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PRESENTATION

Elena Mironova, Deputy Head of IR

Thank you. Dear ladies and gentlemen, welcome to Bank Vozrozhdenie conference call and webcast to discuss our 9 months 2012 results. Presenting today will be Andrey Shalimov, Deputy Chairman of the Management Board, and me. We'll update you on our recent activities and discuss the financial results reported in our press release that was distributed yesterday. The release is also available in the investor relations section on our website. After a short presentation we'll entertain your questions. Please, note that we have a new option for those who will be following us with a webcast. You can ask your questions in the 3d inlay in the webcast frame. And we'll be glad to come back to you with the answers after the call. Now let's move to the presentation.

First, we'll look through the key developments of 9M 2012 and then I'll comment in more detail on Q3 results. On slide 2, you can see the key highlights for 9M 2012. We've managed to gain Rub 1.8 bln in net profit that is 59% higher than the result of the same period of the last year. Net interest income was improving (it added up 27% for 9 months), supported by non-interest revenues with the fee income as the main contributor. Our net interest margin improved by 70 bps YoY and came at 4.7%. Another positive trigger in the reporting was an increase of the bank efficiency and significant improvement of cost-to-income ratio that was down to 56%. Thus, our ROEs kept growing and for the whole period made up 12.3%.

Now let's move to slide 3 and look through the trends of Q3 in more detail. The results there were more moderate and let's just look at their background. The macroeconomic developments we saw this quarter were not inspiring, and to some extent they affected our performance as well. The slowdown of the economy with the GDP growth falling to 2.9% in Q3 and deterioration of investment growth resulted into lower corporate loans expansion across the sector. All the recent quarters, retail trade was the key growth driver of the economy but it decelerated in September, and inflation's speed-up failed to support consumer spending. Capital outflow continued, coupled with tight liquidity in the system that we still observe. These developments translated into some of our balance sheet trends and forced us to respond. We've maintained liquid assets at the level above 20% to feel more comfortable and secure. Corporate demand was weak but stronger retail loan growth almost offset this decline on the corporate side. We still keep sticking to conservative currency and maturity structure of the balance sheet and give preference, on the currency side, to rouble instruments, just to protect ourselves from significant fluctuations. Due to limited money supply interest rates kept growing both on deposits and loans so we had flat net interest income, though supported by non-interest revenues that made up 42% of our operating income in Q3. In such environment we focused on operating efficiency and kept our expenses under strict control.

Let's move to slide 4 and look at our asset structure. It remains more or less stable. This quarter we increased the share of liquid assets to 23%, though managed to improve its profitability as well. We were placing available funds in securities and correspondent accounts due to stagnation of the loan portfolio. However, share of interest-earning assets comprised 77% of the loan book and the yields were going up, with the main contribution coming from the portfolio structure.

On slide 5, you can see the breakdown of our loan portfolio. It shrank by 0.5% for the quarter amid low business activity, lack of demand, and repayment of a number of large loans and loans to administrations. However, share of our key client segment - SMEs - improved to 63% of the portfolio and made up Rub 77 bln. At the same time, the bank's retail portfolio outpaced sector and delivered 11% increase in 3Q. Mortgage loans are still the most important product for us in retail, on a quarterly basis it grew by 12% and now represents 67% of the retail book. As of the end of 1H2012, we were on the 8th place by mortgage issuances among Russian banks. The bank's stance to consumer loans is more conservative. We do not offer them to the street, focusing more on employees of our corporate clients, payroll programme members, and depositors. Nevertheless, portfolio stood at Rub 8.6 bln, delivering 9% increase for the quarter. The regional diversification remains intact - Moscow and Moscow Region gains the share of 58%. The key sectors for us are trade and industrials.

Let's move to slide 6 - credit quality management. The NPLs of the bank increased this quarter quite substantially, to 9.4%, due to one big-ticket loan of Rub 2.1 bln in large corporates. This loan is from transportation segment, it was an investment project we participated in. In 3Q we saw substantial deterioration of its position, and the first overdues to come. So we've increased provisioning on it that pushed our cost of risk higher as well. For the quarter, the cost of risk stood at 2.9%. However, on the accumulated basis it was 2.1% for 9M2012 that is quite close to the higher limit of our guidance. Another add-up in the NPLs was in the retail portfolio. There we had one quite large mortgage loan moved to overdue. But the bank expects to solve this issue in quite a short term due to the high liquidity of the collateral. However, on the key clientelle for us - SMEs - we saw positive developments in both absolute and relative terms, partially due to repayments and workout of problem loans that we are currently sticking to.

