SMART GROWTH STRATEGY

ANNUAL REPORT 2016
The 2016 outcomes once again showed that the course towards evolutionary development of the Bank and its smart growth chosen by the management team put us on the right track. A substantial rise in the number of active clients, the increased net revenue in principal areas of operation, and the reduced cost-of-risk indicator were attained through the skilled implementation of the Bank strategy approved back in 2012.

Mikhail Fridman
Member of the Board of Directors

ALFA-BANK 2016

<table>
<thead>
<tr>
<th>branches and offices</th>
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<tr>
<td>employees*</td>
<td>21 276</td>
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<tr>
<td>corporate clients</td>
<td>334 100</td>
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<td>equity, USD million**</td>
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<td>loan portfolio, USD million**</td>
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</tr>
<tr>
<td>total assets, USD million**</td>
<td>38 247</td>
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* Without taking into account the number of the Public Joint-stock Company «Baltiyskiy Bank».
** For the purposes of this report, the term «Alfa-Bank» is used to describe ABH Financial Limited and its subsidiaries.
ALFA-BANK’S AWARDS IN 2016

12.2016
Alfa-Bank wins the Financial Olympus Award in ‘Reliable Bank’ category
Alfa-Bank was recognized as the leader in terms of transaction business growth rates, based on the survey titled ‘Cash Management in Russia: Market Leaders’ of the RAEX (Expert RA) rating agency, supported by the Association of Corporate Treasurers.

12.2016
Alfa-Bank declared premium banking service leader
Alfa-Bank and its ‘Maximum +’ premium program were listed in the Top 3 premium banking services by Frank Research Group. The Bank also won the ‘Best Remote Banking Service’ nomination with its special offer for clients of ‘Maximum +’ service package and Alfa-Mobile Premium A-Club.

11.2016
The Next card becomes the finalist of National Payment Initiative contest
The NEXT youth card won the best non-cash payment practice contest, National Payment Initiative, which took place at the IV National Payment Forum.

10.2016
Alfa-Bank leads in transaction business market
Alfa-Bank was recognized as the leader in terms of transaction business growth rates, based on the survey titled ‘Cash Management in Russia: Market Leaders’ of the RAEX (Expert RA) rating agency, supported by the Association of Corporate Treasurers.

10.2016
Alfa-Bank shareholders and top managers again rank amongst best managers
Alfa-Bank shareholders and top managers were once again named as Russia’s best managers; they occupied the first 17 positions in the annual Top-1000 Russian Managers ranking prepared by the Kommersant Publishing House together with the Russian Managers Association.

08.2016
Alfa-Bank wins again
Alfa-Bank won the Award of VISA payment system, Visa Global Service Quality Performance Awards, for high quality operational services in 2015 provided to Bank’s clients, VISA card holders. Alfa-Bank won its fifth award in the categories of ‘Authorization Approval Rate’ with the highest ratio of debit product authorization approval and ‘Risk Efficiency’ with the highest ratio of risk management efficiency.

08.2016
Forbes names Alfa-Bank Private Banking best amongst Russian private banks for millionaires
A-Club Private Banking topped the Forbes rating of Best Russian bank for millionaires amongst Russian private banks. The private banking ranking of Russian banks was based on a number of parameters, such as the opinion of bankers, banks financial performance, the number of certified employees, the presence of bank offices in foreign countries, and the product range.

06.2016
Alfa-Bank ranks first by Forex turnover in Central and Eastern Europe
According to the Euromoney FX Survey 2016, Alfa-Bank ranked first by Forex turnover in Central and Eastern Europe posting a market share of over 18% (vs. 7%, fourth position in the previous year) and climbed ten positions to 21st place in the world rating with a share of about 1%. In the European ranking, Alfa-Bank was listed together with such global giants as JPMorgan (market share of 12%) and Citi (9%).

06.2016
Alfa-Bank recognized as one of most impressive borrowers in emerging markets
Financial market experts and global capital market actors lauded the USD 500 mln Alfa-Bank Eurobond issue closed in 2015. It was the first public offering of Eurobonds conducted on such a scale by a Russian financial institution after the global financial com-
The community had revised the outlook for Russia’s country risk due to the 2014 events. Experts were polled by the authoritative financial edition Global Capital at the end of 2015. Alfa-Bank won in the following categories. It ranked second in the ‘Most Impressive EM (ex. Asia) Financial Institution Borrower’ category (Alfa-Bank ranked second to National Bank of Abu Dhabi and surpassed Emirates NBD Bank, which ranked third); It came third in the ‘Most Impressive Borrower in CEEMEA (Central and Eastern Europe, the Middle East and Africa)’ category (Poland ranked first, and Turkey occupied the second position).

05.2016
Alfa-Bank receives award for project implementing Basel Committee on Banking Supervision standards
Alfa-Bank was awarded for a project implementing Basel Committee on Banking Supervision standards (Basel II, Basel III): for the concept and team approach in the Security, Fraud, and Risk Management nomination of the contest of the company Celent, a member of Oliver Wyman Group — a global management consulting company. The jury picked from over 120 global projects and institutions. Only 18 banks were declared victorious. The award ceremony took place at the Museum of American Finance in the very heart of Wall Street in NY.

04.2016
Alfa-Bank wins ‘Best Forex Desk’ award at Moscow International Currency Association’s Dealer of the Year contest for fourth year in a row
Alfa-Bank won the 2015 Best Forex Desk award at the Moscow International Currency Association (MICA)’s Dealer of the Year contest. The XIV award ceremony of the MICA Dealer of the Year contest took place in Moscow on April 12.

03.2016
Alfa-Bank call center again recognized as Russia’s best
Alfa-Bank again won the international contest Crystal Headset in the ‘Best Financial Call Center’ category. Alfa-Bank was also the best in a number of team and individual nominations. More than 250 contestants representing over a hundred call centers from Russia, Ukraine, Kazakhstan, Kyrgyzstan, Belarus and other countries participated in the contest.

03.2016
Alfa-Bank four awards at Banking Sphere Awards
Alfa-Bank was named among three leaders in the Banking Sphere Award categories: Most Innovative Bank, Small and Medium Business, Interaction with Industry Media, and Payment Service.

The Banking Sphere Award is bestowed for innovative and efficient solutions for a standard set of bank products. A panel of 78 experts, analysts, banks and representatives of the Russian financial market infrastructure named winners in 18 categories. All the nominees were assessed by economic and technological parameters of a solution for a bank product. Alfa-Bank has been winning in various categories since the award was established.

03.2016
Alfa-Bank named most reliable among Russian private banks
The annual Forbes ranking of reliable banks named Alfa-Bank the most reliable Russian private bank. The business edition based its rating of bank reliability on information from Russian and foreign rating agencies, among them Expert RA, Interfax, S&P, Fitch, Moody’s, and also financial institutions. Alfa-Bank demonstrated the best performance amongst Russian private banks.

03.2016
Association of Factoring Companies lists Alfa-Bank amongst three factoring leaders in Russia in 2015
Alfa-Bank was listed amongst Russia’s three factoring leaders in 2015 by the Association of Factoring Companies. Alfa-Bank posted factoring turnover of RUB 158.635 bn and control of 9% of the market in 2015. The Top Five consisted of VTB Factoring (24%), Promsvyazbank (19%), Alfa-Bank (9%), Otkritie FC Bank (8%), and Gazprombank Factoring (7%).

03.2016
A-Club joins Russian market’s Top Five
Alfa-Bank Private Banking (A-Club) has become a member of the Russian market’s Top Five in the Private Banking & Wealth Management category, according to Frank Research Group.

02.2016
Alexey Marey is Banker of the year 2015
The Banki.ru portal named Alfa-Bank CEO Alexey Marey Banker of the year 2015.

01.2016
Alfa-Bank named most profitable private bank in 2015
Alfa-Bank posted the highest profit amongst Russian private banks in 2015. Its net profit grew by 1.6% to RUB 49.5 bn.

01.2016
Alfa-Bank becomes major bookrunner amongst Russian banks in Russia and CIS
Alfa-Bank was named No1 bookrunner amongst Russian banks and ranked sixth amongst global players in the CIS market, according to Bloomberg.
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The opinions of our clients are the most important assessment of our work, so the feedback from those who daily use banking services bears a special meaning for us. It is the driver of many adjustments made to our products, which are already available or are just being developed. We also appreciate the fact that market professionals and clients give their voices to Alfa-Bank in the evaluation of banking service quality.

We are living in a century of high technologies and digital solutions. The Bank does not stay aside from those trends. A lot of work was done in 2016 to renovate and optimize the technological platform of corporate and retail business. While designing new projects, we keep in mind that their primary objective is to make the life of our clients easier and more comfortable. Hence, we pay a lot of attention to the creation and development of mobile services for retail and corporate clients. It is our task to make the Bank accessible whenever it is needed.

Alongside the pursuit for business goals, we always remember our duty to the country and society. Alfa-Bank is a socially responsible institution. Importantly, it not only provides financial support to disadvantaged social groups but also gives this opportunity to clients by means of special functions, which may be used for assistance to the needy. The Bank prioritizes support to cultural projects and educational initiatives, and its corporate policy welcomes comprehensive development of every employee. The success of every day and every year depends on our team, the Alfa-Bank team.

A new five-year cycle in Alfa-Bank’s development begins in 2017. This is a period of ambitious plans to be fulfilled under the new strategy, the ‘strategy of doubling’. We seek to achieve higher results in the coming years thanks to the foundation of future success laid through the entire history of Alfa-Bank, which is getting closer to its clients year upon year.

The Alfa-Bank annual report for your attention. The summing-up not only demonstrates what the company has achieved in a particular period of time but also helps assess the correctness of its development strategy and business model. The outcomes from 2016 once again showed that the course towards evolutionary development of the Bank and its smart growth chosen by the management team put us on the right track. A substantial rise in the number of active clients, the increased net revenue in principal areas of operation, and the reduced cost-of-risk indicator were attained through the skilled implementation of the Bank strategy approved back in 2012.

Alfa-Bank Group posted 21.5% year-on-year growth of total assets under IFRS to USD 38.2 bn. AO Alfa-Bank is a key asset of the group. It is one of the ten systemic banks of Russia. As of January 1, 2017, AO Alfa-Bank occupied the following positions in the ranking of the Banki.ru portal: it was 7th in terms of assets, 5th in terms of equity (Alfa-Bank is the largest private bank), 3rd in terms of retail deposits, and 7th in terms of the credit portfolio.

Efficient interaction with big corporate business resulted in a tangible decrease of Alfa-Bank Group’s cost-of-risk ratio. The number of Medium and Regional Corporate Business clients was up 52% by the end of the year, while the Mass Business Block posted a 32.9% rise in its clientele and markedly overfulfilled the net revenue plan. Retail Bank’s achievements included a net profit growth of practically 2.5 times and a record market share in the sector of retail on-demand deposits.

Rivalry on the banking market has been tightening year after year, yet the Bank’s competitive edge, such as quality service, care for client convenience, flexibility and innovations, makes it possible not only to retain the ground but also to annually improve its performance. We continue to develop and our approach to clients, which had already established itself, reached a new level last year. In Alfa-Bank’s eyes, a client had always been the one that sets the trend in the development of products and services, and this concept was logically developed in 2016. We are getting closer to our clients by incorporating our services into their life scenarios and exceeding the boundaries of a classic financial institution.
Alfa-Bank has been replacing the notion of products and solutions per se with the notion of 'value' for clients. This value may manifest itself in the peculiarities of financial service, a convenient way of bank-client interaction, or the commencement of a new service. It is our task to maximize the speed of delivering these values to clients by getting closer to them. The process of related structural transformations is called Value Stream. Value Stream is currently a keynote notion for our Bank, as it is describing the approach to interaction with clients we are seeking to foster in the upcoming years, and its success is proven, in particular, by the 2016 outcomes, i.e. an increased number of active clients posted by most business lines.

