



Financial Results

ProCredit Bank's total assets grew by 0.6% to EUR 288 million in December 2013. The increase was closely linked to the growth in customer funds, in spite of the continuous interest rate cuts during the year. On September 2013 the bank has increased the subscribed capital by a EUR 3 million, positively influencing the capital adequacy ratio. The long term borrowings to financial institution were stable during the year, slightly decreased by the scheduled principal repayments. Less short term funding were needed due to higher funds attained from customers.

The bank's deposits base increased further by 1.5% to a total of EUR 232 million. Within the deposit portfolio structure, throughout current year there was a shift from time deposits towards savings accounts and a decline of current accounts from businesses.

The gross loan portfolio increased by 2.3% compared to year end 2012, reaching EUR 175.5 million. It shows positive growth especially in April and May, but afterwards a drop of new disbursements was noticed. In December 2013, the bank reached its peak disbursement amount for 2013 (Eur 12.7 million).

Allowance for impairment on loans and advances to customers increased by EUR 3.8 million compared to year end 2012, due to the higher amount of PAR>30 loan portfolio.

Interest income declined, mainly due to the reduction in funds available for investments in financial instruments as well as market price drop in Treasury Bills (12M yield dropped by 2.7% within the year) and also due to the changes in the loan portfolio structure in terms of client categories (as well as by the deterioration of WAIR). However, this was partially compensated by the lowering of interest expenses due to decrease of deposits interest rates.

The prioritization of cost optimisation and increasing efficiency facilitated the reduction of operating expenses by almost 11.4%, leading to an overall improvement of the cost-income ratio to 76%.

Risk Management

The Board of Directors has the ultimate responsibility to develop and implement the appropriate structures and mechanisms to identify, assess, and mitigate the bank's exposure to risk. The Board of Directors has set up the Risk Management Committee to monitor the full range of risks to which the bank is exposed. Moreover the Risk Management Committee has the decision-making authority in connection with risk.

Risk at ProCredit Bank Albania is measured and reported according to risk management policies, which have been approved by the bank's Board of Directors. The policies are in full compliance with the legal regulations valid in Albania and with the requirements imposed by the Bank of Albania. The policies are based on the Group Handbook on Risk Management and Control, which in turn is based on the German Federal Financial Supervisory Authority's policy document "Minimum Requirements for Risk Management". ProCredit Bank Albania reports its risk position to the Group Risk Management Committee (GRMC) regularly.

ProCredit Bank's culture of internal and external transparency is crucial to our risk management efforts. Thanks to our clearly defined procedures and our encouragement of open communication, our well-trained employees are in a strong position to detect risks and take the steps necessary to mitigate them.

Credit Risk Management

Lending to small businesses is ProCredit Bank's main asset-side operation and consequently classical credit risk, i.e. the risk that borrowers will be unable to repay, is the most important risk that the bank faces. Credit risk accounts for the largest share of risk in the context of risk bearing capacity calculation.

ProCredit Bank Albania has adopted credit risk policies based on the ProCredit Group Credit Risk Management Policy and the Group Collateral Valuation Policy, which together reflects the experience, gained in more than two decades of successful lending operations in developing and transition economies and is in full compliance with Albanian regulations. For every single customer of the bank a credit exposure limit is set and credit decision-making authority is clearly defined; all decisions to issue a loan, or change its terms, are taken by a credit committee, and all credit risk assessments are carefully documented.

Above all, the bank seeks to build and maintain long-term relationships with its customers, thus ensuring that it is fully aware of their financial situation, and great care is taken to avoid over-indebting them.

Credit risk is also mitigated by the fact that our portfolio is highly diversified. The businesses we serve operate in a wide range of sectors, and their exposure to global market fluctuations is limited. Moreover, the majority of our credit exposures are relatively small.

As the vast majority of the bank's loans are repayable in monthly installments, a borrower's failure to meet a payment deadline is treated as an initial sign of potential default and draws an immediate response from the bank. When a payment of interest or principal is overdue by more than 30 days, the loan in question is assigned to the portfolio at risk (PAR>30), which serves as the key indicator for the quality of the loan portfolio and for measuring classical credit risk.