On slide 7, you can see the static picture of the NPLs. Due to that increase, our coverage dropped but still remained above 100%, making us feel quite comfortable. For loans with more than 90 days overdue the indicator stands at 153% that is more or less ok. The share of rescheduled loans made up 4.6% of the portfolio, same level as it was last quarter.

Let's move to slide 8 – our liability structure. It remains stable. We have limited dependence on market instruments, and the main source of funding for us is client accounts. In 3Q retail deposits added up 1.8%, compensating slight decrease in corporate client funds that is currently one of the most volatile and competitive instruments on the market. The bank managed to enforce its capital base: Tier 1 and total capital adequacy ratios grew to 12.1% and 14.2%, correspondingly, supported by the first tranche of subordinated debt that we raised in July. Moreover, the volume of our risk-weighted assets shrank by 1.4% due to increase of liquid instruments' share in the balance sheet. These were the key points on our balance sheet.

Now let's move to the P&L. On slide 9 you can see it in the brief form, and we'll comment on it in more detail on the further slides. On slide 10 you can see the dynamic of interest income and net interest margin. In 3Q, net interest income remained flat with interest revenues' growth almost fully offset by funding costs. However, core interest income kept improving and reached Rub 4.3 bln on the back of high rates across the corporate portfolio and stronger focus on retail loans. However, growth of the indicator was limited due to repayments in the corporate portfolio. Interest expenses were also increasing, reflecting the continued repricing of corporate and retail deposits. On the corporate side competition is gaining pace. But our share of the corporate deposits in the total liabilities is just 23% so it's not as sensitive. On the retail side increases were much milder, and the growth is creeping. We maintain funding costs at the level of 4.7% that is still quite comfortable for us. So as the yields on interest-earning assets also increased to 11.4% for the quarter, interest spread remained more or less flat and made up 6.7% in the third quarter. Net interest margin slightly contracted by 16 bps but mostly driven by the base effect as you can see on the right bottom graph.

Let's move to slide 11. Our operating revenues grew by 2.7% for the quarter on the back of high fee income and improved other operating income contributed by one-off items - proceeds from cession operations and revenues from sale of part of our non-core assets. Non-interest income provides stability to our revenues. In the third quarter it made up 42% of the operating revenues before provisions, and it's one of the highest levels in the sector. Our net fee margin of 2.7% is still one of the strongest among peers. In comparison to the second quarter fee income growth was quite modest at the level of 2% due to lower business activity and the seasonally weaker third quarter, reflecting the economy's slowdown. As for the segmentation of fee income, it's largely stable, major part is contributed by corporate business (55% share), followed by card business (delivering 23%) and retail (with 18% contribution).

Let's move to slide 12, our costs dynamic. It was one of the positives of the third quarter and the 9 months as well because this year we focused on costs very closely and did our best to limit their growth. So for 9 months 2012 it stood at just 4.8% that is even below the inflation level for the period. In the third quarter costs contracted by 4.9% supported by declines both in personnel expenses and administrative costs. The staff costs contracted by 1.9% due to decline in the headcount, while other operating expenses were supported by tight cost control. So our cost-to-income ratio fell to 53% for the quarter, and it is the lowest level for the last three years. If you might remember, we are in a large cost efficiency project with a consulting agency, and currently we are on the second stage of it, preparing all the IT infrastructure, coaching our staff, and developing a new motivation system. In several branches we are closely monitoring pilot projects, and testing the processes to find the smoothest way to implement the changes, striving not to harm our client relations. On the third stage of the project we'll proceed to replicating this stance for the whole bank but looks like it would be the issue of next year.

Please turn to slide 13. Due to positive dynamics of non-interest income and costs, operating profit before provisions and taxes grew by 12% for the quarter and made up 1.8 billion rubles marking continued progress in returns recovery. Elevated level of provisioning offset growth of core profit, bringing our bottom line down by 14% in the third quarter. However, we still stick to prudent credit policy of providing comfortable coverage in advance. This stance protects us from material fluctuations of the profit-generation capacity. Same, if we look at ROE's development before provisioning: continuing growth is still in place.