For instance, Mass Business clientele grew by 32.9% in 2016, from 217,000 to 288,000, while the Medium and Regional Business segment reported nearly 20,000 corporate clients and an increase of its share on the corporate lending market from 3.18% to 3.46% over the year. Meanwhile, Retail Bank maintained the number of active clients on the previous year's level although the scope of repayment of loans granted in 2013, 2014 and early 2015 exceeded the volume of new loans at the beginning of the year. The share on the market of retail demand accounts hit a record level of 9.09%, compared to 8.17% in the year beginning, and the block's net profit grew by almost 250%. The number of retail clients of the Bank topped 14 mln by the end of 2016.

The increase in clientele resulted in an 8.4% growth of Alfa-Bank's net fee and commission under IFRS; the year-on-year rise in its ruble terms stood at 19.2% to USD 634 mln. The share of net fee and commission income in operating profit before provisions reached historically record level of 32.0% in 2016. This reflects the Bank's strategy focusing on increase of stable risk-free income and strengthening of the transaction business.

Alfa Banking Group's total assets increased by 21.5% compared to the last year and amounted to USD 38.2 bn as of December 31, 2016. The increase excluding FX revaluation effect amounted to 11.9%. There was another important event, which deserves a special mention: at the beginning of 2017 the international rating agency S&P Global Ratings revised the outlook on Alfa-Bank to «Positive» from «Stable» and affirmed long-term counterparty credit rating at «BB».
In late 2016 Alfa-Bank successfully closed a perpetual Eurobond issue totaling USD 700 mln. It was the first public issue converted into Tier 1 capital in strict compliance with the Basel III requirements. The issue was included in the fixed capital consistent with Basel III and helped the Bank maintain a high level of capital adequacy ratio.

The Bank's gross loan portfolio increased by 10.4% and amounted to USD 23.9 bn as of December 31, 2016 compared to USD 21.7 bn as of December 31, 2015. The Bank slightly adjusted its lending policy in 2017. Focusing on reliable borrowers we plan to expand retail and corporate lending. Alfa-Bank has been very successful in dealing with past-due debts: and the cost-of-risk ratio of Alfa-Bank Group declined from 3.12% to 1.30% in 2016, while collection of past-due debts from retail clients exceeded 96%. Considering those achievements, the Bank management decided to step up lending. The market is favorable for us: the number of banks capable of steady lending operations has shrunk, while Alfa-Bank possesses the relevant technological platform and a streamlined lending process and therefore can use the new opportunities to its advantage. Seeking to bolster loan efficiency, we will continue to improve our lending process: one of our goals in the area of credit financing retail clients is to reduce the decision-making period to 10-15 minutes, from the filing of an application to the crediting of money to a borrower’s account. The Bank also has a potential for loan refinancing. The reserved lending policy of recent years and a relatively small loan portfolio make it possible to launch the refinancing service with lower financial costs than the one borne by big banks receiving numerous requests for lesser rates from their clients.

In 2016, Alfa-Bank confirmed its reputation as fair creditor by finding solutions to complicated situations together with its clients. It arrived at an amicable agreement with Uralvagonzavod Corporation.

In the year 2016, the Bank completed a five-year development cycle and approved a new strategy, a strategy of doubling, for the period from 2017 till 2021. The program called Alfa 3.0 became the base of the new strategy and its 'test pad'. The success of past experience confirmed the concentration on three main areas: development of adaptive organization, focus on digital technologies, and long-term relationships with clients. The first focus is linked to the notion of Value Stream and our intention to be closer to our clients; the second focus will foster the Bank’s digital transformation from the angle of client service and internal processes.

The Bank is not seeking merely extensive growth in the coming years; instead it wants 'smart' growth to happen in priority areas. This strategy has proven efficient, and we will stay adherent to it. A number of client segments were chosen last year for the expansion of our presence and the faster implementation of the new approach to banking service; this is where the pace of transportations will drastically accelerate. Our work has already begun. The primary focus is the Mass Business and Affluent Retail segment.

The Next youth card is a good example of our new approach to retail clients. We realize that many clients of ours are young and have their needs. The Bank has created a debit card for satisfying the needs of this target group. Holders of this card acquire numerous additional options: they can use mobile banking for free, communicate with Bank employees via online chat, make any payments by several clicks without entering card details, and wear wireless payment bracelets. The Next card has a modern design and provides discounts with fashion stores and cafes. The card is very popular, which means we understand this group of clients and their needs well. Another product adjusted to special client needs is the children's card. We understand that many of our clients are parents, and their children are being familiarized with money. They need an instrument for easy integration into the world of finance, and we accommodate their needs with the issue of the children’s card. The project will continue to develop in 2017, as we intend to launch a mobile application, a convenient tool for communication between parents and children regarding money and other subjects. This is how the Bank is raising loyal clients from a young age.

We have another project planned for 2017. Many Bank clients are thinking about the optimal way of traveling across the modern city space, including the purchase of an automobile. Historically, Alfa-Bank has been reserved about car loans, but we can see that our clients have such needs and plan to help their wishes come true. Our new approach will have a trial run in 2017: we will not only develop car loans but will also test operating lease programs. Considering that retail clients have limited savings and their wages grow slowly, we want to give our clients more for the money they have at their disposal. This is the task an operating lease may achieve, as, on the one hand, a person may procure a better car for less and, on the other hand, he or she can decide when to change the car and how. Such services definitely meet the current trend of a sharing economy, which is so popular with the young.

Finally, the third area to be developed in 2017 for accommodating the needs of our clients is mortgage loans. Russia has not been a leader in terms of square meters of housing space per capita, especially in new real estates, so we would like to help people buy a home or to improve their living conditions. This is the reason why we will develop mortgage loans, and expect to achieve a lot in this area in the upcoming years.

The Bank understands and accepts ongoing changes in this environment, which prompt it to undergo a profound digital transformation, not just to reconfigure solutions and offers we make to our clients but also to adjust internal processes, the technologies we are using and most importantly corporate culture. Our transformation models are based on global practices. Alfa-Bank's team studies the best available practices around the world for their subsequent implementation.

Importantly, we value not the technological effectiveness of business per se but its ability to improve the quality of life of our clients. Being aware that many clients spend a lot of time using their smart-phones, we are offering technological solutions built into a phone. Mobility
of services and financial solutions minimizing the loss of time are a long-term strategic focus of the Bank’s technological development. A great deal was done in that area in 2016: new remote service options were provided for retail and corporate clients. For instance, companies may open their second and additional accounts or receive statements without visiting a Bank office. The trend continued to develop in early 2017: it is now possible to activate a card, to change a code word, and to receive a bank statement for an embassy via remote service channels.

Speaking of major achievements of particular Bank blocks, we should start with Corporate Investment Bank, which posted tangible growth in net fee and commission income. As with the overall operation of the Bank, interaction with big business followed the policy of ‘smart’ growth in the most promising segments, and a lot was done to attain that objective. For instance, Alfa-Bank was the second of systemically important to join the program of preferential agrarian loans and stepped up interaction with companies from this vital sector of the national economy.

The Bank’s investment business was also successful in 2016. Its key blocks were renovated for heightening the degree of automation and reducing transaction processing risks. Alfa-Bank became No1 book-runner amongst Russian banks, ranked fourth amongst global actors on the CIS syndicated loan market, and once again did well on the FOREX market in 2016. According to Euromoney FXSurvey, it occupied the first place in terms of FOREX turnover in Central and Eastern Europe and was 21st in the global ranking. Alfa-Bank remains the only Russian bank in the world’s top 50 and the only ‘local’ bank in the top ten of Central and East European banks by FOREX transactions.

Speaking of medium corporate business, I cannot help but mention a keynote event of last year, namely the appearance of a separate block of Medium and Regional Corporate Business due to the sizable increase in clientele of this important sector for the Bank. The sector’s clientele grew by 52%, which was a big success. The ongoing growth of risk-free revenue in this segment is no less important; it is achieved, in particular, by means of services supporting foreign economic activity. The service attracted thousands new clients of the Bank in 2016.

Mass Business had record achievements in 2016: the net profit target was exceeded by 150%, commission income was much larger than expected, Alfa-Bank’s share on that market reached 5.61%, and the client portfolio grew to 300,000 companies and sole proprietors.

Retail Business did more than merely increase its net profit. According to IFRS reports, retail deposits amounted to USD 12.3 bn, including USD 7.1 bn demand accounts, 50% more than in 2015. Again, we were very successful in the development of added-value products, which were both popular with our clients and acknowledged by market professionals; we won a number of 2016 Bank Loyalty Program awards. The active development of the segment strategy focused on affluent and mass-affluent segments also delivered results. The unit tasked with interaction with the highest client segment of the Bank was recognized as the best Russian bank for affluent clients by SPEAR’S Russia Wealth Management Awards 2016, topped the Forbes rating, and received the title of the Best Russian Bank for Millionaires amongst Russian private banks. Finally, I would like to mention the invariably high level of Alfa-Bank service, which again gained public recognition: Alfa-Bank won the Best Retail Client Service nomination of the Future Banking portal. Clients enthusiastically cast their votes, which means that the high quality of our service is recognized both by experts and by those using our services on a daily basis.

Summing up the results of Alfa-Bank’s performance in 2016, I would like to speak about our plans for the near future. The doubling strategy approved in 2016 for the next-five year period means that its implementation begins as early as 2017; this year will lay a foundation for the next five-year period, whose successful completion will contribute to the high achievements of the next period. Issues prioritized by each block will be our focal point. Big Corporate Business, where our fair creditor policy has proven its value for the past 25 years, will develop its success of the previous years and will accentuate broader technological advantages. Technological upgrades of our platforms for big corporate business will be an essential ingredient of our success for the coming years.

We expect our medium and small business segment to concentrate on the development of relationships with clients and a growth of clientele. The fact that several tens of thousands of companies choose us as their principal bank every month is a good trend. We will continue to improve our products and services in order to justify the confidence of our clients. We also plan to upgrade the technological platform for those segments. Pending transformations in the medium corporate segment will happen in Internet banking, while small business will have mobile banking services changed, as owners of small companies spend a lot of time in transit and need a convenient instrument for operative control of their finances.

An important task for 2017 is to increase the number of active retail clients; this is part of the general plan to double the number of retail clients in the next five years. The development of our success in the affluent segment is essential, as we are determined to create the best bank for affluent clients in the CIS by accommodating every need of the client segment demanding quality service. Alfa-Private is the successor to Alfa-Bank’s Alfa Club, it preserves the very best the Bank has achieved over ten years of building relations with the most demanding clients and fosters these advantages.

The year 2017 is coming and the plans for the next 5 years. On the one hand, we will continue the same course of development which the Bank has adhered to in recent years, namely, the emphasis on the quality of customer service, the importance of client relations and significant investments in technological leadership. But new era calls for new approaches, so we will look for non-standard ways of launching individual initiatives, including, in particular, partnership with market players. I am sure that this tactic will help us reach the objectives of the strategy’s second stage, i.e. doubling our business five years from now.
The Bank is not seeking merely extensive growth in the coming years; instead it is aimed at ‘smart’ growth in priority areas. A number of client segments were chosen in 2016 for the expansion of our presence and the faster implementation of the new approach to banking service; this is where the pace of transformation will drastically accelerate.
OVERVIEW OF RUSSIAN ECONOMY AND BANKING SECTOR

Global economy in 2016

In 2016, the global economy was challenged by several black swan events. Firstly, in June 2016, the UK voted to divorce from the EU in the Brexit referendum, a move which led to the trigger of Article 50 and the formal start of the exit procedure in March 2017, a process which will require a couple of years of negotiations to establish a new economic partnership. Secondly, in November 2016, Donald Trump was elected President of the United States in a vote that represented a shift in US foreign and domestic policy, which will dictate the direction of world economic trends going forward. Both of these events pose threats to the existing global economic model and may affect growth in the coming years - 2017, 2018.

