupt. The legal dispute is currently being conducted against the bankruptcy trustee of AO Invest. During 2008, the litigated amount decreased to CZK 138,000,000 as a result of the plaintiff withdrawing the claim for compensation of CZK 100,000,000. At the end of 2008, the bankruptcy trustee sold the receivable, which is subject to the legal dispute, to MISORA HOLDINGS Limited, incorporated in British Virgin Islands. No decision has yet been taken regarding the involvement of this entity in the legal dispute. The legal dispute has not yet been completed and it is highly difficult to predict the development for the Bank, nor can the reliable estimate of the outflow of economic benefits be made.

3.24. Related party disclosures

Related parties of the Bank comprise:

1/ The Czech state. Dividend allocations are described in Note 3.20 and income taxes in Note 3.7.
2/ the associated undertaking MUFIS, with which the Bank entered into derivative transactions concluded in the normal course of business - see Note 4.2.2 for the detail of the balances;
3/ key management personnel (being defined as Board of Directors, Supervisory Board and Bank's senior management) - for the detail of the expenses see Note 3.4; and
4/ entities controlled by the same controlling entity, i.e. by the Czech state.

The balances from related-party transactions with the Czech state and entities controlled by the same controlling entity (in the table below - "Other related parties") at the balance sheet date, related expense and income for the year (except for the income taxes and dividends) and off-balance sheet exposures are as follows:

CZKm	31 December 2010	31 December 2009
Assets	**35,091**	**32,243**
Czech state	33,633	31,865
Other related parties	1,458	378
Liabilities	**24,293**	**26,668**
Czech state	14,092	15,846
Other related parties	10,201	10,822
Revenues	**1,485**	**1,641**
Czech state	1,343	1,470
Other related parties	142	171
Expenses	**290**	**519**
Czech state	38	84
Other related parties	252	435
Collaterals provided under repo transactions and other off-balance sheet assets in the normal course of business	**6,220**	**5,940**
Czech state	5,115	4,764
Other related parties	1,105	1,176
Collaterals received under reverse repo transactions and other off-balance sheet liabilities in the normal course of business	**271**	**343**
Czech state	24	34
Other related parties	247	309

A number of banking transactions are entered into with related parties in the normal course of business. These include current accounts, loans, deposits and securities issued by these entities and provided collaterals and loan commitments.

In PANEL guarantee programme the Bank receives from SFRB a fee of 1.5 % p.a. of the guaranteed balance amount which is included in Fee and commission income of CZK 69,000,000 (2009: 84,000,000).

Revenues from the Czech state include also interest income (see Note 3.1) from the infrastructure loans taken over from the Ministry of Finance. For details of the transaction see Note 3.11.

Terms and conditions of the related party transactions - average effective interest rates

The table below provides average interest rates of significant items of related parties assets and liabilities as of 31 December 2010 and 2009.

	31 December 2010	31 December 2009
Assets		
Loans to customers	5.02 %	5.14 %
Available for sale securities	2.37 %	3.74 %
Securities at fair value through profit or loss	4.88 %	3.56 %
Securities held to maturity	4.00 %	3.74 %
Liabilities		
Amounts due to customers	1.16 %	2.09 %

4/ Risk management and financial instruments

4.1. Credit risk

4.1.1. Risk management method

Credit rating of amounts due from customers and banks

The credit rating of the enterprises that are small and medium-sized businesses, municipalities, water management enterprises, housing associations and associations of owners of housing units, and non-profit organisations is undertaken in accordance with the Bank's internal regulations and involves assessing the borrower's credit worthiness on the basis of an analysis of economic and other aspects. The assessment of other than economic aspects involves analysing external and internal factors that impact the client's activities and operations. The economic assessment focuses on undertaking a financial analysis of economic indicators and additional information. Credit worthiness is evaluated in relation to each transaction that carries an element of credit risk; credit risk exposure and the ratings are periodically assessed over the whole life of the loan transaction. Credit risk is expressed by assigning the borrower the relevant risk category. Credit risk exposure involved in a specific transaction is controlled by establishing contractual conditions and obtaining collateral in support of the transaction.

The monitoring of rating and credit risk involves assessing the following criteria (at minimum):

- Current financial and economic situation of the clients;
- Compliance with contractual terms, specifically reviews of the repayments of loan principal and interest amounts, payment of the fee for the provision of a guarantee, contractual penalties and charges, provision of information to the Bank, and balances on the client's bank accounts;
- Restructuring;
- External factors, primarily economic, political and legal;
- Loan analysts quarterly monitor the development of selected data and information for the monitoring of all clients as part of a client's financial analysis;
- Staff of the Risky Transactions Department monitor the records of clients in bankruptcy, settlement and liquidation on an ongoing basis, with regular weekly checks;
- Staff of business units monitor, on a monthly basis, the summary of clients for which the central loan register indicates that they have past due receivables.

Measuring credit risk of the portfolio

The Bank uses the following techniques to measure risks inherent in the loan and guarantee portfolio:

The method of quantified losses on the portfolio of loans and guarantees exposures compares the total quantified losses of doubtful and loss receivables with the redemption of these exposures. The quantification of losses also reflects the current balances of substandard exposures adjusted by an empirical and well-established coefficient which represents an estimate of the default rate of exposures in this category.

The weighted risk exposure method compares the weighted risk exposure with the original contractual amount of the loans (the balance of the actual loan draw-down) and guarantees. The weighted risk exposure consists of the sum of recorded provisions, the sum of receivables written-off, the sum of outstanding principal, the sum of outstanding interest and the sum of outstanding contractual penalties on client accounts, segmented by individual years of the portfolio's duration.

The risk category method compares quantified losses with the original contractual value of the loans or guarantees.

The incurred loss method is derived from calculated probabilities of individually unidentified default on individual internal risk categories described below and loss given default for specified type of exposures (loans, loans granted within the water infrastructure support programme and guarantees).