In Q4 2013 the bank's overall PAR>30 rose from 8.48% at the start of the year to 9.87% on December 2013, in particular as the ongoing impact of the financial crisis was still being felt. One of the ways in which ProCredit Bank has met the challenge to portfolio quality posed by the financial crisis is to offer loan restructuring to those clients that are judged to have the potential to regain stability. Restructurings follow a thorough analysis of each client's changed payment capacity.

The decision to restructure a credit exposure is always taken by a credit committee and aims at full recovery. ProCredit Bank Albania takes a conservative approach to loan loss provisioning. Allowances for individually significant exposures with signs of impairment are set aside based on the results of an individual assessment of impairment, while provisioning for impaired loans that are not individually significant is calculated according to historical default rates. For all unimpaired credit exposures, portfolio-based allowances for impairment are made. At the end of December 2013 the coverage ratio (loan loss provisions under Bank of Albania Methodology as a percentage of PAR>30) stood at 120%.

Loans considered to be irrecoverable are consistently written off. Nonetheless, recovery efforts continue even after a loan has been written off and collateral collection is rigorously enforced.

In principle, ProCredit bank accept all types of collateral. The collateral serves as a guarantee that the bank, as the creditor, can recover the credit exposure and as a means of motivating the borrower to repay the credit exposure. The valuation of collateral is done according to the Group Collateral Valuation Policy, which reflects the experience, gained in more than two decades of successful lending operations, and it is in line with European Standards of Collateral Valuation.

Liquidity Risk Management

Short term liquidity risk specifies the risk that the bank will no longer be able to meet its current and future payment obligations in full, or in a timely manner. The bank must therefore maintain at all times sufficient liquid funds available to meet its obligations, even in times of stress. Several factors inherent to the bank's business model offset liquidity risk. Firstly, the bank's diversified, high quality portfolio of loans means that incoming cash flows are highly predictable. Secondly, our customer deposits are spread across a large number of depositors each holding relatively small amounts.

To determine the robustness of the bank's liquidity in the face of potential shocks, the bank performs regular stress tests based on scenarios defined as a group standard by the Group Liquidity Risk Management Policy. The assumptions on which the stress tests are based are regularly challenged and adjusted to reflect the market conditions. Whenever necessary to bridge liquidity shortages, ProCredit Bank Albania, like the other ProCredit group banks, is able to obtain short-term funding from ProCredit Holding.

Currency Risk Management

Foreign currency risk specifies the risk of negative effects on bank's financial results and capital adequacy caused by changes in exchange rates. ProCredit Bank Albania has a low level of exposure to currency risk because it does not enter into speculative open currency positions, nor does it engage in derivative transactions. Currency risk is managed in accordance with the Foreign Currency Risk Management Policy and Bank of Albania regulations on Foreign currency risk administration. The bank continuously monitors exchange rate movements and foreign currency markets, and manages its currency positions on a daily basis. Stress tests are regularly carried out to assess the impact of exchange rate movements on open currency positions (OCP) in each operating currency.

Interest Rate Risk Management

Interest rate risk specifies the risk that movements in market interest rates will adversely affect the bank's economic value and its interest earnings and eventually capital. Interest rate risk is managed in accordance with the Interest Rate Risk Management Policy and Bank of Albania guideline on Banking book interest rate risk administration. During 2013 interest rates have exhibited a gradual declining trend. Exposure to interest rate risk is measured through maturity gap analysis. Stress tests are used to measure and analyse the impact of interest rate shifts on the economic value and interest income. As a policy measure to mitigate interest rate risk, ProCredit Bank attracts long-term fixed rate funding and offers loans with variable interest rates, allowing the bank to raise (or lower) the rates it charges in line with shifts in the market interest rates.