The main ramifications of these events are the reinforcement of deglobalization risks. After the rapid growth in world trade during the 1990s, fueled by the creation of the WTO in 1995 and the development of global value-added chains, this indicator has stabilized at around 60% of global GDP since 2011. A number of countries have started to introduce trade restrictions since 2008 aimed at minimizing the negative implications of the global financial crisis; as of 2016, there were 1,263 active trade restrictions versus 324 restrictions in 2010. As a result, the yearly growth in global trade in 2014-15 fell below annual world GDP growth for the first time since the 1990s, signaling a worrying precedent for future world economic growth.

On the other hand, the US election victory of Donald Trump was positively received by global financial markets. Both the US and emerging stock markets displayed significant growth last year: the S&P 500 Index increased by 10% y/y (versus a 1% y/y loss in 2015) and the MSCI Emerging Market Index advanced by 9% y/y (versus a 17% y/y contraction in 2015). It is estimated that a USD 100 increase in the capitalization of US stock market indices leads to a USD 5 increase in domestic demand; thus, stock market growth improves the outlook for US economic growth. That recovery was accompanied by improved commodity market sentiment: following the OPEC-led production cut deal, oil prices recovered and stabilized in a range of USD 50-60/bbl, where they remained during 1Q17.

In addition, attention in developed countries was refocused from foreign economic policy to domestic policy, especially economic efficiency and innovation, offering the opportunity to accelerate structural changes. According to a number of studies, the economies of developed countries suffered from a high share of unprofitable firms, just as happened to Japan in the 1990s. The share of these zombie companies, which are 30-40% less productive than their more efficient counterparts, now accounts for about 5% of...
all companies in the OECD zone. For the most part, they are large (in excess of 250 employees) matured entities (older than 41 years), which on average have deprived more efficient companies of 10-15% of the capital resources and around 5% of the labor force in the OECD zone over the past 11 years. The process of cleansing the economy of zombie companies is preparing countries for the upcoming technological changes that are necessary for future global growth.

Finally, despite the previous market skepticism towards Fed rate hikes, the decision to tighten monetary policy is now seen as a positive signal of a faster-than-expected economic recovery: the Fed has already hiked rates twice since the election of Donald Trump as US president. Moreover, the Federal Reserve has indicated that two more rate increases are on the cards for 2017 followed by a further six interest rate hikes in 2018-19 (three raises annually), which will place the Fed on target for a rate level of 2.75%-3.0% by 2020. Changes to monetary policy worldwide will thus be in focus during the coming years: although other countries are taking a wait-and-see approach for now, they will have to tighten policy following the Fed move.

Tight budget and monetary policy were key issues for Russia’s economy in 2016

In Russia, the debate over the scale of the economic crisis and the need for economic reforms has intensified in recent years. Rosstat recently revised its 2015 GDP growth estimate to a contraction of 2.8% y/y versus the previous figure of minus 3.7% y/y. This is not surprising considering the significant increase in defense spending in recent years. In nominal terms, the federal government’s defense expenditure has virtually doubled from RUB 2.1 tn in 2013 to RUB 3.8 tn in 2016; this is reflected by the 4.1% growth the sector has posted since 2013. The rapid 3.6% y/y growth in the agriculture sector in 2016 is also not a surprise, considering the introduction of food countersanctions by Russia. At the same time, key sectors such as construction and manufacturing have shown strong declines since 2013, pointing to the structural weakness of the Russian economy.

In addition, we should not overestimate the success of those sectors where growth is evident. For instance, agriculture — a sector that was expected to benefit from the countersanctions regime via import substitution — in reality did not expand its share of total GDP. Despite the sector being the best performer over the longer term, its share of GDP remained at 3.6% in 2016 versus 3.3% in 2011, and growth averaged 3% y/y in 2014-16, which is not substantially different from the average growth
rate of 2% y/y in 2011-13. Import growth threatens the future performance of the agriculture sector: it recovered by just 7% y/y in 2H16 while delivering 25% y/y growth in 1Q17.

Efforts to use the period of ruble weakness to support export growth have also delivered mixed results. Since 2013, a rapid increase in export volumes has been evident in the agriculture sector, but because of the drop in global prices, this has failed to have a favorable effect on Russia’s export structure: non-oil exports declined by 17.9% in 2015 and were down 9.4% y/y in 2016.

Since 2014, the main structural change in the Russian economy has been the decline in household consumption as a percentage of GDP. In contrast to 2009-10, when local consumers found support from the state, in 2014-15 they suffered most from the crisis. In 2009, the 7.8% GDP contraction was accompanied by a 5.1% decline in private consumption, while in 2015 the 2.8% GDP contraction coincided with a 9.8% y/y decline in private consumption. That said, despite the cumulative drop of 14% in real terms in 2015-16, the level of consumption is still 3% above the 2008 level, which explains why social sentiment remains relatively positive.
The economic growth outlook for 2017 remains conservative, in light of the country’s clear preference for tight monetary and budget policy. The government favors a prudent approach to expenditure: in 2015-16, federal budget expenditure grew by 5% y/y, which was below the inflation rate. At the same time, defense expenditure grew by 28% y/y in 2015 and 19% y/y in 2016, meaning that budget expenditure in the non-defense and non-social sectors shrank. Thus, while annual defense expenditure totaled RUB 3.8 tn in 2016, the yearly education allocation declined to RUB 600 bn (down from RUB 670 bn in 2013) and annual healthcare expenditure came in at RUB 507 bn (vs. RUB 502 bn in 2013).

The preference for tight budgetary policy can be explained by two facts: firstly, there is a decline in government savings: while the National Welfare Fund is stable at USD 72 bn, the Reserve Fund has declined to USD 16 bn (or RUB 972 bn). It is worth mentioning that this amount would be much less if the state’s stake in Rosneft had not been privatized at the end of 2016 for a sum of RUB 692 bn. Secondly, there is concern that despite spending austerity, the budget is still balanced at a breakeven level of USD 70-75/bbl and under a scenario of ruble appreciation, this will approach USD 80/bbl.

The tight monetary policy was another important aspect of Russian economic policy in 2016. With a free-floating ruble exchange rate, the monetary authorities must show success in achieving their inflation target. For this reason, the Russian Central Bank made only two rate cuts in 2016 and until very recently maintained conservative guidance for its key rate policy for this year. The significant deceleration in inflation, which dropped from 5.4% y/y in December 2016 to 4.3% y/y in March 2017, will allow the CBR to start a cycle of rate cuts. However, the potential for lowering the key rate is still limited, as it comes against the backdrop of an increased Fed rate. Also worth mentioning is the ongoing geopolitical tensions between Russia and the West which will force the CBR to adopt a cautious approach to monetary policy.

Banking sector — demand remains under pressure

In 2016, the Central Bank continued to actively revoke banking licenses. After the withdrawal of 102 licenses in 2015, the Central Bank cancelled a further 95 licenses in 2016, leaving the number of banks as of end-2016 at 586 versus 1,007 at the beginning of 2010. The share of the 200 largest banks at end-2016 amounted to 98% of total banking sector assets versus 95% in early 2014. The process of consolidation is expensive, but necessary. Since 2011, about RUB 1.4 tn has been allocated by the DIA to cover payments of insured deposits, of which RUB 660 bn was spent in 2016. At the same time, the number of unprofitable banks in the sector is growing — in 2016, every third bank was unprofitable, the highest figure since 2009. This means that in 2017, the banking sector cleanup will continue.

The main beneficiaries from the sector’s consolidation are Russian state banks. They continue to grow their presence across almost all segments: they increased their share of corporate lending to 67% at end 2016 (vs. 64% in 2015), their share of retail lending increased from 58% in 2015 to 62% in 2016, and their share of retail deposits increased from 59% to 61% over the same period. While in the corporate deposit segment, their presence remained unchanged at 62%.
The recovery of the loan market was extremely sluggish last year. In the corporate segment, lending activity adjusted for currency revaluation decreased by 5% y/y in banks' loan books as of end-2016. Ruble-denominated corporate loans showed steady growth of 3-4% y/y from the middle of 2015, while forex-denominated corporate loans (32% of the total portfolio) declined by 19% y/y in 2016. The largest reduction in lending activity was seen in the construction segment, where forex-denominated loans fell by 33% y/y in 2016 and ruble-denominated credits decreased by 4% y/y. In other words, under a strong ruble, companies are trying to reduce forex-denominated debt. In retail lending, there was a significant discrepancy between the performance of mortgage and non-mortgage lending. Non-mortgage loans have not increased since the summer of 2016, while the mortgage segment has grown at a steady rate of 12% y/y for the last two years.

That said, the decline in non-performing loans is signaling that stabilization of lending activity is not far off: in the corporate segment, NPLs declined from RUB 2.3 tn in January 2016 to RUB 1.9 tn at end-2016. In the retail lending segment, NPLs fell from RUB 920 bn in August 2016 to RUB 860 bn in December 2016.

The high interest rate level maintained by the Central Bank (the key rate is 9.75% as of March 2017) ensures stable deposit growth. Retail deposits increased by 4% y/y in 2016, while ruble-denominated retail deposits increased by 13% y/y. Corporate ruble-denominated deposits have also grown at a stable rate of 8% y/y since mid-2016. Due to the inflow of deposits, banks have repaid their debt obligations to the Central Bank: as of end-2016, total debt fell to RUB 2.7 tn (3.4% of the sector's liabilities) from RUB 9.3 tn in 2014 (12% of the sector's liabilities).

The high level of dollarization remains a problem. In the retail segment, the share of forex-denominated deposits was 24% in 2016 and in the corporate segment the figure was 41% (vs. 29% and 49%, respectively, in 2015). The aggregate amount of forex-denominated deposits in banks totaled USD 262 bn as of end-2016 compared to USD 280 bn in early 2016. This figure represents about 70% of the Central Bank's gold and foreign currency reserves and reflects an extremely slow restoration of confidence in the ruble. This statistic suggests that the preference for tight monetary and budget policy will prevail in the coming years.
OVERVIEW OF RUSSIAN ECONOMY AND BANKING SECTOR

Figure 11. Ruble and forex-denominated corporate loans, % y/y
Sources: CBR, Alfa Bank

Figure 12. Mortgage and non-mortgage loans, Sept. 2014 = 100
Sources: CBR, Alfa Bank

Figure 13. Retail and corporate forex deposits, % deposits market
Sources: CBR, Alfa Bank

Figure 14. Retail and corporate forex deposits, $ bn
Sources: CBR, Alfa Bank
In the year 2016, the Bank completed a five-year development cycle and approved a new strategy, a strategy of doubling. The program called Alfa 3.0 became the base for the new strategy. The success of past experience confirmed the concentration on the development of adaptive organization, focus on digital technologies, and long-term relationships with clients.
In addition, a great deal was done in 2016 to explain the Bank's lending policy to potential clients. Alfa-Bank has been rather conservative about the evaluation of lending risks for years, which is why its portfolio is one of the most sustainable in the market. Potential clients realize that the Bank's lending policy is consistent rather than harsh and that reliable borrowers can count on advantageous terms of cooperation.

Dealing with overdue loans

It is precisely the conservative lending policy and risk management expertise that allow Corporate Bank to successfully handle overdue loans or even to avoid it in many cases. Alfa-Bank Group markedly improved its cost-of-risk ratio at the end of 2016 according to IFRS; the ratio declined from 1.9% in 2015 to 1.0% in 2016 thanks to a major improvement of the credit portfolio. The non-performing loans ratio (90+ days) declined from 7.5% on December 31, 2015, to 4.6% as of late 2016, and 90+ coverage ratio remained at the conservative high level of 107.9%.

The Bank has designed detailed methodology, which often averts the occurrence of non-performing loans and uncovers corporate problems before an event of default. We are constantly studying the businesses of our clients, evaluating the ability of their business models to endure various kinds of risks, monitoring the financial status of companies, and controlling the situation in the market. Whenever a client’s business model is basically sustainable but is experiencing problems for objective reasons, we try to find a solution together in order to keep the client’s business going. Alfa-Bank is a trusted partner of clients, and it is ready to help them at a time of a crisis. Nonetheless, we prefer to part with clients whose business models we deem to be unfeasible under the current market conditions, before they run into serious financial problems. A combination of mechanisms devised by the Bank makes us more efficient in responding to overdue loans than other financial institutions.