Risk categories

The Bank has risk (internal rating) categories 4 to 10, which are linked to the Czech National Bank's risk categories: standard loans 4, 5 and 6, watch 7, substandard 8, doubtful 9 and loss 10.

Credit enhancement

In the course of its lending and guarantees business, the Bank accepts movable and immovable assets pledged as collateral. This fact is also considered in calculation of the impairment provisions. The Bank also uses various forms of guarantee statements to collateralise its loan receivables.

Movable and immovable asset collateral is recorded in operating records and is valued on the basis of an appraisal prepared by a licensed appraiser (nominal value of collateral). The Bank centrally revalues real estate collateral to market values every two years on the basis of pricing maps prepared by an external agency. Collaterals provided by individuals and legal entities and bills of exchange are recorded in operating records and are valued at estimated values provided by the Bank's internal regulation.

The recoverable value of collateral takes into account both the cost of recovering collateral and the time value of money.

If the borrower's receivable is past due by more than 360 days, the Bank does not attribute any value to the collateral, since the historical evidence proves negligible workouts from such collaterals.

Recovery of Amounts due from Borrowers

The Bank recovers due receivables arising from bank guarantees and loans through its internal debt work-out system by using all statutory recovery instruments available according to generally applicable legal regulations. With a view to expediting the recovery process, the Bank has employed an arbitration clause in respect of loan contracts and enforceable notarial and distrainer deeds.

Risk Concentration

Economic sector risk concentrations

The Bank principally monitors risk concentrations in the area of loans issued to small and medium-sized businesses and receivables arising primarily from water management loans. These risks are periodically monitored and reassessed at least on an annual basis. Credit risk limits are approved by the Board of Directors. This concentration translates into the definition of the classes of the loans to customers.

Geographical concentrations

Although the Bank performs its key activities in the Czech Republic, some investments in securities are done also outside of the Czech Republic. For the geographical concentrations see Note 4.1 b.

Credit risk of other financial assets

Generally, in accordance with its internal regulations, the Bank defines eligible financial instruments for its investments. These principally involve deposits, bonds (mortgage bonds, CZK bonds, EUR bonds, and other foreign currency bonds) and derivatives (FX FWD, FX SWAP, CCS, IRS, Euro Bond Futures).

Credit assessment of counterparties and issuers involves analysing the borrower's solvency on the basis of credit ratings published by internationally recognised rating agencies and evaluating economic and other aspects. The solvency of counterparties and issuers is periodically assessed over the whole life of the commercial loan transaction.

4.1.2. Credit risk – quantitative disclosures

aa) Quality of amounts due from customers

Information about the credit quality of financial assets that are neither past due nor impaired

31 December 2010

	Risk category							
CZKm **Classes of financial assets**	**4,5**	**6**	**7**	**8**	**9**	**10**	**Not specified**	**Total**
Loans to private legal entities and individuals	456	1,992	335	72	1	8	235	3,099
Loans to the Ministry of Finance of the Czech Republic and other government entities	13,959	-	-	-	-	-	-	13,959
Loans to municipalities	27	303	-	-	-	-	-	330
Total	**14,442**	**2,295**	**335**	**72**	**1**	**8**	**235**	**17,388**

31 December 2009

	Risk category							
CZKm **Classes of financial assets**	**4,5**	**6**	**7**	**8**	**9**	**10**	**Not specified**	**Total**
Loans to private legal entities and individuals	634	2,299	417	-	-	-	181	3,531
Loans to the Ministry of Finance of the Czech Republic and other government entities	16,462	-	-	-	-	-	-	16,462
Loans to municipalities	76	437	-	-	-	-	-	513
Total	**17,172**	**2,736**	**417**	**-**	**-**	**-**	**181**	**20,506**

Analysis of financial assets that are individually determined to be impaired

31 December 2010

	Risk category							
CZKm **Classes of financial assets**	**4,5**	**6**	**7**	**8**	**9**	**10**	**Not specified**	**Total**
Loans to private legal entities and individuals	-	-	2,443	500	412	655	109	4,119
Loans to the Ministry of Finance of the Czech Republic and other government entities	-	-	-	-	-	-	-	-
Loans to municipalities	-	-	598	181	63	-	-	842
Total	**-**	**-**	**3,041**	**681**	**475**	**655**	**109**	**4,961**

31 December 2009

CZKm Classes of financial assets	Risk category 4,5	6	7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	-	-	1,537	588	427	526	17	3,095
Loans to the Ministry of Finance of the Czech Republic and other government entities	-	-	-	-	-	-	-	-
Loans to municipalities	-	-	530	51	115	-	-	696
Total	**-**	**-**	**2,067**	**639**	**542**	**526**	**17**	**3,791**

Analysis by internal rating

The loans to clients as of 31 December 2010 comprise the following, broken down by classification:

CZKm	31 December 2010	31 December 2009
Standard	16,948	20,079
Watch	3,394	2,496
Substandard	762	639
Doubtful	475	540
Loss	770	542
Total	**22,349**	**24,296**
Impairment provision for loans to customers (Note 3.5)	(1,573)	(1,491)
Net amounts due from customers	**20,776**	**22,806**

Analysis of provisions by risk category

CZKm Risk category		31 December 2010 Type of provision Individual	Portfolio	31 December 2009 Type of provision Individual	Portfolio
4 – 6	Standard	-	115	-	122
7	Watch	398	60	284	74
8	Sub-standard	220	-	209	-
9	Doubtful	286	-	366	-
10	Loss	494	-	436	-
Total		**1,398**	**175**	**1,295**	**196**
Total provisions		**1,573**		**1,491**	

Analysis by collateral

The loan portfolio as of 31 December 2010 and 2009 comprises the following, broken down by type of collateral:

CZKm	31 December 2010	31 December 2009
Bank guarantees and collateral by reliable guarantors	35	47
Cash collateral	30	38
Real estate collateral	1,923	1,821
Other loan collateral	382	158
Uncollateralised	19,979	22,232
Total	**22,349**	**24,296**
Impairment provision for loans to customers (Note 3.5)	(1,573)	(1,491)
Net amounts due from customers	**20,776**	**22,806**

Notes to the financial statements for the year ended 31 December 2010

Renegotiated loans to customers

CZKm	31 December 2010	31 December 2009
Loans to private legal entities and individuals	179	444

Aging analysis of loans past due which are not classified as individually impaired

31 December 2010 and 2009

CZKm	Past due 30 days	Past due 30 – 60 days	Past due 60 – 90 days	Past due 90 – 180 days
Loans to private legal entities and individuals	1	-	-	3
Total	**1**	**-**	**-**	**3**

Analysis of loans past due which are not classified as individually impaired, by collateral

31 December 2010 and 2009

CZKm	Bank guarantee and collateral by reliable guarantors	Collateral by pledged real estate	Uncollateralised
Loans to private legal entities and individuals	-	-	4
Total	**-**	**-**	**4**

ab) Quality of guarantees portfolio

31 December 2010 in CZKm

	Risk classification								
Programmes	**5**	**6**	**7**	**8**	**X9[1)]**	**9**	**10**	**No risk category ***	**Total**
Guarantees for small and medium sized enterprises provided until 2006	36	214	558	286	307	31	628	-	2,060
PANEL small portfolio guarantees	-	51	100	-	-	-	-	273	424
PANEL investment guarantees	2	1,462	4,685	528	86	-	1	16	6,780
Other previously provided guarantees	-	-	1	-	1	-	41	-	43
VADIUM	-	-	150	1	-	-	-	-	151
Small portfolio guarantees for businessmen since 2007	9	317	1,293	370	48	19	8	4,584	6,648
Investment and operating guarantees for small and medium sized enterprises since 2007	56	816	5,813	589	149	10	110	-	7,543
Total	**103**	**2,860**	**12,600**	**1,774**	**591**	**60**	**788**	**4,873**	**23,649**

* Portfolio approach

31 December 2009 in CZKm

	Risk classification								
Programmes	**5**	**6**	**7**	**8**	**X9[1)]**	**9**	**10**	**No risk category ***	**Total**
Guarantees for small and medium sized enterprises provided until 2006	55	393	808	437	455	32	720	-	2,900
PANEL small portfolio guarantees	-	5	17	-	-	-	-	227	249
PANEL investment guarantees	10	1,406	3,702	318	86	-	1	6	5,529
Other previously provided guarantees	-	-	6	-	3	-	46	-	55
VADIUM	-	-	95	-	-	-	-	-	95
Small portfolio guarantees for businessmen since 2007	11	138	774	257	17	16	6	2,603	3,822
Investment and operating guarantees for small and medium sized enterprises since 2007	110	910	4,354	378	102	14	46	-	5,914
Total	**186**	**2,852**	**9,756**	**1,390**	**663**	**62**	**819**	**2,836**	**18,564**

* Portfolio approach

[1)] Category X9 is used by the Bank to designate guarantees where the Bank anticipates delivery of the pay-out call.

ac) Quality of securities portfolio

The securities portfolio of the Bank comprises the following, broken down by rating classification and classes of financial instruments:

31 December 2010

CZKm	**AA- to AA+**	**A- to A+**	**Lower than A**
Securities at fair value through profit or loss	324	1,274	-
Securities available for sale	6,499	10,134	483
Securities held to maturity	3,043	2,062	-
Total	**9,866**	**13,470**	**483**

31 December 2009

CZKm	**AA- to AA+**	**A- to A+**	**Lower than A**
Securities at fair value through profit or loss	-	1,116	-
Securities available for sale	913	12,941	268
Securities held to maturity	-	5,214	-
Total	**913**	**19,271**	**268**

All securities are neither past due nor impaired, except for the impaired available-for-sale securities with fair value of CZK 32,000,000 at 31 December 2009. There is no collateral provided for these securities.

ad) Quality of derivatives portfolio

The derivatives portfolio as at 31 December 2010 and 2009 includes established banking counterparties (with external rating equivalent of AA+ to A) and transactions with the associate MUFIS a. s.

Notes to the financial statements for the year ended 31 December 2010

b) Geographical concentration of assets

31 December 2010

Assets CZKm	Czech Republic	European Union	Other	Loan provisions and accumulated depreciation	Total
Cash and balances with central banks	10,586	-	-	-	10,586
Amounts due from banks	2,332	206	-	-	2,538
Securities at fair value through profit or loss	1,279	319	-	-	1,598
Positive fair values of financial derivative transactions	89	15	-	-	104
Loans and advances to customers	22,349	-	-	(1,573)	20,776
Securities available for sale	15,698	1,091	327	-	17,116
Securities held to maturity	5,105	-	-	-	5,105
Other financial assets	67	-	-	-	67
Total financial assets	**57,505**	**1,631**	**327**	**(1,573)**	**57,890**
Non-financial assets	**904**	**-**	**-**	**(555)**	**349**
Total	**58,409**	**1,631**	**327**	**(2,128)**	**58,239**