On slide 14 there are the key takeaways of the third quarter. What we see there: though the whole portfolio stagnated, we continued to dwell on retail mortgages and SMEs that are key client segments for our portfolio. They are taking average asset yields higher. Liquidity issues stand quite tough in the current environment, so we keep the liquidity ratio above 20%. Our current funding structure works well with us, with retail deposits providing stability, and the corporate funding that is choppier, but helps us to react quickly to the loan portfolio trends. We keep partially passing on higher costs of deposits to our borrowers, and taking into account the results of the third quarter, we feel quite comfortable with our net interest margin guidance for the whole year. So the key for us, going forward, would be to defend margins. We'll also keep dwelling on operating efficiency. The project we've started is expected to bring the first fruits in 2013. It is going to contribute to our core business strengths remaining intact. So, with all that, we are quite confident in the future performance and try to do our best to deliver better results. So, that's all with the presentation. Now let's move to Q&A session, and don't forget of the new option of asking questions in the webcast.

QUESTIONS AND ANSWERS

Moderator

Ladies and gentlemen, if you do with to ask a question on this call, please press "*1" on your telephone keypads now. And our first question is coming from the line of Alex Kantarovich, J.P. Morgan. Please, go ahead.

Alex Kantarovich, J.P. Morgan

Thanks. Andrey, Elena, really two questions. First one is on provisions. Regarding the provision expense, what would you view as normalized provisioning level and when can we expect the bank to revert back to normal?

Andrey Shalimov, Deputy chairman of the management board

Good afternoon. Indeed, what we observed in the third quarter, we hope that was a one-off thing. But nonetheless that was we had been talking about for some time, the level of over-provisioning of 120-140% - that's exactly for such kind of situation. When there could be some serious exposures soaring we need to have some cushion in our provisions to absorb without serious detriment to the current profits, not to say about capital. Of course, now cost of risk is above 2%, what we see this year, but we hope after fourth quarter we still could bring it below 2% on the annual basis. Nonetheless it is still not far from our guidance of 1.8%. The key to answer this question, I suppose, is the development of economic situation. What we saw in the third quarter, when credit demand stalled and corporate activity was lighter than normally, that's a bit worrying, and today the news that VAT collection plans adjusted downwards for our tax agency, that means that activity not so good as people expected. So that's the key to understand whether it's some maybe one or two quarters, or some slowdown, or that's a new trend. Provided it's simply peculiarity of this fall and increase in industrial production, next year we expect, of course, lower normalized provisioning. But if economy really stalls and growth would be close to zero, of course, we could expect some rough times on asset quality side.

Alex Kantarovich, J.P. Morgan

Right. But again, under normal conditions, 120-140% would be your expected range, if I heard you correctly.

Andrey Shalimov, Deputy chairman of the management board

You mean cost of risk?

Alex Kantarovich, J.P. Morgan

Yes.

Andrey Shalimov, Deputy chairman of the management board

I suppose, in situation of 4-5% growth in economy, the cost of risk, of course, should be below 1.5. I couldn't say whether it could be below 1% but it should be within 1-1.5%, and closer, maybe, to 1%.

Alex Kantarovich, J.P. Morgan

Ok, fair enough. And my second question is on your asset structure. As it often happens with the bank, cash is at very high levels which is a clear drag and helps explain the gap between the spread and the margin. Other banks don't have it like this, and my question, I guess, is if you can picture normalization of cash within the balance sheet.

Andrey Shalimov, Deputy chairman of the management board

The key thing and the worst, of course, it's a currency structure, we discussed it last time. What we're doing, we're lowering the rates on our liabilities since, unfortunately, our options to deploy this cash productively, are limited. Due to very tough competition from all banks in currency lending it's very difficult to find large enough borrower to apply serious amount of cash, and suitable borrower with good export revenues, etc., etc. And in our core niches, like retail or SME, of course, we don't see serious options to employ this cash. So the key and, maybe, the only measure at the moment is to cheapen our liabilities, of course, not to 0% but, I suppose, we are not far from being below 3% on average on term deposits in currency, to lighten up this burden on the balance sheet.

Alex Kantarovich, J.P. Morgan

Ok, I understand. Thank you very much.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. Our next question is coming from the line of Bob Kommers from Deutsche Bank. Please go ahead.

Bob Kommers, Deutsche Bank

Good afternoon. I have a question regarding asset quality. As mentioned, the NPL ratio increase is due to the big loan to the transportation sector that turned bad in the third quarter. But at the same time, and maybe I misunderstood, you expect actually the recovery on this loan to be good due to the high liquidity of the collateral. If that's the case my first question is why do you build up a big provision for it. And my second question is what will you expect that NPL ratio to be at the end of the year? And, related to that, why would you expect the risk cost for the full year 2012 to be above 2% which would be implying higher than 2% risk cost in the fourth quarter if indeed you expect to recover a big part of that bad loan. Thank you.