2016 was definitely a success for Corporate Investment Bank, which demonstrated healthy growth in every key area and bolstered its market position, once again proving the sustainability of the chosen business model. Thus, the total number of corporate clients increased in 2016 to 334,100 companies, compared with 255,000 in 2015. The Bank’s share in the corporate lending market went up to 3.46% from 3.18% at the beginning of the year.

Nowadays, major players are reliable borrowers, setting high requirements for the quality and technological efficiency of banking service and terms of cooperation. This is the time for a successful bank to preserve and to develop relations with such clients, with due account for their needs and wishes and by means of a broader lending program and by offering risk-free products. Financial expertise and the ability to give professional advice to clients on any financial matter of their interest create a competitive edge. Interaction with Corporate Investment Bank clientele will be successful if banking service priorities are set and developed. The approach based on the Bank’s long-term development strategy brought results in the previous years and continued to promote business development in 2016. Corporate Bank prioritizes higher efficiency achieved through optimization of business processes and cost reduction, yet one should not forget that business development and the search for new opportunities and new deals are still the only way to achieve strong financial results. All those tasks were actively dealt with by the Bank team during the year of 2016.

Regarding our employees, we should say that interaction with large corporate businesses requires the highest level of professional training due to the demanding attitude of such clients and the complexity of tasks they set for the Bank. So, the experienced team proficient in banking business is another advantage of Alfa-Bank. The Corporate Unit’s team was formed a long time ago and has remained relatively stable — these are top-notch managers able to make decisions and be entrusted with sizeable responsibilities.

MAXIM PERSHIN
Member of the Executive Board, Co-Head of Corporate and Investment Banking

CORPORATE-INVESTMENT BANKING
Corporate lending

The 2016 outcome of large business loans went beyond Alfa-Bank’s widest expectations. One reason is that the economy was steadier than predicted back in 2015 and that the ruble strengthened. Another reason is a rather positive view of market and economic perspectives maintained by our clients. As a result, before the creation of Alfa-Bank’s reserves the corporate portfolio stood at approximately USD 20.9 bn according IFRS, in late 2016. We are expecting a surge in our credit portfolio in 2017. Experts have forecast rapid growth in a number of sectors and particular business projects, and we are ought to stand by our clients at such moments. Based on our forecasts, we are expecting a surge in our corporate portfolio in 2017; we set an ambitious goal to increase the market share of lending within five years especially in principal market sectors. We want to be a first-choice bank for companies operating in those sectors, as we can provide field-specific expertise, priority deal consideration, flexibility, out-of-the-box thinking, and avoidance of red-tape to rapidly accommodate the needs, which may be complicated but are important to our clients.

Portfolio growth is not a goal in itself; our actual objective is to increase corporate lending revenue. Corporate Bank has created a pool of large clients, with whom establishing a broader relationship is given high priority, as well as sectors on the verge of boom. Without doubt, we treat every large corporate client as an important asset, but our additional efforts are still focused on areas and sectors demonstrating the highest degree of stability and widest business opportunities.

Priority sectors

The Bank deems exports, as well as substitution of imports, especially agro-industry and the petrochemical sector, and areas of primary consumer significance, such as pharmaceuticals and retail trade, to be the most promising and aspires to a heavier presence in those markets.

There are also machine-building industries selling their products inside and outside the country, and transport and logistics projects, considering Russia’s geography and financing opportunities offered by railroad and air transport, ports and logistic hubs. There is no doubt that telecommunications and information technology, including data processing and storage centers, will continue to develop in the upcoming years. Another promising area is financing of the real estate sector.

Plenty of deals of interest to Alfa-Bank and its clients were closed in the aforementioned sectors in 2016. Client satisfaction with the Bank is of paramount importance: this is evidence of our ability to meet their expectations and to provide quality service, accommodating the financial needs of large businesses.

We should also mention that Alfa-Bank has been the second systemically important financial institution to join the preferential lending program for agriculture. Alfa-Bank and the Russian Agriculture Ministry have an agreement on preferential agricultural lending at an annual rate of less than 5%, which is part of the new mechanism providing financial support to the sector. Alfa-Bank took an active part in the debate on the new model of subsidies as a member of the Russian Agriculture Ministry’s working party. A fast decision-making process, experience of complex deals, and the readiness to accommodate clients’ needs have always been our strong points. The program provides not only preferential loans but also the advice of Bank employees as to how the new lending mechanism works.

In 2016, Alfa-Bank built a relationship with Steppe Group, an agricultural subdivision of AFK Sistema, which received an opportunity of long-term financing for purchasing agricultural assets. The company procured assets in the area of its presence, the Rostov region and the Stavropol territory. The deal enlarged land assets of Steppe Agro-Holding to 313,000 hectares. We are glad we have supported the agro-holding’s acquisition of strategic assets and wish to carry on our relationship.

TAIF Group has been successfully collaborating with Alfa-Bank for a number of years. In 2015, the Bank contributed USD 800 mln to the TAIF-NK investment program, including a capital-intensive project of a plant processing heavy oil residue. Last year saw another major deal: Alfa-Bank granted an additional loan of USD 230 mln for TAIF current operations and investment. Hopefully, our relationship will continue in the future.

Alfa-Bank has been active in funding Russia’s copper industry. It is a partner to every major copper manufacturer in the country and expects to develop its presence in this sector. For instance, a partnership between Alfa-Bank and Russian Copper Company (RCC) has existed since 2004. RCC lauds the professional performance of the Alfa-Bank team, the readiness to understand clients’ needs, and the fast and transparent decision-making process, while the Bank values RCC as a reliable partner.

In 2016, Alfa-Bank and RCC’s Novygorod Metallurgical Plant entered into a three-year USD 40.5 mln loan agreement. In addition, the Bank financed RCC’s Aleksandrinsk Mining Company. The three-year USD 61.5 mln loan was granted in November 2016 on the guarantee of other industrial assets of RCC Group. The funds refinanced current debts of Group companies.

In all, Alfa-Bank lent over USD 300 mln to RCC Group companies in 2016. RCC, which has established itself as a responsible and financially stable borrower, appreciates its relationship with the Bank, meaning our collaboration will go on.

In 2016, Alfa-Bank gave a one-year USD 24 mln loan to Highland Gold Mining Ltd. (HGML). Novo-Shirokinsky Mine JSC was designated as the borrower. The total debt of Highland Gold Mining...
to Alfa-Bank stands at USD 60 mln, including this loan. In addition, Alfa-Bank provides hardware leasing and insurance and payroll services to HGML personnel stationed in Moscow. Crediting of the real economy is a priority of the Alfa-Bank Corporate Unit, so we value our partnership with Highland Gold Mining, a reliable borrower and a major player of Russian’s gold-mining industry.

Also in 2016 Alfa-Bank entered into a seven-year RUB 19.2 bn loan agreement with Rail1520 leasing company, an entity of United Wagon Company (RPC UWC). The money will refinance credit lines of PRC UWC leasing companies.

TransFin-M leasing company and Alfa-Bank have been cooperating since 2012. Last year the companies entered into a 12-month RUB 1.965 bn loan agreement. TransFin-M intends to invest the money in leasing projects, including coal mining. This is a reliable borrower, which is proven by the increased number of its partner banks, the scope of borrowing, and high credit rating assigned by domestic and leading international rating agencies, so the Bank is interested in further relationships.

Evraz Group has been Alfa-Bank’s client for over a decade. In 2016, the Bank provided Evraz with an USD 85 mln loan. The money refinanced Evraz current debts. The deal helped the client optimize its credit portfolio with lesser service costs and longer repayment periods.

Rolf Company has been cooperating with Alfa-Bank for over 15 years. A major settlement project was implemented a few years ago to service the company’s revenue from selling new and second-hand vehicles. Despite the general plunge in the car market, Rolf Company has been financially stable, and the Bank is interested in funding its projects. In 2016, Alfa-Bank and Rolf Company entered into a 2.5-year RUB 2 bn loan agreement.

Risk-free income

Enlargement of risk-free income is a primary objective of Alfa-Bank and every other financial institution interacting with corporate business. The year 2016 also produced better results than expected in terms of commission income, demand deposit balances and transactional income as a whole. The expanding clientele increased the Corporate Business Unit’s commission income by 23.2%, and totalled USD 324 mln. A 35.5% growth was achieved in the ruble equivalent.

The bigger commission income helped diversify and stabilize the Unit’s revenue, which is why it remains a development priority of the Bank. We proved again last year that we could be more consistent and flexible in accommodating the needs of our partners and counterparties than our rivals. A project servicing part of outgoing ruble and foreign currency denominated payments of telecommunications company VimpelCom is a good example. The Bank created an efficient settlement platform relevant to the VimpelCom business technicalities and scope, capable of simultaneously processing up to 15,000 payments. The system interface enabled the company to cut bank commission costs and provided it with a convenient and friendly settlement and FOREX control interference. The VimpelCom settlement platform is a unique solution based on the Alfa-Finance factoring IT module customized to VimpelCom’s needs. This is another demonstration of Alfa-Bank’s flexibility in client transaction service.

Alfa-Bank has a strong competitive edge compared not only to other private financial institutions but also to state-run banks — our team is younger and capable of adjusting the mode of operation to current market needs, it makes rapid changes whenever necessary and its decisions come fast; every unit is a team of people who see eye-to-eye on interaction with our clients and on Bank priorities. The Bank’s image is fully consistent with its approach to retail and corporate service: this is a private bank prioritizing clients, their objectives and needs.

Financial capacities of state-run banks allow them to heavily invest in new projects and this is an additional resource for our bank, which keeps a wary eye on rivals and implements the most promising ideas after they are tested by other financial institutions. Alfa-Bank and S7 Airlines were actually Russia’s first to implement a project of blockchain-based smart letter-of-credit contracts. Being a member of the Central Bank’s working party, the Bank declared the launch of a Masterchain platform jointly with the Central Bank in October 2016 and presented the Flow application for Know Your Client (KYC) blockchain-based client identification purposes. S7 was the first partner in the introduction of blockchain-based technologies in large corporate business. Alfa-Bank provided its partners in the deal with additional options in the Alfa-Business Online system: a client may apply for opening a letter of credit, and a contractor may submit documents certifying the performance of works and the provision of services to the bank. The blockchain-based technology addresses two primary aspects of trade financing: trust and speed. By using the blockchain-based technology, the bank offers a platform for absolutely transparent transactions between clients. This is an ideal solution for businesses interacting with a large number of partners and new counterparties.

There is another event which deserves a mention: the Bank signed an agreement with Japanese financial institutions in December 2016 in order to fund export-import contracts. The Japanese partners are searching for new foreign markets for their products via partner contracts with local banks. The agreement introduced the Bank to a mechanism of partner financing for its clients. We are currently working on the technicalities of pending projects.
The ability to look at our work, our services and our products through the client’s eyes helps us understand better those for whom we are working day after day. We have been improving our products and have been maintaining the highest quality of service, the Alfa-Bank’s quality, for over 20 years.
INVESTMENT BUSINESS

The Investment Unit did well in 2016. Every segment of the investment market was stabilizing, and stock markets were booming. Given those circumstances, the Bank somewhat loosened its conservative policy. In 2016, we closed new deals and expanded portfolio limits imposed in 2014. Nevertheless, the investment sector and other types of financial markets were struggling with plummeting liquidity amounts, range of popular tools, and the number of clients. Some markets were showing signs of recovery while other remained in the ‘orange’ risk zone. Hence, the general economic stabilization and the upward dynamics of stock markets did not cut the risk of sharp price fluctuations, and the Investment Unit remained cautious about its development planning.