31 December 2009

Assets CZKm	Czech Republic	European Union	Other	Loan provisions and accumulated depreciation	Total
Cash and balances with central banks	17,586	-	-	-	17,586
Amounts due from banks	304	504	-	-	808
Securities at fair value through profit or loss	1,117	-	-	-	1,117
Financial derivatives	94	26	-	-	120
Loans and advances to customers	24,297	-	-	(1,491)	22,806
Securities available for sale	11,626	1,917	579	-	14,122
Securities held to maturity	5,214	-	-	-	5,214
Other financial assets	97	-	-	-	97
Total financial assets	**60,335**	**2,447**	**579**	**(1,491)**	**61,870**
Non-financial assets	**878**	**-**	**-**	**(530)**	**348**
Total	**61,213**	**2,447**	**579**	**(2,021)**	**62,218**

c) The Bank's maximum credit risk exposure

31 December 2010 in CZKm

		Total exposure	Collateral held
	On-balance sheet	Total credit exposure	
Cash and balances with central banks	10,586	10,586	10,283
Amounts due from banks	2,538	2,538	1,642
Securities at fair value through profit or loss	1,598	1,598	-
Financial derivatives	104	104	-
Loans to customers	20,776	20,776	2,370
- *Loans to private legal entities and individuals*	5,877	5,877	1,763
- *Loans to the Ministry of Finance of the Czech Republic and other government entities*	13,959	13,959	-
- *Loans to municipalities*	940	940	607
Securities available for sale	17,116	17,116	-
Securities held to maturity	5,105	5,105	-
Other financial assets	67	67	-
Financial guarantees and loan commitments	-	25,803	3,295
Total financial assets	**57,890**	**83,693**	**17,590**
Non-financial assets	349		
Total assets	**58,239**		

31 December 2009 in CZKm

		Total exposure	Collateral held
	On-balance sheet	Total credit exposure	
Cash and current balances with central banks	17,586	17,586	16 535
Amounts due from banks	808	808	300
Securities at fair value through profit or loss	1,117	1,117	-
Financial derivatives	120	120	-
Loans to customers	22,806	22,806	2,063
- *Loans to private legal entities and individuals*	5,348	5,348	1,387
- *Loans to the Ministry of Finance of the Czech Republic and other government entities*	16,462	16,462	-
- *Loans to municipalities*	996	996	676
Securities available for sale	14,122	14,122	-
Securities held to maturity	5,214	5,214	-
Other financial assets	97	97	-
Financial guarantees and loan commitments	-	20,288	2,437
Total	**61,870**	**82,158**	**21,335**
Non-financial assets	348	-	-
Total assets	**62,218**	**-**	**-**

The maximum credit exposure is presented at carrying values net of any impairment losses recognized. Collaterals held for due from banks represents the fair value of the securities obtained under reverse repo transactions, for loans to customers principally the collateralized mortgages (see Note 4.1.2) and in case of the financial guarantees the current level of funds deposited by the programmes partners to cover risks attached to providing of the financial guarantees (see Note 3.18).

4.2 Market risk

4.2.1. Management of the market risk

Characteristics of Market Risks

The principal market risk management strategy is defined in the Bank's internal regulations and in the documents approved by the Board of Directors of the Bank, and primarily provides guidance on the following areas:

- Acceptable degree of market risks;
- Market risk management techniques;
- Set of limits used; and
- Basic requirements regarding the Bank's organisational structure in terms of market risk management, including segregation of duties and information flows.

Description of Transactions Carrying Market Risks

The Bank is exposed to market risks associated with losses arising from fluctuations in prices, exchange rates and financial market rates.

The Bank is exposed to market risks in acquiring, holding and selling investment instruments defined in the Investment Strategy of ČMZRB. This risk arises from open positions in interest rates and currencies.

Market Risk Measurement

The Bank measures interest rate risk using basic techniques (interest rate GAP analysis, duration and elasticity of interest rates) and techniques to calculate capital adequacy as set out in Czech National Bank Regulation 123/2007 Coll. In addition, the Bank has developed a series of internal limits to restrict its market risk exposure. The interest rate GAP analysis measures interest rate risk inherent in the trading and banking book on a collective basis. Interest rate risk is restricted through limits to net interest rate exposure in each time bucket. Interest rate risk inherent in all bond portfolios is restricted by having a limit in place in respect of the elasticity of the bond portfolio. The Bank undertakes stress testing on a quarterly basis in accordance with the requirements of the Czech National Bank.

Market Risk Management

The Bank's instrument for managing market risks involves the external capital adequacy limit and internal limits for interest rate risk and elasticity of the interest rate in respect of the bond portfolio. In addition, the market risk is mitigated through the implementation of an internal capital adequacy limit. Foreign currency risk is controlled through the use of the limits set out in Czech National Bank Regulation 123/2007 Coll.

Interest rate risk limits restrict the size of interest rate GAP in each time bucket of an interest rate GAP analysis in relation to the Bank's capital and are expressed in percentage terms.

The limit for elasticity of the interest rate in respect of the bond portfolio restricts the market risk associated with all bond portfolios together with derivatives hedging risk arising from the change in exchange rates when the Bank holds foreign currency bonds.

The Bank's internal capital adequacy limit sets out requirements that are more stringent than the external capital adequacy limit established by the banking regulator.

The Bank uses hedging derivatives to manage market risk. The Bank has secured loans from European Investment Bank and German Kreditanstalt für Wiederaufbau as well as bonds. The risk management department of the Bank calculates accounting hedge effectiveness.

4.2.2. Derivates

Trading Derivatives

	31 December 2010		31 December 2009	
CZKm	**Notional value asset**	**Notional value liability**	**Notional value asset**	**Notional value liability**
Interest rate swaps	636	636	607	607
Currency forwards	200	199	333	331
Currency and cross-currency swaps	1,729	1,790	1,904	1,899
Total	**2,565**	**2,625**	**2,844**	**2,837**

	31 December 2010		31 December 2009	
CZKm	**Positive fair value**	**Negative fair value**	**Positive fair value**	**Negative fair value**
Interest rate swaps	10	9	11	9
Currency forwards	9	8	18	16
Currency and cross-currency swaps	46	89	75	60
Total	**65**	**106**	**104**	**85**

Derivatives held for trading – related parties

CZKm

	31 December 2010		31 December 2009	
CZKm	**Notional value asset**	**Notional value liability**	**Notional value asset**	**Notional value liability**
Currency forwards	105	95	176	156
Total	**105**	**95**	**176**	**156**

	31 December 2010		31 December 2009	
CZKm	**Positive fair value**	**Negative fair value**	**Positive fair value**	**Negative fair value**
Currency forwards	9	-	18	-
Total	**9**	**-**	**18**	**-**

Hedging Derivatives

The Bank uses the fair value hedging derivatives to hedge currency risk relating to recognized hedged items, which are securities denominated in foreign currencies (see Notes 3.12 and 4.3) and assets and liabilities from a specific transaction concluded with the Ministry of Finance of the Czech Republic (see Note 3.11).