Andrey Shalimov, Deputy chairman of the management board

Thank you. On the first part, why we decided to provision extensively. It's not totally new, a problem. Indeed, this customer was restructured, and then it did fine, so there was no serious suspicion that it could turn to NPL. But, as we stressed in the first and second quarter conference calls, we were particularly cautious this year on transportation, and unfortunately our suspicions this year turned true. It's indeed not a new problem. As it reoccured as a problem, of course, we decided to provision heavily. Since one time we saw and accepted customer's business plan and we considered it reliable, etc., etc., etc., and it turns wrong - not completely wrong, since people are not seriously overdue and out of payment schedules, but nonetheless, if it's the second time, of course, approach is much more strict. Talking about whether it could be quick recovery, let's see. If we take a look at this sector, demand is linear and maybe there could be a chance to sell some assets but pricing is a bit questionable at the moment, and another feature is legal procedures, as we stressed not one time. Unfortunately it could take up to 2-3 years to have assets legally cleared. So collateral is not bad indeed by quality and valuable but we in procedure, and only starting this procedure, of course, it could take some time. But we already made 50% provision so maybe no need to make 100%, let's see, and it looks manageable.

Bob Kommers, Deutsche Bank

And then on the cost of risk implication…

Andrey Shalimov, Deputy chairman of the management board

Talking about the fourth quarter, you never know what could happen. Sometimes, as we discussed, it could be very volatile figure, since it's the rainfall from the budget, and many people, whom we even don't expect to pay some exposures back, could do so. Now, under our formulae, we are seriously above 2% cost of risk. Maybe external calculations due to different base indicate slightly more than 2%. But nonetheless we see on our realistic forecast the figure could be something around 1.9% (or 190 bps) of cost of risk, under our formulae. So it could slightly differ depending on how you calculate this figure. But still expect it should be below two percentage points.

Bob Kommers, Deutsche Bank

Ok, below 2%, ok. And just regarding this collateral, given that this is a transportation company, is the collateral cars, or trucks, or am I completely, I mean, what type of collateral is it?

Andrey Shalimov, Deputy chairman of the management board

I suppose that's more complex one. Some real estate and, yes, some transportation equipment, or something like that, so it's sellable but all depending on price. If you track real trucks prices, it was a decline this year due to low demand from lease companies of state banks - VTB Leasing and VEB Leasing. And that's still under process. So of course we have some security margin in the prices but situation not very stable in this market so let's see. It's a matter of a month, maybe, of appearance of this situation and, of course, we are now checking what could be possible damages, how fast we could sell the collateral. But at the surface it looks manageable.

Bob Kommers, Deutsche Bank

And second question regarding the margin dynamics: what are the trends that you are expecting for your asset yields and your funding costs?

Andrey Shalimov, Deputy chairman of the management board

Indeed we still see upward trends on both sides but September-October is a slightly different story. With stall on demand side, of course, the room to increase rates looks limited at the moment. On the other hand we still see the demand and still see that potential credit supply is limited. So it's a question of what could be higher: either this limited demand or limited supply. And still maybe limited supply is the driver, and we still provide loans at significantly higher rates than we did in spring. On the other hand situation is very tense on funding side. Two biggest banks in the market pay very high rates on corporate deposits and, subsequently, the whole market following suit. As for the decline in corporate deposits for us, for example, in the third quarter there are two reasons: of course, slower demand on corporate loans coupled with expensiveness of this funding. We decided not to renew some deposits, since pricing in the market looks unreasonable for us. It's a luxury. But there should be something positive in every situation, and in this situation of slow demand and good core deposit, especially core retail deposit, of course, we have a luxury, say, to omit some expensive offers on corporate deposits. But nonetheless trend is upward but there are only two big players who increase rates and really make this market. So provided any change in their behavior there could be serious plunge in the rate. But we don't expect it.

Bob Kommers, Deutsche Bank

Ok, thank you.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. Our next question is coming from the line of Mikhail Shlemov, VTB Capital. Please go ahead.