Infrastructural transformations inside the Bank were among the key events of 2016. Last year, we managed to rejuvenate a number of major units created decades ago and, by doing so, developed transaction processes with a higher degree of automation and a lesser degree of risk. The work done in 2016 laid a foundation for further reform of all Investment Unit operations. Those transformations were truly revolutionary, as we implemented new software and new processes in our most complex products. The transformations were aimed at designing an efficient transaction mechanism and at laying groundwork for service to other companies, i.e. our efficiency leading to us earning on commissions on the service rendered to corporations and to other financial institutions. The second stage of structural transformations has begun in order to build new systemic Investment Bank architecture on principles different to those our rivals are currently using. Once the project is implemented, Alfa-Bank will be one of the most high-tech investment banks in the world.

Collaboration with U.S. partners is another point of interest and importance for our Investment Unit. It is a type of model for building up our competitive edge by using capacities of other institutions. In 2016, Alfa-Bank and U.S. brokers Auerbach Grayson organized a fact-finding mission of U.S. investment funds to Russia. Two meetings between potential investors and top managers of leading Russian companies were arranged during the year. The mission was tasked with evaluating the possibility of additional investments in Russian assets in general and in particular companies presented to it. The investors exhibited a particular interest in the in the consumer, finance, and transport sectors.

The project was a result of Alfa-Bank’s partnership with Auerbach Grayson; the parties concluded a cooperation agreement in summer 2015. Auerbach Grayson represents the interests of institutional investors on global markets in 98 countries, and Alfa-Bank is its sole partner in Russia. The interest in Russian issuers is growing alongside economic stabilization, which means the joint work can be even more fruitful. Russian companies operating in certain sectors can count on keen interest from investment funds, which will lead to a higher ranking of their stock during prospective offerings. The partnership with Auerbach Grayson, whose partners are major U.S. investment funds, has broadened the Bank’s horizons in organizing IPO/SPO deals.

Retail business was the third area rapidly growing in 2016. Last year we markedly improved our interaction with A-Club, whose members often needed investment services. A special application, Alfa Dealer, was designed for local private investors, and retail service was modified through a review of our objectives and development strategy and an update of our sales model.

As before, we kept an eye on market opportunities and never missed the chance of an interesting deal. Some of those deals were closed last year, and some may happen in 2017.

Organization of debt issues for clients

Collaboration with Corporate Bank is highly significant for the Investment Unit. This includes corporate exchange-traded bonds and syndicated loans; 2016 was a year of new achievements
through synergy between corporate and investment business. We still think this partnership has a huge potential, and set ambitious goals for the future. Regarding the placement of exchange-traded bonds for our corporate clients, I would like to mention a series of important deals closed by the Bank last year:

The bid book was successfully closed in September 2015 for Series 001P-01 of the 15-year RUB 15 bn X5Finance exchange-traded bond issue (4-36241-R-001P-02E dated 16.09.2016). Successful marketing created strong demand from investors, and the number of bidders was larger than expected.

The bid book for Series 001P-01 of the 5-year LSR Group exchange-traded bond issue closed on September 26 was also a great success. The strong interest in LSR bonds made it possible to repeatedly lower the coupon benchmark rate. The overall demand for bonds topped RUB 15 bn. The placing was brokered by Alfa-bank and Raiffeisenbank.

On September 20, PJSC TransContainer (-/Ba3/BB+) closed the bid book for Series BO-02 of the 5-year RUB 5bn amortizable exchange-traded bond issue with a 9.4% annual coupon rate. Twenty-five investors, among them banks and investment and management companies, participated in the placing. The final coupon rate was far lower than the Central Bank's key rate; it was comparable to the rates of the latest placements of corporate exchange-traded bonds rated on the sovereign level. The issue was brokered by Alfa-Bank, VTB Capital and Raiffeisenbank. A large bid book demonstrates investors' interest in corporate exchange-traded bonds, which is good for future placements. Alfa-Bank will do its best to bolster cooperation with this company.

Another successful closure of a bid book took place on September 6, this time for Series BO-08 of State Transport Leasing Company exchange-traded bonds. Investors were offered exchange-traded bonds with semi-annual coupons of RUB 5.0 bn nominal value. The loan maturity is ten years, with a 5-year non-amortizable buy-out offer. The bonds had the first listing level. The rate was fixed at annual 12.00-12.50% for original marketing purposes and reduced three times in the course of book-building due to the high demand. The final coupon rate stood at 11.10%. The aggregate demand exceeded the nominal issue more than 5-fold and topped RUB 25 bn. The issue was brokered by Alfa-Bank and Gazprombank.

LenSpecSMU made another appearance on the market of public debt instruments with Alfa-Bank's assistance. On June 15, the company closed a bid book for Series 001P-01 of 5-year RUB 5 bn amortizable exchange-traded bonds. The demand exceeded the nominal value 3.3-fold and reached RUB 16.6 bn. The coupon rate was fixed at 11.85% yield to maturity, compared to the original rate of 12.5%-12.9%. The placement was brokered by Alfa-Bank, Raiffeisenbank, and Sovcombank. We are pleased to continue interaction with this company on the public debt market. The synergy between the Alfa-Bank Investment Unit and the issuer’s corporate bank and team worked wonders: LenSpecSMU raised funds at a much better rate than in the pre-crisis year 2012.

In addition, Alfa-Bank brokered placement of 5-year RUB 5 bn bonds for Miratorg agricultural holding. The demand topped RUB 12.5 bn. The coupon rate was fixed at 12.0%, compared to the original rate of 12.5%. The issue was brokered by Alfa-Bank, Raiffeisenbank and Otkritie FC Bank. Miratorg is Russia's largest producer of pork and beef, and also tops the ranking of agricultural businesses in terms of revenue. The Fitch international rating agency assigned a B rating to the bond issue. It was a successful first of interaction with Miratorg for Alfa-Bank in the capacity of an issue organizer although we maintain close contacts in the area of Commercial Bank. Hopefully, our partnership will continue.

**Syndicated lending**

Alfa-Bank boosted its standing on the syndicated lending market in 2016 thanks to its strong market reputation, and the interaction with clients and team expertise. Bloomberg named Alfa-Bank No 1 book-runner in Russia and the ranked fourth in the CIS syndicated lending market. In 2016, Alfa-Bank arranged five syndicated lending deals in the region in the book-runner status, and its share on the market grew by 1.3% year-on-year to 5.7%. Alfa-Bank climbed two positions to the fourth place in the Bloomberg ranking, which monitors activity of investment banks in the Russia and CIS syndicated lending market by volume and number of brokered deals. The ranking is based on syndicated loans granted in the region over the reporting period. We are expecting the syndicated lending market to grow and our business to develop in 2017.

**Activity on Belarusian market**

Alfa-Bank is a leader in the Belarusian investment market. We have been cooperating with major Belarusian banks for two years, and the Bank has brokered six syndicated loans by now. We have been successful in that market for a number of reasons. First of all, there is Alfa-Bank (Belarus), which is a part of ABH Holdings S.A. and gives Investment Bank access to the biggest corporations in the local market. Additionally, the high level of Alfa-Bank’s investment business in Russia enables it to make quality offers to those companies. The successful deals closed by the Bank in Belarus in previous years encourage potential clients to enter into a relationship with Alfa-Bank. The three important elements (access to clients, quality products and the success story) have made us a leader in this market segment.
In 2016 Alfa-Bank brokered a syndicated loan for Belagroprombank. The loan of EUR 75 mln, USD 4 mln, and RUB 7 bn will be spent on general purposes, including financing of trade contracts between Belarusian and Russian companies. Belagroprombank thus set its own record of public borrowings. The syndicate comprised eight more banks, namely Transcapitalbank, Promsvyazbank, Sviaz-Bank, Rosselkhozbank, Eurasian Development Bank, Finservice Bank, Ak Bars Bank and Nefteprombank. Alfa-Bank acted as an authorized lead organizer, a book-runner, and a documentation and paying agent.

FOREX market

Alfa-Bank has been No1 in terms of FOREX market turnover in Central and Eastern Europe for a number of years, according to Euromoney FX Survey. In 2016, the Bank improved its global ranking and climbed to the 21st position. It is the only Russian bank in the world’s Top 50 rankings and the only local bank in the Top 10 Central and East European banks. Alfa-Bank’s share in the market of Central and Eastern Europe increased from 7% in 2014 (4th position) to 18% in 2015 (1st position), and it surpassed such global giants as JP Morgan and Citi in this segment.

The results were achieved thanks to Alfa-Bank’s authority in the inter-bank market, its high FOREX activity, and the development of client service. The unit’s team is constantly working on new FOREX technologies and is hiring the best talents to do the job. We made a quality improvement of our software last year to speed up and to expand system setting options for risk management and client service purposes. The speed of transactions increased to hundreds of thousandths of a second, and predictability of market dynamics was up to one ten thousandth of a second.

FOREX transactions are an important area of Alfa-Bank's corporate investment business. More than 98% of the Bank’s FOREX transactions are conducted in the e-trading format. In addition to using classic channels, clients make transactions on their own, using the Alfa-FOREX trading and settlement data platform. The state-of-the-art technologies enable the Bank to remain a leader of a market dominated by the world’s biggest automated traders. The Moscow International Currency Association (MICA) has named Alfa-Bank the Best FOREX Desk for four years in a row.

Alfa-Direct

As for state-of-the-art investment business technologies, it is worth mentioning that in 2016 Alfa-Bank did a lot to explore client preferences and developed the concept of the Alfa-Direct 4.0 Terminal. The concept featured an array of renovated products and services, which might be useful for novices and professional traders. Most innovations became available to users at the beginning of 2017, while the rest will be commenced in the near future.

2017 outlook and plans

The successful strategy and priorities of the Investment Unit will not change in 2017. Emphasis will be placed on further interaction the Retail Bank and clients in the Affluent and Private Bank sectors. The Unit will continue to modernize its infrastructure and to automate principal processes to be used for the solution of standard and unusual tasks. The third focal point of the investment business is a larger presence on the M&A and shareholder equity markets in the IPO area and stock broker services. As before, we will prioritize joint business with the Corporate Unit.

As for our interaction with large corporate business, we are counting on interaction with other business units in 2017, which may bring additional revenue to the Bank as a whole and Corporate Investment Bank, in particular. We will concentrate on further integration with the Investment Unit and collaboration with A-Club clients.

Despite the impressive results achieved in previous years, our unit will have new complex tasks to tackle in 2017 in order to increase revenue. We are prepared to work hard, given that Corporate Investment Bank boasts not only many years of professional experience and best available financial business technologies but also a stable and close-knit team which has been successfully delivering results year after year.
Alfa-Bank's team is capable of adapting to the market, and its members have a common outlook toward the interaction with our clients and toward Bank priorities. The Bank’s image is fully consistent with its approach to its service: this is a private bank prioritizing clients, their objectives and needs.
An event significant for the entire Alfa-Bank corporate segment, the emergence of the Medium-sized and Regional Corporate Business unit, took place in 2016. This is another step towards the implementation of the Bank segment-based approach, which has proven efficient both with retail and corporate business. Client segmentation gives the Bank a better understanding of problems, objectives and requirements of every group, while segments are treated proportionately to their expectations.

The interaction with medium-sized corporate clients (companies posting revenue from RUB 350 mln to RUB 3.5 bn) has been so successful in the past few years that their number is nearing 20,000 legal entities: this means that such companies can and should be grouped into a separate segment. The unit was also designed to service regional business, because such clients (local companies posting revenue from RUB 3.5 bn to RUB 10 bn) are closer to medium-size corporate business rather than to big corporate clients in terms of strategy. There is another reason why medium-sized and corporate businesses have been attributed to the same unit: most big corporate clients are seated in Moscow, while there are no companies of such size in regions and even the leading actors of a particular regional market belong to the medium-sized segment by their scope, meaning that the network of regional clients is governed by the same principles as medium-sized corporate business.

Objectives for both segments are set on the basis of a similar approach: the primary task of medium-sized and regional businesses is to increase their clientele and the range of Bank products in their use. For now, the unit defines the establishment of a lasting relationship with the maximal number of clients through satisfaction of their demand for financial services as its strategic goal. Judging by the past two years, this is an efficient model delivering high financial results.