	31 December 2010		31 December 2009	
CZKm	Notional value asset	Notional value liability	Notional value asset	Notional value liability
Cross currency swaps	3,331	3,806	3,733	4,351
Total	**3,331**	**3,806**	**3,733**	**4,351**

	31 December 2010		31 December 2009	
CZKm	Positive fair value	Negative fair value	Positive fair value	Negative fair value
Cross currency swaps	39	890	16	1,095
Total	**39**	**890**	**16**	**1,095**

4.3. Foreign currency risk

The Bank's financial position and cash flows are exposed to the risks of changes in exchange rates of common foreign currencies. The Bank monitors its foreign currency positions on a daily basis. In the event that the Bank breaches limits, it undertakes measures as outlined in its internal regulations relating to foreign currency exposure limits.

The table below provides summary information about the Bank's exposure to foreign currency risk. The tables set out foreign currency assets and liabilities at carrying values, analysed by currency.

The Bank covers its open position by using financial derivatives as can be seen from the tables below and the sensitivity analysis.

31 December 2010

CZKm	CZK	EUR	USD	HUF	GBP	Total
Cash and balances with central bank	10,586	-	-	-	-	10,586
Amounts due from banks	2,222	313	2	1	-	2,538
Securities at fair value through profit or loss	324	1,023	251	-	-	1,598
Financial derivatives	104	-	-	-	-	104
Loans to customers, net	15,226	5,550	-	-	-	20,776
Securities available for sale	16,799	317	-	-	-	17,116
Securities held to maturity	5,105	-	-	-	-	5,105
Other financial assets	67	-	-	-	-	67
Total financial assets	**50,433**	**7,203**	**253**	**1**	**-**	**57,890**
Non-financial assets	**349**	**-**	**-**	**-**	**-**	**349**
Total assets	**50,782**	**7,203**	**253**	**1**	**-**	**58,239**
Amounts due to banks	9,996	8,912	-	-	-	18,908
Amounts due to customers	26,756	318	-	-	2	27,076
Short sales	198	-	-	-	-	198
Financial derivatives	996	-	-	-	-	996
Other financial liabilities	257	-	-	-	-	257
Total financial liabilities	**38,203**	**9,230**	**-**	**-**	**2**	**47,435**
Non-financial liabilities and equity	**10,796**	**-**	**8**	**-**	**-**	**10,804**
Total liabilities and equity	**48,999**	**9,230**	**8**	**-**	**2**	**58,239**
On balance sheet position, net	1,783	(2,027)	245	1	(2)	
Off-balance sheet derivatives notional position, net	-	2,081	(244)	-	-	
Net position	**1,783**	**54**	**1**	**1**	**(2)**	

31 December 2009 CZKm	CZK	EUR	USD	HUF	GBP	Total
Cash and balances with central bank	17,586	-	-	-	-	17,586
Amounts due from banks	706	95	7	-	-	808
Securities at fair value through profit or loss	559	424	134	-	-	1,117
Financial derivatives	120	-	-	-	-	120
Loans to customers, net	16,910	5,890	6	-	-	22,806
Securities available for sale	13,710	339	-	73	-	14,122
Securities held to maturity	5,214	-	-	-	-	5,214
Other financial assets	97	-	-	-	-	97
Total financial assets	**54,902**	**6748**	**147**	**73**	**-**	**61,870**
Non-financial assets	**348**	**-**	**-**	**-**	**-**	**348**
Total	**55,250**	**6,748**	**147**	**73**	**-**	**62,218**
Amounts due to banks	10,642	10,454	6	-	-	21,102
Amounts due to customers	29,500	88	6	-	-	29,594
Financial derivatives	1,180	-	-	-	-	1,180
Other financial liabilities	233	-	-	-	-	233
Total financial liabilities	**41,555**	**10,542**	**12**	**-**	**-**	**52,109**
Non-financial liabilities and equity	**10,108**	**-**	**-**	**-**	**1**	**10,109**
Total	**51,663**	**10,542**	**12**	**-**	**1**	**62,218**
On balance sheet position, net	3,587	(3,794)	135	73	(1)	
Off-balance sheet derivatives notional position, net	-	3,848	(129)	(68)	-	
Net position	**3,587**	**54**	**6**	**5**	**(1)**	

Foreign exchange rates sensitivity analysis

Set out below is a sensitivity analysis to foreign currency risk. The balance sheet items in foreign currencies were tested in respect of the upward movement of a foreign exchange rate by 10 % (a 10 % appreciation of the currencies would have an equal and opposite effect). The open position in EUR, USD and HUF currencies is hedged using derivatives. The hedging instruments almost fully counter-balance the open position (see tables above) and therefore also the income statement and equity impact of the movements in foreign exchange rates is not significant as of the balance sheet date and also during the year. The table below summarises the sensitivities in CZK in comparison only to CZK/EUR exchange rates valid as of 31 December 2010 or 2009 as EUR was the only significant currency in which the Bank had open position as at that date (for open position amounts see above).

	2010 CZKm	2009 CZKm
Sensitivity to changes in EUR rates		
Expected rate fluctuation, %	10 %	10 %
Open position	54	(54)
Effect on profit and loss	(26)	(5)
Effect on equity	32	-

4.4. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk.