Mikhail Shlemov, VTB Capital

Good evening. A couple of questions from me. First, I would like to start with costs. Obviously, the improvement in the third quarter has been very solid. If you could discuss a little bit underlying trends, how it was achieved, in particular, regarding how far you are now on the headcount reduction, and what we should expect in the coming quarters, and what would be your cost/income guidance for next year. And the second question comes on the capital side: your N1 ratio is 11.6%. I saw some remarks that Andrey made yesterday to the press saying a number of capital options are on the table for next year. I wanted to ask how Basel II implementation upcoming in the beginning of 2014, is impacting your risk-weighted assets and do you think you can pass over only with subordinated debt or you need to do an equity issue. Thank you.

Andrey Shalimov, Deputy chairman of the management board

Thank you. On costs - yes, there were some achievements, and some reduction in the headcount, it was in the headquarter, it's still not concerning our branch network, and we are preparing to change the network structure, and that's of course not very fast process. But in the headquarter we managed to do some changes, and it really saved some money for us. But the key is to have really consistent roadmap for coherent steps since of course the example of Sberbank indeed it's a two-way story. They manage to cut the number of employees but on the other hand they raised salaries in much more serious proportion and then they have spiraled IT expenses, both OPEX and CAPEX. And what we are trying to avoid is this serious increase in IT spending. So the key here is to find the balance between salaries expenses reductions and, maybe, temporary increase on IT spending. There is a number of other results on horizon. Maybe in the fourth quarter but I suspect more in the first quarter next year. But it's still on the first stage, and to see more serious results, of course, we need more time. And the key here of course is to have successful pilot projects with, say, two or three branches or smaller points of sale, and then, of course, we could replicate all that swiftly, since consistency of branch network is a pretty good thing in Moscow Region, especially, where branches are very similar, structure and operations are very similar. So after some successful pilot projects, of course, scaling of results could be pretty fast. But I suspect that's a matter of 2013 and key goal for 2013. So I suspect no serious results really in this year results. So, that's on timing. And by the scope and eventual result the target, of course, to lower this ratio below 50%. It's now under discussion, the terms of the business plan and horizon of the target to settle this ratio at the level of 50% bank-wide level for the end of 2013. Whether it's achievable - there is good chance but we need to finalize our discussions. We feel we have sufficient resources to restructure process both in headquarter and in branch network, so it should be carefully planned, orchestrated, and executed next year. For this year, it would be nice to see our cost-to-income ratio below 60% on a year-wide basis but, of course, it's very hard to foresee it at 50% this quarter. I suppose the figure still should be higher since some payouts in the year-end should be done. Maybe results could be better than we anticipated, it's still a possibility that payout ratio could be higher. So the key for this year is to be below 60% and for next year - to make steps to 50%.

Mikhail Shlemov, VTB Capital

Ok, thank you, Andrey. You were talking about this possible 50% cost/income ratio next year. Could you specify other parameters, in particular on the top line, which you are looking at? For example, what percent of the loan growth you are looking at, what level of net interest margin?

Andrey Shalimov, Deputy chairman of the management board

The key level to defend on the margin side, of course, is 4.5%. It's still under extensive discussion. And the key here is not only to manage interest rate but to turn some overtaken assets into cash, to put it into work. That's a key for us. To sell a number of overtaken assets. That's very important. Then to change slightly the composition of currency structure of the balance sheet. And it's extensive search for some number of currency borrowers. If we managed to do these two things simultaneously we could defend 4.5% margin even in case of ruble spread compression. So that's a fine-tuning of the plans, of course, conservative, and we focused on that now. Talking about growth rates, as I said, third quarter results in economy are very worrisome, and we need to see how the situation changing in November and in December. Still we regard 15% loan book growth as quite achievable but the composition within this growth could change. If weak corporate demand persists, of course, we need to focus on our retail products. There may be some change in our policy. Maybe to increase the retail book to 25% or slightly above 25% of the total book. But it's still not decided. It's one of the options we're working on. But the base case scenario is still 15% growth, something around 10-12% on corporate side and something between 20-30% on retail for next year. And on capital - yes, there is a number of options available. Of course, most of them concern subordinations. We checked Central Bank reaction on different instruments, and they are still ok on some plain-vanilla structures, and there are people ready to discuss and provide this funding. It should be ok for our capital purposes, at least in some number of years. So capital base could be strengthened, and we have some plans on that side, but of course, pricing is a key. Talking about Basel II impact and even, to some extent, Basel III impact, of course, it's a very sensitive question. But we don't see serious pitfalls for us. The proper calculation of operational risk is pretty rough and very serious under Central Bank regulation. Let's see whether we could negotiate a more gentle approach under IFRS, that's still a point of discussions with auditors. But in many aspects we have already applied very tough principles in our calculations. Of course, it's good to have very qualitative mortgage book as most part of our retail exposure. And we are not heavily involved in derivative trading which is positive, again. Of course, it's a big question how to deal with non-banking, non-core assets. And that’s a matter of special review, and we try to consult as many people as possible, both locally and internationally. So at the moment we still don't expect a very significant decrease in capital ratios, comparable what was the decrease under Central Bank regulation in 2011-2012 when they implemented all things concerning operational risk and non-core assets, assets with increased risk, etc., etc. So at least at the moment we are more or less comfortable. On the other hand people in charge are on alert, attending conferences, consulting, discussing, and provided some material impact, of course, we try to disclose the information as fast as possible.