As to corporate client service in regions, centralized governance of the entire network of offices is an obvious competitive edge of Alfa-Bank. It is our task to provide an equally high quality of client service to individuals and legal entities in any Bank office across the country. Hence, bank employees are being constantly trained for the purposes of professional development and awareness of Bank products and services, including such complicated matters as hedging, bi-currency deposits, etc.

The medium-sized corporate business segment evidently stabilized in 2016. Many companies were dropping out of the market in 2014-2015, being unable to cope with the new financial circumstances, but the market was much steadier last year. At the same time, banks were facing additional difficulties — the lending market margin continued to decrease against the backdrop of a great deal of cheap or pseudo-cheap loans provided by little-known financial institutions. As a result, competition was tight and clients became more demanding about banks and bank products. Besides, after the crisis some companies made a principled decision not to use credit products while others used loans exclusively for covering cash shortfalls and for similar purposes.

Nevertheless, the number of medium-sized and regional corporate clients grew by 52% year-on-year in 2016 (19,791 medium-sized corporate clients and 911 regional business groups in 2016, compared to 12,935 and 680, respectively, in 2015), in addition to a minor increase in operating profits from RUB 7.2 bn in 2015 to RUB 8.3 bn in 2016, according to management accounts. The growth has contributed to the stability of our income base: a large number of clients helps to diversify incomes, while revenue coming from several big companies may lead to substantial losses in case cooperation with any of them stops. Commission income grew by 22% for regional corporate business and by 34% for medium-sized corporate business despite a credit portfolio decline triggered by a conservative lending policy in this segment. The unit is facing greater objectives in 2017 in terms of client and revenue enlargement.
Alfa-Bank’s reputation as a reliable bank is another reason why clients choose it for the achievement of their financial goals. The strong brand and the long history of success make the Bank a market leader. One should not forget that medium-sized corporate clients usually use services of several banks at a time, which creates constant rivalry. We are tirelessly improving our products in response to the needs and aspirations of our clients, which helps us score additional points in this tight competition. We are endlessly conducting analytical surveys to determine the priorities of businesses, their focal points and banking service deficiencies in order to upgrade the model of our interaction, our products and services.

The unit prioritizes both risk-free cash settlement products and lending to segment clients. It is our purpose to accommodate client needs, whatever they may be, and if a company is expecting credit products from the Bank we will be ready to provide them. A relationship which would be clear and comfortable for both parties, in addition to a transparent policy and the readiness to provide a service of interest to our clients is the most efficient strategy for the medium-sized corporate business segment. In this case, no matter what product is prioritized by a company, it will gladly expand cooperation with the bank as need be. The development of a convenient and ‘safe’ method of lending to medium-sized businesses is a unit priority in 2017.

Another focus of the previous year and the year before is services rendered to foreign trade companies. Alfa-Bank made a real breakthrough in servicing foreign trade companies in 2015: it designed the best remote currency control system available on the Russian market for the end user’s convenience and speed. In addition, internal processes of servicing foreign trade companies were optimized. The financial effect of the Bank’s investment in this area went beyond the widest expectations in 2016. As many as 1,200 new foreign trade clients were attracted during the year, which brought RUB 50 mln worth of commission revenue to the Bank.

No detail is too small for medium-sized corporate clients, and their requirements for the bank may be higher than those of big or small companies. Internet banking is no exception, which is why we are annually improving our online banking service for business to make it extremely convenient for users. We ask our clients for feedback and comments on the desired expansion or modification of functionalities, and improve and modernize our service on that basis. That was also the principle of Alfa-Business Online upgrades in 2016. We did a lot to facilitate the algorithm of standard transactions, so that the Bank became maximally convenient for its principal users, accountants of our clients. Flexibility and the knack of adjusting our services and products to the current situation and client needs constitute an important competitive edge of Alfa-Bank in the field of banking technologies and every other business development aspect.

While improving our service to meet client expectations and developing new products and services, we never forget about the most important thing: our team. The competency of our employees is crucial in encouraging potential clients to establish a relationship with the Bank and motivating existing clients to carry on and to expand cooperation. Every client wants to interact not just with bank employees but with experts who can correctly help handle their financial tasks and give professional advice whenever necessary. Clients want the bank to meet and to anticipate their needs, and that can be done by highly trained personnel. Constant modification of laws, which employees should be aware of and take into consideration, are factors complicating the banking business. What is more, the banks’ product ranges are also changing and new products are emerging, which means that education of employees and refreshment of their knowledge are continuous. We pay attention to the way our managers communicate with clients: the effort to maintain service culture at a high level and to improve it whenever necessary is an important element of work with the personnel. The unit annually conducts testing to verify the competency of employees on every level, including their skills and ability to communicate with clients and to interact with coworkers.

Another important quality, which distinguishes our employees from many others, is the ability to take responsibility whenever necessary. As of today, the unit has 33 branches, which means that some important decisions are made locally in accordance with the Bank’s strategy, and each office must have a manager ready to take responsibility for its performance; these are the type of people we choose for working in regions. Efficient interaction with segment clients in the biggest cities of the country also requires top-notch client managers with financial analysis and transaction structuring skills, proficient in various areas of business and corporate finance intricacies, and capable of giving professional advice to a client and accommodating their needs. We train managers of this level at the Medium-Sized and Regional Corporate Business unit, because our team is our main competitive advantage, which is developed year upon year and cannot be copied without doing many years of thorough work.

As to the 2017 outlook, we should start by saying that experts are forecasting a rather stable market. This does not mean the year will be easy; for instance, we may expect further reduction in the number of banking institutions capable of efficiently servicing corporate business. However, that will mostly apply to banks which have failed to build a successful model of interaction with companies of our segment. Meanwhile, Alfa-Bank’s share in the medium-sized and regional corporate business segment has been growing year upon year thanks to its systemic approach to the interaction with such companies. We are set to continue development of our business in 2017 on the basis of client needs and aspirations, both in transaction business, in lending, and the entire range of products. We realize that we have vast opportunities to continue to increase our clientele, and we will be expanding the unit’s team in priority regions in order to do so.

We have done a great deal in the past few years, and we have an ambitious goal to become one of the segment’s top three actors in the upcoming period. Each year our tasks become even more complex, as advancement and constant development is the only strategy that can make the Bank a success.
Fierce competition prompts an improvement of bank offers. Alfa-Bank has been trying to offer its clients not only banking facilities but also non-financial services. The comprehensive approach enables Alfa-Bank to occupy leading market positions.
RETAIL BANKING

The Retail Bank was very successful in 2016. The financial result of the block in accordance with IFRS growth an over 250% from USD 119 mln in 2015 to USD 297 mln in 2016. The share of retail demand accounts hit a record of 9.09%, compared to 8.17% the year before. The amount of funds raised from retail clients topped USD 12.3 bn at the end of the year, including USD 7.1 bn demand accounts, which grew by 50% year-on-year. The number of the Bank’s retail clients stood at more than 14 mln people in late 2016.

Retail lending

According to IFRS, the retail credit portfolio reached USD 3 bn at the end of 2016. The Bank ranked fourth on the credit card market with a USD 1.1 bn portfolio. Retail lending proceeded with caution, especially in the first half of the year, which resulted in a slight decline of portfolio to USD 406 bn since 2015. The cash credit portfolio stood at USD 1.3 bn.

By the end of the year, according to IFRS the ratio of debts overdue for more than 1 day decreased from 7.2% to 4.5. The outlook for 2016 was rather pessimistic, and we were expecting negative trend in client debts; however, the careful lending policy reduced the risks and maintained past-due debts at a low level. Successful dealing with client debts enables us to focus on growth by developing lending policy in 2017.

Interaction with clients and segment strategy

The Retail Bank has been actively developing the segment strategy for the past four years. Alfa-Bank is a universal Bank which interacts with every client segment, such as private, affluent, mass affluent and mass, which has prompted the Bank to divide its clients into segments and to bring any one of them in compliance with clients’ goals, objectives, needs and wishes. The higher client segments are mostly focused on saving and capital multiplication, while the rest concentrate on current operations and use of borrowed funds. Considering those factors, it is our goal to be the best in every sector for the purpose of building long-term relationships.

The cost of attracting new clients rises year upon year, and competition for higher segment clients grows fierce, which increases the significance of clientele retention. It was a key objective of 2016, and Retail Bank developed a new corporate metric titled ‘Clients stay with us’. Seeking to raise the number of loyal clients, we keep a wary eye on variables, which indicate clients’ readiness for a long-term relationship with the Bank. These include Net Promoter Score (NPS) and Loan-to-Value Ratio (LTV), the number of products, and the income per client in every segment. It is our goal to become the principal Bank for the maximal number of clients, and the evaluation of these indicators, in addition to the number of transactions, expenses and account balances helps us understand how close we are to our objective.

A special program called On-boarding was designed in 2016 to retain our clients and to develop our relationships. It lasts for an average period of six months for many clients in each segment. We ask clients for feedback at every stage of interaction for the purposes of a fast response to possible negative signals. The On-boarding program is implemented by a VIP manager or a financial consultant in higher segments, while the mass segment implements the program in the online mode — clients receive SMS messages, e-mails and other information providing the Bank with their feedback and enabling clients to ask their questions and to receive answers.

A-Club

Speaking of higher client segments, we would like to single out the achievements demonstrated by A-Club in 2016. Alfa-Bank (A-Club Private Banking) received SPEAR’S Russia Wealth Management Award 2016, Russia’s only private banking and wealth management industry prize, as the best Russian bank for affluent clients. We are pleased with the high evaluation of our work and are actually doing a lot so that affluent families and their representatives find our interaction convenient and receive exclusive service. For instance, we are offering such clients the most comfortable remote service, including telebanking...
and a special type of mobile bank with unique functions, in addition to the entire range of private capital management and consulting services. The quality of our service is being improved on a daily basis.

Additional proof of the Bank’s leading position in this client segment is the first place it occupies in the Forbes ranking and the title of the Best Russian Bank for Millionaires amongst Russian private banks. The rating of Russian banks providing private banking services was based on a number of parameters, such as the opinion of bankers, financial performance indicators, the number of certified employees, the availability of offices abroad, and the range of products.

The high level of service is not a prerogative of higher segments; every one of our clients is entitled to it, which is proven by Alfa-Bank’s victory in the FutureBanking portal’s Best Retail Client Service nomination. The survey covered 25 major banks controlling more than 89% of the debit card market and almost 93% of the credit card market. Alfa-Bank’s Perekryostok card won the Maximum Benefit for All in the Mass Segment nomination of Frank Research Group, while the Alfa-Bank cash back card was one of the top 5 card in the campaign period received 4,000 bonus points, and 2,000 bonus points were awarded to the next 20,000 clients.

A new strategic stage will begin in services provided to big private capital in 2017. The block interacting with affluent clients and their families will be renamed Alfa Private. Alfa Private will be the successor to A-Club to preserve the very best the Bank has achieved over 10 years of building relations with the most demanding clientele. In addition to service and technological advantages enjoyed by A-Club private banking clients, Alfa Private will provide ‘one-stop’ access to every task, from basic banking operations to complex investment business missions.

Added value products

A large number of the Alfa-Bank retail clientele is simultaneously using services of several financial institutions. In order to become their principal bank we should enter into their life and, without pushing for anything, make Alfa-Bank services part of their daily routine. Products which fit this objective include cash back cards, transport cards (joint projects with Aeroflot and RZD) and, certainly, the new MasterCard Perekryostok Alfa-Bank.

In 2015, the Bank created a debit cash back card, which refunds 10% of the money clients spent at gasoline stations and 5% of their cafe and restaurant bills. This is a profitable offer for car owners, which helps them easily save money. The card is very popular.