The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market interest rate before maturity, the next repricing date. Those assets and liabilities that do not have contractual maturity or a repricing date were grouped in the 'non-specified' category.

The Bank has a significant portion of amounts due to customers which are not interest bearing instruments. These comprise part of state deposits and risk funds (see Note 3.18). These liabilities are presented as liabilities with non-specified interest rate sensitivity.

Impaired loans are carried on a non-accrual basis and presented as items with non-specified interest rate sensitivity.

31 December 2010

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Non-specified CZKm	Total CZKm
Cash and balances with central bank	10,578	-	-	-	8	10,586
Amounts due from banks	2,536	-	-	-	2	2,538
Securities at fair value through profit or loss	14	64	968	552	-	1,598
Financial derivatives	-	-	-	-	104	104
Loans to customers, net	2,065	2,107	8,852	6,685	1,067	20,776
Securities available for sale	1,438	3,912	7,428	4,338	-	17,116
Securities held to maturity	208	758	2,523	1,616	-	5,105
Other financial assets	-	-	-	-	67	67
Total financial assets	**16,839**	**6,841**	**19,771**	**13,191**	**1,248**	**57,890**
Non-financial assets	**-**	**-**	**-**	**-**	**349**	**349**
Total	**16,839**	**6,841**	**19,771**	**13,191**	**1,597**	**58,239**
Amounts due to banks	5,066	1,191	7,002	6,270	(621)	18,908
Amounts due to customers	16,128	6,558	-	-	4,390	27,076
Short sales	198	-	-	-	-	198
Financial derivatives	-	-	-	-	996	996
Other financial liabilities	-	-	-	-	257	257
Total financial liabilities	**21,392**	**7,749**	**7,002**	**6,270**	**5,022**	**47,435**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**10,804**	**10,804**
Total	**21,392**	**7,749**	**7,002**	**6,270**	**15,826**	**58,239**
Net interest position	**(4,553)**	**(908)**	**12,769**	**6,921**	**(14,229)**	**-**

31 December 2009

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Non-specified CZKm	Total CZKm
Cash and balances with central bank	17,576	-	-	-	10	17,586
Amounts due from banks	599	-	206	-	3	808
Securities at fair value through profit or loss	1	10	710	396	-	1,117
Financial derivatives	-	-	-	-	120	120
Loans to customers, net	1,287	2,159	9,115	8,408	1,837	22,806
Securities available for sale	1,119	3,784	4,861	4,356	2	14,122
Securities held to maturity	-	2,250	2,294	670	-	5,214
Other financial assets	-	-	-	-	97	97
Total financial assets	**20,582**	**8,203**	**17,186**	**13,830**	**2,069**	**61,870**
Non-financial assets	**-**	**-**	**-**	**-**	**348**	**348**
Total	**20,582**	**8,203**	**17,186**	**13,830**	**2,417**	**62,218**
Amounts due to banks	4,120	1,399	7,450	8,337	(204)	21,102
Amounts due to customers	19,085	6,073	-	-	4,436	29,594
Financial derivatives	-	-	-	-	1,180	1,180
Other financial liabilities	-	-	-	-	233	233
Total financial liabilities	**23,205**	**7,472**	**7,450**	**8,337**	**5,645**	**52,109**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**10,109**	**10,109**
Total	**23,205**	**7,472**	**7,450**	**8,337**	**15,754**	**62,218**
Net interest position	**(2,623)**	**731**	**9,736**	**5,493**	**(13,337)**	**-**

Interest rate sensitivity analysis

Balance sheet items sensitive to interest rates were analysed under the 2 % expected parallel increase in interest rates. The Bank modelled 8 scenarios for possible movements of interest rates as the benchmark; the most probable alternative of 2 % parallel shift was selected for reporting purposes. The impact on profit and loss and equity (in the case of available-for-sale securities) is outlined below.

Balance sheet item	31 December 2010 Sensitivity/Impact	31 December 2009 Sensitivity/Impact	Comment
Assets			
Loans to customers	(1,203)	(1,358)	
Loans to banks	(307)	(493)	
Held to maturity securities	-	-	Only fixed interest rates securities in the portfolio
Available for sale securities	(411)	(170)	Impact on equity
Available for sale securities	(245)	(123)	Impact on profit and loss
Financial derivatives	(313)	(366)	
Liabilities			
Due to banks	931	1,182	
Due to customers	1,011	971	
Financial derivatives	314	403	

4.5. Liquidity risk

Liquidity risk is the risk that the Bank will lose its ability to meet its financial obligations as they fall due or that it will not be able to fund its assets. Liquidity risk may result from a temporary payment insolvency and low liquidity of the market with financial instruments, which makes it impossible to quickly close out positions thereby limiting access to funding. The basic liquidity management tool involves the record-keeping and planning of the Bank's cash flows. In support of liquidity management, the Bank uses two mechanisms - payment notices and price setting. The liquidity management strategy is established and implemented through the preparation of a 'Liquidity Scenario' and 'Emergency Plan for Events Jeopardising the Bank's Liquidity'. The Bank's liquidity position is monitored through the liquidity reserve limit in relation to the value of adjusted weighted risk exposure.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs, guarantees, margins and settlement of derivatives. 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.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based upon the remaining maturity period as of the balance sheet date.

As the main depositors of the Bank are state institutions (Ministry of Finance, Ministry for Regional Development etc.) the current accounts of the Bank are presented as being repayable on demand because these funds can be withdrawn upon demand. However these deposits represent specific financing granted, e.g. funding for state approved programmes and therefore their withdrawal is not likely in large volume upon demand.

The Bank has a significant portion of amounts due to customers which are held for an undefined amount of time to finance individual support programmes. These comprise part of state deposits and risk funds (see Note 3.18). These liabilities are presented as liabilities with undefined maturity.