Operational and Fraud Risk Management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, from people and systems, or from external events. This definition includes legal risk as well as reputational risk. The operational risk policy of ProCredit Bank Albania is in full compliance with Bank of Albania's regulations on Operational risk administration as well as with the Group Operational Risk Policy and the Group Fraud Prevention Policy. To minimise operational risk and the risk of fraud, all processes are precisely documented and subject to effective control mechanisms. Job descriptions are comprehensive, duties are strictly segregated, and dependency on key individuals is avoided. When recruiting, the bank pays close attention to personal integrity, a quality which is reinforced through the bank's strictly enforced code of conduct and through comprehensive training programmes designed to promote a culture of transparency and risk-awareness.

Operational risk issues are reviewed on the Operational Risk Committee which is a subcommittee of Risk Management Committee, also led by a Management Board member. Its purpose is to determine policies on people risks, process risks, IT and systems-related risks, external risks and other aspects of operational risk, and to monitor for adherence to these policies. It also discusses significant entries in the bank's Risk Event Database.

The group-wide Risk Event Database (RED) ensures that operational and fraud risks are addressed in a systematic and transparent manner, with all remedial and preventive action clearly documented and accessible to management control, both at bank level and at group level. Employees are required to report all events which represent an actual or potential loss exceeding EUR 100 using the RED interface. Those reported events that entail the most extensive risks, or which are considered most likely to be repeated, are subjected to in-depth analysis by the Operational Risk Committee, which then proposes appropriate preventive measures.

A crucial aspect of risk management is the risk culture of the institution, which is transmitted to all employees through regular trainings. As part of their initial training, all new staff members are taught how to recognise and avoid operational and fraud risk and how to maintain information security.

Capital Adequacy

The bank's capital adequacy is calculated on a monthly basis and reported both to the management, Bank of Albania and to the Group Risk Management Committee, together with rolling forecasts to ensure future compliance with capital adequacy requirements.

Strong support from our shareholders once again enabled the bank to maintain a comfortable capital cushion. On September, the shareholders of ProCredit Bank increased by Eur 3 million the paid in capital. At 31 December 2013 the capital adequacy ratio (tier 1 and tier 2 capital / risk-weighted assets) stood at 14.3% (Bank of Albania Methodology), well above the group-wide minimum standard of 12%, which is also the locally required minimum.

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of balance sheets, are:

- to comply with the capital requirements set by the Bank of Albania;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Community Directives, as implemented by Bank of Albania, for supervisory purposes. The required information is filed with Bank of Albania on a quarterly basis.

The risk-weighted assets are measured by means of a hierarchy of four risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

The Bank has implemented the Methodology as per Bank of Albania Supervisory Council Regulation on Capital Adequacy, approved by the Decision No.58, dated 05.05.1999, amended recently by Decision No.26, dated 27.03.2013 of the Supervisory Council of the Bank of Albania.

Bank of Albania requires each bank or banking Group to: (a) hold the minimum level of the regulatory capital of 1 billion ALL and (b) maintain a ratio of total regulatory capital to the risk-weighted asset (the 'Basel ratio') at or above the internationally agreed minimum of 12%, and the Bank is in compliance of these requirements.

The Bank's regulatory capital is divided into two tiers:

- 1 Tier 1 capital: share capital (net of any book values of the treasury shares), retained earnings and reserves created by appropriations of retained earnings and
- 2 Tier 2 capital: qualifying subordinated loan capital, collective impairment allowances and unrealised gains arising on the fair valuation of equity and debt instruments held as available for sale. On 28 September 2009, the Bank has received two subordinated promissory notes of EUR 1.5 and EUR 3.5 million, from ResponsAbility SIVAC (Luxembourg) and Credit Suisse Microfinance Fund Management Company (Luxembourg), respectively. Both subordinated promissory notes maturity date is 28 September 2019. On 29 October 2009, the Bank has received from DWM-SNS Institutional Microfinance Fund II, incorporated in Connecticut, USA. a subordinated debt of EUR 4 million at a maturity date of 29 October 2017.