Another successful project is the co-brand card, RZD MasterCard Alfa-Bank. More than 100,000 cards of the sort were issued over the first year, it was the first joint project on the Russian market enabling clients to accumulate points both on debit and credit cards and to exchange them for travel by RZD trains. Cardholders accumulated over 120 mln points over the year, which was sufficient for more than 9,000 trips from Moscow to St. Petersburg and back or more than 600 shuttle trips between Moscow and Vladivostok. The most popular route chosen for the exchange of accumulated points was Moscow-St. Petersburg; about 34,000 persons traveled there over the past year. The first runner-up was the Moscow-Nizhny Novgorod route, and trips to Samara, Kazan, Kirov, Saratov and Yaroslavl followed. In the period from August to October 2016, Alfa-Bank, Federal Passenger Company and MasterCard were holding a promotion campaign, whose grand prize was the Year Travel Pass enabling the cardholder and his or her companion to travel an unlimited number of times by trains of Federal Passenger Company, including high-speed Sapsan and Strizh trains. The winner was St. Petersburg resident, Dmitry Sologub, who used the card for the maximum of transactions during the campaign period. There were other perks for campaign participants, such as the one-year premium gold status in the RZD Bonus program and a two-night stay at the Hilton Moscow Leningradskaya Hotel. The first 5,000 clients issued with the card in the campaign period received 4,000 bonus points, and 2,000 bonus points were awarded to the next 20,000 clients.

A third product, which occupied top positions in many rankings, is the joint card of Perekryostok and MasterCard. The Perekryostok retail chain is a leading federal network of Russia for a broad range of clients. The joint project of Alfa-Bank, X5 Retail Group and the MasterCard international payment system yielded a co-brand bank card, MasterCard — Perekryostok — Alfa-Bank. Every purchase made with this card scores points, which can be spent at Perekryostok supermarkets: every 10 points are equivalent to 1 ruble, and one can gain more points by shopping at Perekryostok. The program provides three types of co-brand cards: reloadable prepaid, debit and credit. All types of cards feature the MasterCard innovative contactless technology, which makes one-touch purchases simple, fast and safe. The project was launched in December, and its popularity continued to grow. Thousands of new clients join in every week, as every person has to buy food.

In 2016 Alfa-Bank released the Next debit card for the young. Holders of the new card have multiple opportunities: they may use the Alfa-Mobile application for free, communicate with bank employees via online chat, and make any payments in several clicks without entering card details. Importantly, the card provides up to 30% discounts in fashion stores and cafes for the young holders. The Next card has a modern design, and the holder can choose any of the 12 options. In August 2016 Next card holders were offered contactless payment bracelets. The bracelets are equipped with a mini-tag card similar to the SIM card of a mobile phone.

The Bank’s projects were appreciated by clients and professionals. Frank Research Group named Alfa-Bank amongst winners of the Frank RG Banking Loyalty Award 2016 upon surveying bank loyalty programs. The survey covered 25 major banks controlling more than 89% of the debit card market and almost 93% of the credit card market. Alfa-Bank’s Perekryostok card won the Maximum Benefit for All in the Mass Segment nomination of Frank Research Group, while the Alfa-Bank cash back card was one of the top five in the Maximum Benefit for Automobilists in the Mass Segment nomination, the Wargaming card was one of the top three in the Maximal Benefit for Gamers nomination, and Alfa-Miles Classic was one
of the top five in the Maximum Benefit for Travelers in the Mass Segment and the Maximal Benefit for Travelers in the Affluent Segment nominations.

**Retail Bank’s Value Stream**

We introduced the Value Stream notion in Retail Bank for the purpose of efficient management of client segments. The Value Stream approach concentrates all operations conducted with a particular client segment in the hands of a group of field-specific professionals, who follow liberalized proceedings in the agile format. For instance, we get rid of practically every internal regulation and agreed on the rapid approval of new products. The transition began in April 2016 and already bore fruit for the affluent segment. Most probably, Value Stream will develop for every sub-segment of our clientele.

**Interaction with team**

Every year brings something new to our interaction with the Block team. We have shifted from the aggressive sales strategy to the policy of a client-focused long-term relationship over recent years. For instance, we have changed the motivation of our managers, which not so much depends on the profitability of the products sold as on client satisfaction. This is our key objective, which determines for how long the client stays with the Bank and how actively he or she uses Bank services. The constant feedback (client’s voice) we receive from every possible channel and point of interaction, in office, the call center and ATM service is of great help to us.

**Technological development**

Alfa-Bank has a reputation as one of the most high-tech banks on the market; each year it does a great deal to maintain this reputation and to meet expectations of its clients. The Alfa-Bank mobile application was updated in 2016. The new design was based exclusively on the user scenario (UX), i.e. the application responded to the routine operations of our clients and standard transactions became simpler and easier. One of the most popular transactions performed by banking application users is money transfer, so we have fully remodeled card-to-card transfer scenarios to facilitate clients’ operations in the mobile application to the fullest extent. The most popular functions were gathered together under a single big red button on the main screen, which also contains ‘payment and transfer’ templates. One can easily transfer money and pay for Internet, phone or public utility services in just a few clicks. Since the middle of 2016, users have been able to transfer funds, to make a loan payment or to convert money in a single operation using the Drag–and–Drop technology. The Alfa-Bank mobile application is using customary digital user scenarios, for instance, swiping a finger across the screen, just like one does in email or messenger services. Another important innovation of 2016 year is the remote access to Internet and mobile banking without a visit to the office. The innovation was implemented by means of a new authorization and registration system. The opportunities to manage one’s services through the mobile application expanded last year, for instance, it became possible to disable and enable services.

As to bank cards, one may set limits (for instance, for cash withdrawal or online payments) and to block or unblock cards by means of the application. The mobile application also gives access to Apple Pay tokens (a unique Alfa-Bank offer). Importantly, many transactions have become free, such as payments for public utility services or traffic fines, and transfer of funds from another bank’s card to an Alfa-Bank card. The zero charge on transfers from cards of other banks brought immediate results — more clients began to transfer funds to our Bank.

In furtherance of our description of the segment-oriented strategy of the Bank’s development, we should say that the application customizes to client segments. For instance, private banking clients see their own application with a special level of service and functions relevant to their service package. Higher segment clients can transfer sums of up to RUB 5 mln using their mobile phone, get in touch with their personal manager using the application, and communicate via the chat function. Our mobile Bank knows a lot about clients: their needs, their life style, etc. This is what clients are expecting from their principal bank; we understand their expectations and modify our products and services consistent with their wishes.

Speaking of Retail Bank’s technological development strategy in general, we are prioritizing technologies, which would expand and simplify online interaction between the client and the Bank, while guaranteeing its security. If a client wishes to increase their income, he or she may see the difference between service packages in the range of deposits and understand how to make more money. For clients using credit products of the Bank, we facilitate the possibility of their payment, for instance with the zero charge on transfers from other cards or the possibility of an early repayment of a loan online.

**2017: outlook and challenges**

Technological tasks will remain a priority of the Bank’s development in 2017. We are intending to expand the horizons of the premium segment and capital management via Alfa Mobile so that clients could buy bonds and make investments via their mobile phone and to lower the investment threshold. We also plan to start up a mobile application for children, which will enable them and their parents to solve financial and non-financial tasks in an easy and convenient way.

Another aspect important for the efficient operation of the entire Retail Bank is attention to rivals, and not just banks, as non-financial entities are actively entering the market of financial services. If one wants to be successful one should be better, faster and more convenient than rivals and guarantee top-notch service to clients.

The third aspect, which remains a constant priority of the Bank, is the interaction with employees and the development of corporate culture, which rests upon the ability to look at one’s work, one’s services and one’s products through the client’s eyes. This helps us understand better those for whom we are working day after day and year after year, for whom we are improving our products and services, and for whom we have been maintaining the highest quality of service, the Alfa-Bank quality, for over 20 years.
Alfa-Bank values its employees and provides them with a wide range of opportunities for professional and personal development, because the success of Alfa-Bank was made possible by its employees.
MASS BUSINESS

The Alfa-Bank Mass Business Block saw record growth in every key segment in 2016. The Block’s market share increased by 1.2% and reached 5.6%. According to managerial reports, net profit in 2016 amounted USD 152 mln which exceeds the plan one and a half time. Commission income increased more than 50% and reached USD 216 mln against that of last year.

The Mass Business clientele neared 300,000 entities and sole proprietors, and active client target values were surpassed: 75% of clients were active in 2016. In addition, the Block set another record in terms of client attraction: more than 19,000 clients were attracted in December, compared to the monthly maximum of 14,000 in 2015.

Those achievements resulted from the efficient performance of the entire Mass Business team. Speaking of client attraction on the field level, an average ‘field’ employee attracted nine clients in September vs. the target value of 8.9, and 11.3 clients were attracted per employee in December vs. the target value of 9.7. The plan was surpassed by 20% last year on the agent level (27 clients were attracted on average in December vs. the target value of 22).

In 2016, Alfa-Bank developed a new program of secondary sales based on machine learning mathematical models, which helped forecast client behavior; for instance, calculating the probability of a client’s purchase of a particular additional product. The efficiency of sales based on the calculated probability is several times higher than the efficiency of randomly offering products to a client. What is more, these instruments help avert an outflow of clients, such as timely identifying clients that intend to stop their cooperation with the bank in the three upcoming months.

Mass Business market in 2016

According to the Federal State Statistics Service, the number of small businesses grew a lot in 2016. At the same time, the number of banks interacting with that sector was on the rise. Fierce competition prompts an improvement of bank offers. Alfa-Bank has been interacting with small businesses for six years; from the very beginning, it has been trying to offer financial and non-banking services to its clients in order to optimize business processes and to increase their efficiency. The comprehensive approach, which goes beyond quality bank services, enables Alfa-Bank to occupy leading positions in the ranking of banks for entrepreneurs and small business.

Higher service quality

Service quality and client satisfaction were focal points of Alfa-Bank in 2016. Consistent with this trend, the Mass Business Block initiated a number of projects and researches. Measures were taken during the year to receive feedback from clients for the purpose of service improvement. A travel map was drawn up in collaboration with clients to demonstrate every point of contact between a client and the Bank and to identify zones for development.

A pilot project, ‘Remote City’, was launched in September 2016 to attract clients in cities where Alfa-Bank was not present at that moment. The pilot was successful, and 800 clients were attracted. The Block will start up a new area of its activity, an online distribution model, in 2017 on the basis of this project. The Bank aims at adjusting processes so that clients have the opportunity of remote access to every bank product and service.

Another service improvement project is titled ‘Universal Employee’. Now any office employee is able to service retail and corporate clients. As a result, Alfa-Bank clients receive service
without waiting and much faster than they did in 2016. This is the first and most popular service optimized in this manner. Similar functions, such as cash withdrawals or issue of bank statements, will be optimized next. At the same time, the Bank is working on the online format of a bigger part of standard operations in furtherance of the online distribution project. A great deal will be done in this area in 2017.

In 2016 the Mass Business Block altered its approach to the organization of processes and shifted to the Value Stream principle. The primary objective of this approach is to develop products and solutions based exclusively on client needs, to rapidly upgrade them using the feedback and to deliver value to clients within the shortest possible period of time.

The project assembled cross-teams in 2016 to concentrate on the elaboration of products and to accelerate the speed of their delivery to clients. These alterations will influence the quality of Alfa-Bank’s client life and, respectively, the NPS index and other similar indicators.

Alfa-Cash Ultra affinity-card

Another important project implemented by the Bank together with the Life Line charity fund is the upgraded Alfa-Cash Ultra affinity-card, which enables corporate clients to withdraw and deposit cash via an ATM and to pay for goods and services in stores and online 24/7. By paying with an Alfa-Cash Ultra card, businessmen help children, as Alfa-Bank transfers 0.39% of every payment to the Life Line fund at its own expense.

The project was launched in March, and the amount of card payments grew fourfold within nine months of 2016. The Life Line fund received RUB 9.1 mln.