Mikhail Shlemov, VTB Capital

Andrey, am I hearing you correctly that a possible impact would be, say, within 10% threshold risk-weighted assets increase?

Andrey Shalimov, Deputy chairman of the management board

No material impact, indeed.

Mikhail Shlemov, VTB Capital

So you are saying it will rather be in the low single digits then?

Andrey Shalimov, Deputy chairman of the management board

Yes. If we base on our current calculation, we see figure below two digits.

Mikhail Shlemov, VTB Capital

Ok, that's helpful, thank you very much.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. Our next question is coming from the line of Svetlana Pavlova, Renaissance Capital. Please go ahead, Svetlana.

Svetlana Pavlova, Renaissance Capital

Good evening, Andrey, Elena. Couple of follow-up questions from my side. And the first question is on your net interest margin. The way you talk about it, it sounds like you see some downside risks and you are thinking about defending the NIM at the level we see currently or slightly below that. Could you please be more specific what exactly downside risks you see, where they are coming from?

Andrey Shalimov, Deputy chairman of the management board

Yes, sure. At the moment funding side is a more visible risk, especially in wholesale funding, that could be depressing. But in longer term, if this stance in corporate funding persists for some time, of course, biggest players should be inclined to increase retail rates, too. We still manage to avoid serious rate increases but nonetheless it couldn't last indefinitely. So at some point in the future we need to follow suit. We of course hope they could be piecemeal increases but still a risk of upward pressure on rates. More stable situation is on the asset side. It's still an upward trend, too. Maybe slower than on the funding side, and it's supportive for the margin but on the balance of course we are afraid of some kind of squeeze in ruble spread.

Svetlana Pavlova, Renaissance Capital

I see, thank you very much. And my second question is on the asset quality. Just could you please clarify this for me? So you were talking about large corporate loan in the transportation sector, which is about 2.1 billion rubles, going bad in Q3. If I remember correctly you also had a loan of a similar size going bad in Q1, so my question is: are these two different loans or is this the same story, firstly? Secondly, you mentioned 1.9% cost of risk in Q4. Does this include some extra provisioning against these particular problems or is it a general precautionary provisioning level? And, finally, you mentioned normalized cost of risk of 1-1.5% - should we start seeing this from Q1 already or will it be later in the 2013?

Andrey Shalimov, Deputy chairman of the management board

Let's start in the middle. Yes, this 1.9% annual - it includes provisioning against this exposure. Talking about the first question: after first quarter there were a handful of exposures going bad. Though all in corporate segment but there was a number of borrowers, and they were from different sectors. And the key exposure there was serious development project and it was a death of the owner and key manager of this project, indeed, the reason for the loan turning sour. So that's slightly different situation. But if we talk about the exposure to transportation - yes, the quality of this total exposure to the industry - it's not of the best possible quality among industries in the portfolio. That was disturbing us this year, particularly in the spring and in summer. And if we talk about the third question, in our opinion the condition for this level of normalized provisioning is a more or less not robust but sound - GDP growth at level of, say, 5%. So the growth below 4% could result, of course, in higher provisioning, maybe above 1.5%. But not materially higher, I suppose. And at the moment we don't consider scenarios with higher growth of, say, 6%, 7%, or 8%, so it's out of our consideration now.

Svetlana Pavlova, Renaissance Capital

I see, thank you very much, but just to clarify: so this 1.9% cost of risk - it's for full year 2012…

Andrey Shalimov, Deputy chairman of the management board

It's our assessment. As I said, fourth quarter - it's very volatile, and sometimes there are net write-backs in the fourth quarter so I couldn't exclude such outcome even this year. But if we take trends into consideration - yes, it could be something around and slightly below 2%.

Svetlana Pavlova, Renaissance Capital

Do you plan to make any more provisions for these problem loans that we were talking about, transportation, real estate, etc., or do you feel comfortably provisioned for them?