31 December 2010

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Maturity undefined CZKm	Total CZKm
Cash and balances with central bank	10,585	-	-	-	1	10,586
Amounts due from banks	2,456	-	-	-	82	2,538
Securities at fair value through profit or loss	14	64	968	552	-	1,598
Financial derivatives	20	35	43	6	-	104
Loans to customers, net	2,097	2,415	9,713	6,551	-	20,776
Securities available for sale	1,438	3,912	7,428	4,338	-	17,116
Securities held to maturity	208	758	2,523	1,616	-	5,105
Other financial assets	-	-	-	-	67	67
Total financial assets	**16,818**	**7,184**	**20,675**	**13,063**	**150**	**57,890**
Non-financial assets	**56**	**6**	**-**	**-**	**287**	**349**
Total	**16,874**	**7,190**	**20,675**	**13,063**	**437**	**58,239**
Amounts due to banks	5,142	991	7,002	5,773	-	18,908
Amounts due to customers	18,204	6,613	-	2,259	-	27,076
Short sales	198	-	-	-	-	198
Financial derivatives	12	4	828	152	-	996
Other financial liabilities	-	-	-	-	257	257
Total financial liabilities	**23,556**	**7,608**	**7,830**	**8,184**	**257**	**47,435**
Non-financial liabilities and equity	**633**	**617**	**1,685**	**1,857**	**6,012**	**10,804**
Total	**24,189**	**8,225**	**9,515**	**10,041**	**6,269**	**58,239**
Net liquidity exposure	**(7,315)**	**(1,035)**	**11,160**	**3,022**	**(5,832)**	**-**

31 December 2009

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Maturity undefined CZKm	Total CZKm
Cash and balances with central bank	17,586	-	-	-	-	17,586
Amounts due from banks	602	-	206	-	-	808
Securities at fair value through profit or loss	1	10	710	396	-	1,117
Financial derivatives	21	6	58	35	120	
Loans to customers, net	4,275	2,121	8,292	8,118	-	22,806
Securities available for sale	1,119	3,784	4,861	4,356	2	14,122
Securities held to maturity	-	2,250	2,294	670	-	5,214
Other financial assets	-	-	-	-	97	97
Total financial assets	**23,604**	**8,171**	**16,421**	**13,575**	**99**	**61,870**
Non-financial assets	**55**	**1**	**-**	**-**	**292**	**348**
Total	**23,659**	**8,172**	**16,421**	**13,575**	**391**	**62,218**
Amounts due to banks	4,452	1,400	7,264	7,986	-	21,102
Amounts due to customers	19,430	5,658	-	-	4,506	29,594
Financial derivatives	4	40	1,053	83	-	1,180
Other financial liabilities	-	-	-	-	233	233
Total financial liabilities	**23,886**	**7,098**	**8,317**	**8,069**	**4,739**	**52,109**
Non-financial liabilities and equity	**544**	**640**	**1,672**	**1,649**	**5,604**	**10,109**
Total	**24,430**	**7,738**	**9,989**	**9,718**	**10,343**	**62,218**
Net liquidity exposure	**(771)**	**434**	**6,432**	**3,857**	**(9,976)**	**-**

Contractual liquidity of the main non-derivative financial liabilities at amortized cost and derivatives – undiscounted basis

a) Amounts due to banks and customers

31 December 2010

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	5,142	1,270	8,116	7,034	21,562
Amounts due to customers	18,132	6,654	3	2,333	27,122

31 December 2009

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	4,466	1,724	8,589	9,012	23,791
Amounts due to customers	21,342	6,225	5	2,134	29,706

b) Derivatives settled on a net basis

The table below analyses the Bank's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted net cash flows.

31 December 2010

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	6	(4)	(4)	6	4

31 December 2009

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	10	(4)	(5)	-	1

c) Derivatives settled on a gross basis

The Bank's derivatives that will be settled on a gross basis include foreign exchange derivatives: currency forward, currency swaps and cross currency interest rate swaps.

The table below analyses the Bank's derivative financial liabilities that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

31 December 2010

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Foreign exchange derivatives:					
Cash inflows	70	69	68	-	207
Cash outflows	(70)	(69)	(68)	-	(207)
Cross-currency swaps:					
Cash inflows	590	1,136	3,327	1,061	6,114
Cash outflows	(725)	(1,423)	(3,769)	(1,114)	(7,031)

31 December 2009

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Foreign exchange derivatives:					
Cash inflows	67	67	198	-	332
Cash outflows	(67)	(66)	(197)	-	(330)
Cross-currency swaps:					
Cash inflows	574	1,178	4,339	1,104	7,195
Cash outflows	(686)	(1,504)	(5,031)	(1,116)	(8,337)

4.6. Operational risk

The Bank defines operational risk as the risk of loss arising from human errors, the inappropriateness or failure of internal processes, failures of systems or the risk of loss resulting from external events.

The system of the Bank's operational risk management is built around the following four cornerstones:

- Strategy (clear vision, management attitude, culture);
- Organisation (Board of Directors, Assets and Liabilities Management Committee, internal audit, operational risk management coordinator, and the Bank's departments);
- Processes (identification, evaluation, countermeasures, monitoring and reporting); and
- Infrastructure (system, source of information, data collection and communication).

Identification of Operational Risk

The Bank identifies individual operational risks in all of its departments and categorises them according to the underlying cause (human error, internal process, information system, external factor). Responsibility for identifying operational risks primarily rests with the head of the department where the risk originates (via a self-evaluation form). Collection of information from individual departments and its processing is within the remit of the coordinator. The Bank identifies and records each risk to which it is exposed, even a risk that is no longer treated as a risk due to the countermeasures that are currently being implemented.