Andrey Shalimov, Deputy chairman of the management board

Yes, I dwelled already: we are now checking all options to decide whether we should provision further. As I said, already 50% provisions made, and we don't expect 100% provisioning. But where we should be within this 50-100% range, of course, is still to be determined.

Svetlana Pavlova, Renaissance Capital

Ok, thank you very much.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. Our next question is coming from the line of Andrew Keeley, Sberbank. Please go ahead.

Andrew Keeley, Sberbank

Good afternoon, Andrey, Elena. Just coming back to costs: can you give us a sense of the scale of headcount cuts that have been made so far, I think, in the head office, you said? And can you give us any possible idea of the kind of headcount cut levels you'd be thinking about, you know, through the network next year? And, still on the issue of costs: am I right in thinking that so far it sounds like you've only kind of been tinkering a little bit and that a lot of a major kind of initiatives are actually going to be coming next year? Is it correct to think that things like the back office centralization project - you haven't really started that, and that's going to be something for next year, is that correct?

Andrey Shalimov, Deputy chairman of the management board

First, with headcount in the headquarter: indeed, the total decrease here is slightly below one hundred persons. And this round of cuts is already done. Talking about our targets for headcount reduction across branch network, it's substantial. I don't like to air this figure since socially it's a bit irresponsible and it's not a one-time decrease. But of course we are thinking about substantial decrease. And the essence, of course, is dealing with back office and, indeed, extraction of back office functions from the network, centralizing it at one place - in operational center or in the service center, or maybe in two service centers. It's all natural: focusing all our points only on sales and customer service and lightening these points of sales, standardizing working places, desks and so on, indeed, and cheapening infrastructure. So, decrease the number of back office headcount and standardizing and cheapening working places. And another thing, of course, is more result-oriented compensation system which could be more incentive for lower cost-to-income ratio across the network. So it's three key things. And of course the risk is the splash in IT expenses to organize this centralized processing to set up those service centers.

Andrew Keeley, Sberbank

Ok, that's great. Do you think your cost growth can basically - it's now down at 5% or lower in year-on-year terms - do you think you can maintain that kind of level in terms of year-on-year cost growth next year?

Andrey Shalimov, Deputy chairman of the management board

Unfortunately discussions on expense budget - they are not finalized. We are in the mid of very tough discussions. Eventually last year the decision was taken not to increase overheads apart of salary in comparison with 2011 level. Of course, we should expect some kind of increase this year but the key question whether it could be bold decision to say only 3% or 5% growth, irrespective to results, or it could be more in direct link with some areas' results, for example, the growth in IT spending could be more situated by, say, 30% increase in some product areas. Say, plastic cards, or internet banking fees, or something like that. So at the moment I can't say on some finalized approach. But the key for discussion, of course, is to have cost-to-income ratio at above-mentioned level. So the whole discussion is down to whether it's achievable or how is it achievable, and that's one of the key KPIs for the whole personnel involved in the process.

Andrew Keeley, Sberbank

Ok, that's brilliant. My second question is on your lending mix. You mentioned earlier that given a fairly weak corporate credit demand, potentially increasing the share of retail quite strongly, I am just wondering whether you've done any analysis or you can share with us any thoughts on the potential impact of the Central Bank's proposed regulatory changes regarding consumer loans from early next year? Obviously, consumer loans are a relatively small part of your book, they are about a third or so, I think, but have you done any kind of analysis in terms of the potential impact of that and is it something that is going to kind of cause you to look to increase the share of mortgages even further in the book?

Andrey Shalimov, Deputy chairman of the management board

We made some preliminary analysis of Central Bank proposals. The key takeaways are: we may be situated better than majority of Russian banks, to accommodate those changes. Indeed, there are no rates above 22% at all in our product line, no currency lending to individuals, so minimal impact from that point of view. And it’s only the questions of recognition and provisioning under Russian standards. But, as you know, under IFRS we are provisioning against one day overdue loans and recognise them as NPLs. So no impact on IFRS results and treatment under IFRS, and very small treatment on provision figure under Russian standards, that's all.

Andrew Keeley, Sberbank

Ok, that's very clear. And just finally, coming back to your margins: in terms of trying to defend your NIM, given that it seems to be getting a bit harder to pass on higher funding costs to borrowers, are you inclined to start pushing up your loan/deposit ratio a little bit? Because on net basis it's around 90% or so. It seems like there is a bit of room for an increase in that, or is it something that you're not really thinking about doing?