Evaluation of Operational Risk

Operational risk is evaluated in terms of the likelihood of its occurrence (graded one to five) and the significance of impact if it materialises (graded one to five). The Bank has opted for a qualitative approach to evaluating the risk which better meets its needs and better reflects the situation within the Bank. The evaluation is based on a reasonable estimate and uses scores to assess the likelihood of the occurrence and the significance of impact. Following the evaluation, individual risks are rated according to their overall significance (risk profile) into the following three levels:

- Low (ideal risk profile where the Bank only checks the effectiveness of the existing measures);
- Medium (the risk is acceptable only if the implementation of an appropriate countermeasure to mitigate the risk is too costly); and
- High (the risk is not acceptable, additional countermeasures need to be put in place and the risk mitigated).

Countermeasures

Responsibility for the implementation of an appropriate countermeasure against operational risks rests within the department where the risk originates (mitigation of the likelihood of the occurrence of operational risk or its impact on the Bank).

Monitoring and Reporting

The basic tool for monitoring is the database of incidents and a report on operational risk management within the Bank. These activities result in a risk profile of the Bank. Operational risk events include all events that have a direct impact on the Bank's profit or loss according to the Bank's activities during which the event occurred.

4.7. Capital management

The Bank has identified the following risks which should be covered entirely or partially by capital: market risks, interest rate risk of the banking book, credit risk and concentration risk, liquidity risk and operational risk.

The principal objectives of the Bank in managing capital risks are as follows:

- Quantification of risks in the form of economic capital which is needed to cover potential losses arising from these risks;
- Comparison of capital requirements with capital resources;
- Management of capital resources with respect to current and future risks;
- Determination of the maximum acceptable degree of risks with respect to available capital resources;
- Monitoring and management of the performance of business activities with respect to the risk or the capital requirements; and
- Strategic planning with respect to the risk, allocated capital resources and capital efficiency of individual business activities of the Bank.

The Bank has established an internal limit for capital adequacy at 11 % of the Bank's capital, i.e. 3 % above the required regulatory floor of 8 %. The Bank has implemented the standard approach for capital management which is in compliance with Basel II requirements.

CZKm	31 December 2010	31 December 2009
Tier 1 capital		
Share capital	2,132	2,132
Statutory and other reserves	1,150	1,150
Retained earnings (without profit for the current year, statutory non-consolidated)	1,406	1,250
Less: intangible assets	(21)	(20)
Total qualifying Tier 1 capital	**4,667**	**4,512**
Total regulatory capital	**4,667**	**4,512**
Total capital requirements	**2,273**	**2,376**
Capital adequacy ratio	**16.4 %**	**15.2 %**

5/ Fair values of assets and liabilities and fair value hierarchy

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. When available, fair value estimates are made based on quoted market prices. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other generally acceptable pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates might not be realised in a current sale of the financial instrument.

In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used.

(a) Cash and balances with the Central Bank

The carrying values of cash and balances within the central bank are generally deemed to approximate their fair value.

(b) Securities Held to Maturity

Fair values of securities in the 'Held-to-Maturity' portfolio are taken from the active market, where these instruments are quoted.

(c) Due from banks

The fair value of amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk).

(d) Loans to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

(e) Amounts due to banks and customers

The fair value of term deposits repayable on demand approximates the carrying value of amounts repayable on demand as of the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as of the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using market interest rates.

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

CZKm	31 December 2010 Carrying value	31 December 2010 Fair value	31 December 2009 Carrying value	31 December 2009 Fair value
Financial assets				
Cash and balances with the central bank	84	84	863	863
Amounts due from banks	13,040	13,035	17,531	17,517
Loans to customers	20,776	19,968	22,806	21,783
- Loans to private legal entities and individuals	*5,877*	*5,232*	*5,348*	*4,514*
- Loans to the Ministry of Finance of the Czech Republic and other government entities	*13,959*	*13,959*	*16,462*	*16,462*
- Loans to municipalities	*940*	*777*	*996*	*807*
Securities held to maturity	5,105	5,098	5,214	5,227
Financial liabilities				
Amounts due to banks	18,908	18,797	21,102	20,809
Amounts due to customers	27,076	26,991	29,594	29,468

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed debt instruments on exchanges (for example Prague Stock Exchange and other recognized stock exchanges).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes over-the-counter derivative contracts. The sources of input parameters like PRIBOR or other yield curves are Bloomberg and Reuters.
- Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes financial instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Bank considers only relevant and observable market prices in its valuations and does not have any financial assets or liabilities at fair value to be categorized in Level 3. There have not been any reclassifications between the Levels 1 and 2 during the presented periods.

31 December 2010

	Level 1	Level 2
Financial assets at fair value through profit and loss		
Financial assets held for trading		
Debt securities	324	-
Derivatives	-	65
Debt securities designated at fair value	1,274	-
Hedging derivatives	-	39
Available-for-sale debt securities:	17,116	-
Total assets at fair value	**18,714**	**104**
Financial liabilities at fair value through profit and loss		
Financial liabilities held for trading		
Short sales	198	-
Derivatives	-	106
Hedging derivatives	-	890
Total liabilities at fair value	**198**	**996**

31 December 2009

	Level 1	Level 2
Financial assets at fair value through profit and loss		
Financial assets held for trading		
Debt securities	559	-
Derivatives	-	104
Debt securities designated at fair value	424	134
Hedging derivatives	-	16
Available-for-sale debt securities:	13,911	212
Total assets at fair value	**14,894**	**466**
Financial liabilities at fair value through profit and loss		
Financial liabilities held for trading - derivatives	-	85
Hedging derivatives	-	1,095
Total liabilities at fair value	**-**	**1,180**

6/ Subsequent events

No significant events having a material impact on the financial statements of the Bank for the year ended 31 December 2010 occurred subsequent to the balance sheet date.

The Board of Directors has authorised these financial statements for submission to the General Meeting of Shareholders. These financial statements have been signed, on the basis of authority delegated by the Board of Directors, by Ladislav Macka, Chairman of the Board and Jan Ulip, Member of the Board.

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