Andrey Shalimov, Deputy chairman of the management board

We still wary of it, situation globally is very unstable. Looks like all cards are already on the table from the Central Bank parts and monetary policies don't work globally, and looks like it should be some decisions on budget side whether it could be inflationary burn of the debts or some situation with this notorious budget cliff in the United States. So that's the key, not Russian conditions, for our decisions on appropriate liquidity levels. Nonetheless, we still like to survive in any kind of another world crisis or Russian local crisis. And irrespective of what could be the origin, whether within Russia or in China, or in Europe, etc., etc., we consider this level as appropriate in current conditions.

Andrew Keeley, Sberbank

Ok, great, thanks very much, Andrey.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. Our next question is coming from the line of Mark Rubinstein from Metropol. Please go ahead, Mark.

Mark Rubinstein, Metropol

Hi, good evening, thanks for this presentation. Just a quick question: the commission fees - that's always been a very strong factor and even a driver for bank's earnings. And we see some slowdown in their dynamic in this line. Is it a one-off, and can you say what sort of growth drivers you see for this line, going forward, whether there are new products or new services that can generate increase in this line? Thank you.

Andrey Shalimov, Deputy chairman of the management board

Thank you, Mark. Indeed two things to discuss. First, of course, we worried too about the situation and slowing down in our traditional product niches. It's a slowdown especially directly or indirectly tied to corporate performance. On individuals’ side some depressing factor was state agencies' position on, say, consumer defense. Banks had to abolish some fees or something like that. But nonetheless still, I suppose, situation is very promising concerning fees for individuals. On the corporate side it's a mixed picture and looks like the trend maybe could follow suit in corporate lending. If we see some slowdown, I'm afraid it could be universal slowdown for the whole sector, both for interest income and non-interest fees from those customers. We observed some slowdown in turnovers of some big customers and closely watching whether it was some seasonal or one-off but still haven't made our minds on the subject. Apart of that, of course, the necessity is to introduce new products to the market and we are now ready to offer our mobile and internet banking on all platforms, iOS, etc., etc., so we expect some boost for fee income from that line and it isn't the end of the story. We introduce some electronic services for SMEs this quarter and early next year, and that's one of the key projects to increase fee income at the expense of introduction of new products. But it's some kind of green field. But indeed we are concerned on our brown field and monitor the corporate sector performance very closely.

Mark Rubinstein, Metropol

Ok, thank you.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. We currently have no further questions coming through. Just another reminder: please press "*1" if you would like to ask a question on this call. And we have a question coming from the line of Natalia Berezina from Uralsib. Please go ahead, Natalia.

Natalia Berezina, Uralsib

Thank you. Also a quick follow-up question on provisions: there were comments in media about 300-400 million rubles of provision charge for the fourth quarter so, I guess, it's a bit of a light estimate, right? Your guidance of 1.9% for the full year implies a bit higher figure, actually.

Andrey Shalimov, Deputy chairman of the management board

Yes, it's a bit early, indeed, to provide some firm figures. This assessment of 1.9% is simply based on the trend calculation. People in charge of the business, have their own view, based not on trends but on current performance of their business segments. So there could be this light scenario, there could be slightly deeper provisioning, both. As I said, we couldn't exclude even some write-backs. So it's a bit of guessing still in the mid of November when you have December in sight. It's the most volatile month in a year.

Natalia Berezina, Uralsib

Yes, understood, thanks. Also a follow-up question: so you connect provisioning charge and cost of risk to GDP growth, and could you possibly name your forecast for the next year you use? It's below 4% or not?

Andrey Shalimov, Deputy chairman of the management board

We still like to use this 4% threshold but recent data, of course, had a skew to lower figure, unfortunately. Let's see. For our next-year calculation we still have some room so we finalize our business plan in mid-December. The key components, of course, should be finalized by the end of November but still people like to think about 4% growth.

Natalia Berezina, Uralsib

Ok, thank you.

Andrey Shalimov, Deputy chairman of the management board

Thank you.

Moderator

Thank you. Ladies and gentlemen, final reminder: please, press "*1" if you would like to ask a question. We have no further questions coming through so I hand you back to your hosts to wrap up today's call.

Elena Mironova, Deputy head of IR

Ok, thank you, ladies and gentlemen, for participation, and if we can provide you any assistance, please contact the IR team or visit our website at www.vbank.ru. With that we'll conclude the call today and would be looking forward to updating you again in March with the announcement of our year-end 2012 results.