Alfa-Cash Register and Internet Acquiring Light

A lot was done last year to prepare the Alfa-Cash Register project. The project was rooted in the modification of Federal Law No. 54-FZ dated 22.05.2003 ‘On the application of cash registers in the implementation of cash payments and (or) calculations with the use of payment cards’. The procedure for using cash registers will change in 2017: cash registers will be mandatorily equipped with fiscal memory devices and businessmen will be compelled to enter into an agreement with a fiscal data operator, which transfers fiscal receipt data to the Federal Tax Service.

Most clients from the small business segment are retailers and service companies, which will have to replace their cash registers. Seeking to reduce the burden on business, the Bank and its partners developed a solution, which fully complies with the law.

In addition, the Bank offered businessmen in 2016 a simple way of accepting payments by bank cards without technical upgrades of the website and additional expenses — a new service called Internet Acquiring Light. The service enables businessmen to accept online payments using Visa and MasterCard cards without installing special modules on the website, but simply by sending a payment link to their clients by email. The service gives businessmen a chance to receive payments by bank cards irrespective of the way an order is placed, via a social media group, on the phone or via the website. Internet Acquiring Light is more profitable than the standard Internet acquiring service for small retailers and service companies, as it saves money on technical improvements at the moment of connection and on lesser lump-sum and mandatory payments. There is no subscription fee, and the commission amounts to 2.75% of the transaction amount (at least RUB 5), which is less than charged by payment aggregators providing such services.

Other non-banking services

As we have said before, Alfa-Bank not only provides modern fiscal solutions and account management tools to small companies but also helps its clients develop their business. The Bank has created a unique eco-system, a community where entrepreneurs find their partners, suppliers and potential clients. The Club was commenced four years ago as a privilege program with an emphasis on preferences and discounts offered by Club partners to Bank clients. The opportunity became especially topical after businesses had found themselves in a complex economic environment. Club partners offered discounts, which amounted to 30% or more, as well as goods and services for business operations and development, such as legal and accounting services, furniture supplies, repairs of computers and office equipment, cargo transportation, cleaning services, etc. All information about partner offers is posted on the Bank website, so the search for the best price and a reliable supplier takes minimal time and effort. Federal partners — market majors which operate across the country and offer exclusive terms for Alfa-Bank clients — have an important place in the privilege program. The federal partners include Yandex. Direct, HeadHunter, Beeline and Contour. They were joined in 2016 by Microsoft, MyTarget, Finolog and other services which help entrepreneurs develop their business.

In 2016 the small business club developed into a business community with a broader range of resources. Now all business clients of the Bank can post information about their company in the Club and promote their goods and services. A vast catalogue with a classification list of over 1,500 types of activities and a smart search option enables Club members to find the suppliers and partners they need. The in-built advertisement system posts automatic announcements of Club members depending on the location of website visitors. The Client Club promotes relationships between Alfa-Bank clients: 2,000 deals are closed monthly on its platform.
Another area of Client Club development is its own business media. In the past, articles and useful materials were provided by the Bank and its partners. Now companies can start their own business blogs. A hundred articles are published monthly in corporate blogs. These publications draw visitors to the website and help active members of the Client Club increase their sales.

In 2017 the Client Club will put emphasis on networking, i.e. promotion of close business relationships between entrepreneurs on the Client Club electronic platform, club.alfabank.ru. Club members can carry out their procurements, exchange business offers and share business advice.

In July 2016 Alfa-Bank became the first regional partner of FIFA World Cup 2018™ and FIFA Confederations Cup 2017. Next year the Bank will give its clients access to the top football event on the planet. Alfa-Bank intends to develop a loyalty program for clients, who will accumulate points by performing standard banking operations and will exchange those points for tickets to matches at the FIFA World Cup 2018™ and FIFA Confederations Cup 2017, as well as souvenirs and sport merchandize.

Lending for small business

The Mass Business Block has been an active generator of risk-free commission income of the Bank for a number of years. Lending was not a priority, yet market normalization in 2016 enabled the Bank to resume lending projects.

Loan rates were cut by 4% in 2016, and in November clients received an opportunity to modify the loan rate by adding options to their service package. As a result, companies could borrow funds at one of the lowest rates available on the market, at least 12.5%. Importantly, the low loan rate did not result from a smaller margin, but was achieved through a comprehensive solution, which included settlement and cash services. The policy brought additional commission income to the Block, which used it to subsidize the loan rate and to make a better offer to its clients. The strategy helped us win new clients.

The Bank will further improve its approach to the loan rate, which will depend on the period of client service: the longer the client interacts with the Bank, the smaller rate it can count on. The product range for small business clients will be expanded in 2017: Bank Guarantee and Express Overdraft services will become available in spring. In addition, the Bank will optimize lending processes, which will become automated to the fullest extent, as well as will being simple and clear to clients.

Small business technologies

The Alfa Business Mobile mobile bank and the Alfa Business Online Internet bank were markedly improved in 2016. A survey of the efficiency of Internet banks for small business beginners and mobile banks, which is annually held by the Markswebb Rank & Report analytical agency, ranked Alfa-Bank third and awarded the first place to the iPad application. We are set to occupy the first places in similar rankings in 2017.

In 2016 mobile bank users were offered such options as the creation of an account and the sending of its details to counterparties in the PDF file directly from a smart phone; verification of a counterparty; authorization of several payments with one SMS message; chat with Bank employees, and lots of other functions.

2017 outlook and plans

On the whole, the market of bank services for small business will not change in 2017 and the trends, which manifested themselves in 2016, will prevail: regulators will continue to tighten requirements for client quality, and entities will seek services of a better quality. The number of banks operating on the market will be growing, while the number of market actors will not, which means fiercer competition for clientele.

The Bank will prioritize lending, better service quality and development of remote banking channels in 2017 in the field of interaction with small businesses.
Regardless of financial environment, the Bank remains a socially responsible organization. It pays particular attention to cultural initiatives, providing help to children and vulnerable citizens, and nurturing talented youth.
Operations Department

Alfa-Bank’s Operations Department has a complex yet interesting mission to maintain the Bank’s competitive edge while complying with regulatory requirements and accommodating client needs, which continue to expand. Constant monitoring of legislative and regulatory initiatives and readiness to meet new requirements, control over current Bank operations, and elaboration of new projects to secure a leading position on the market were the areas of Operations Department activity in 2016.

Client service

Alfa-Bank always seeks to make its products and services clear and easy to use. The year 2016 was not an exception. In that period, we set the task to define the range of upgrades, which would enable clients to perform certain operations without visiting an office or would drastically reduce the time of their visit. Changes occurred in the corporate segment, in the first round. For instance, the Central Bank ordered banks to update profiles of all corporate clients. It was necessary to notify clients by mail, to receive documents from clients in bank offices, and to enter correct data into the system. The Bank team developed a new method to accomplish the updates online, without visiting an office, and to automate the entry of new data into the system.

In addition, Alfa-Bank developed a system which spared corporate clients a visit to the office for a number of operations, such as the opening of a second or additional account and the issue of statements (which used to be the primary reasons for visits to offices). The new system is convenient for our clients and for us, as it saves time for office employees and reduces the back office’s workload.

Another important achievement of the previous year is the halved time of transaction: payments are made in the online regime practically every 15 minutes. An additional benefit is longer business hours, which now end as late as possible, at 8:40 p.m. (the Central Bank stops receiving payments at 9 p.m.). The long business hours add to Alfa-Bank’s competitive edge as another factor of its leadership on the market.

In 2016, the Operations Department optimized two important processes, crucial for legal entities. One of them is the opening of accounts. The account opening time was reduced to one day in early 2016, yet the process should take less in certain cases, and this is what the Bank has done by minimizing labor intensity and paperwork. The outcome of these improvements will be tangible in 2017. The other modified process is the interaction with payroll clients, which is a key process for several business lines of the Bank. Modification of this labor intensive and rather complex process started in 2016 and is still ongoing. Importantly, the change is not limited to automation of particular work stages; in fact, the process is being redesigned from scratch and built on new technologies. Other processes important to the Bank will undergo a similar transformation in the future.

For a number of years the Operations Department has been implementing Bank quality standards based on client priorities. We met those standards on a level close to 100% in 2016, which was a great achievement. The project goes on, and the Bank looks into every case of client dissatisfaction with any aspect of cooperation. Every claim is studied, a process failure is identified, and a solution is developed to avoid similar situations in the future. The Bank seeks not to only resolve every particular case but also to do systemic preemptive work.

Same as before, we give much attention to client feedback. The process of feedback regarding collection of past-due debts was launched in 2016. Every fifth client who contacts the Bank in this connection receives a text message requesting them to assess the performance of a Bank employee. About 84% of the polled clients had a rather high opinion of the service last year.
intend to hold similar polls on every principal process, which helps us understand what our clients like and, most importantly, what they dislike, and to rapidly adjust our progress.

Implementation of modern technologies

The Bank set an increase in the scope of electronic document flow management as a 2016 goal. The Operations Department prepared and accomplished in collaboration with the IT Department a complex project of electronic document exchange with the Federal Bailiff Service. The project had a sizable financial effect for the Bank. On one side, we reduced the number of employees processing paper documents and, on the other side, risks related to that process decreased. The Bank is compelled to process documents punctually, and any delays are punishable with penalties. This means a spike in the workload required urgent measures. Now the electronic document minimizes involvement of Operations Department employees, and the work is done on time and in an automatic manner.

Operations Department's tasks in the field of automation of routine operations and technological updates of processes are broadening day after day. Last year we opened a technological development center in Ulyanovsk to address that matter. Ulyanovsk is the seat of most employees of Operations Department, and it was only natural to form a special IT team in Ulyanovsk for looking into processes together with employees and for performing minor upgrades quickly and on site. For example, we developed ‘virtual robots’ in 2016 to perform routine operations in certain processes so that we could save employees’ time and refocus their attention on issues requiring manual interference. In addition, the robots could do the job quicker, within several minutes, while an employee had to spend up to three hours of their time. The Ulyanovsk IT team has been operating for six months only, but the investment has already paid off. We intend to develop this area in 2017.

Other modern technology projects include the implementation of qualified electronic signature. Now Bank executives do not have to sign their ordinances on paper. A number of documents have been digitalized for saving about 59,000 work hours a year.

The year 2016 witnessed the launch of a variety of pilot projects bearing high significance for the Department, as they make it possible to find new methods of boosting its efficiency. We borrowed the developmental model of foreign startups and organized sessions at which specialists told us about their projects. Then our own work began. For instance, results of pilot projects in the area of machine learning and voice and document recognition will become visible in 2017 about their projects. Then our own work began. For instance, results of pilot projects in the area of machine learning and voice and document recognition will become visible in 2017.

The encashment unit was incorporated into Operations Department in 2015 and the task of its increase of client numbers.

Besides, we are now able to process larger amounts of cash and, therefore, can lift limits on the flow method for processing cash. The optimized cash processing saved us USD 2.5 mln.

Moscow implemented an interesting project in the affiliated area: the local cash center implemented Optimization of retail cash balances was important for boosting the efficiency of Operations Department even further. The analysis made last year yielded a special system to control balances and to make cash transaction forecasts. As a result, retail balances were reduced by 50%, and Retail Bank saved about RUB 90 mln by year end.

There is another project prepared by Operations Department in collaboration with E-Business Block and Corporate Bank — the first letter of credit deal based on blockchain technology. It was our letter of credit team that developed the transaction formula and prepared the deal. We not only used a new technology but also drastically reduced the transaction time. The time of letter of credit opening was reduced from 90 to 20 minutes, and the document mailing time shrank from around five business days to practically zero, as the documents are now sent online. We believe that efficient solutions of this kind should not only be used in our Bank, but also implemented in other financial institutions. The Association of Financial Technologies was set up late in 2016 with the participation of the Central Bank. Alfa-Bank is an active member of the Association, which sets the promotion of smart contracts based on blockchain technologies in Russia as one of its objectives.

Continuous improvement culture

The implementation of continuous improvement culture in offices, which began in 2015, was accomplished last year; nowadays, this is a daily routine practice of the Department's personnel. The idea of this approach is that every employee can improve their performance by offering simple and fast optimization solutions. A total of 2,200 employees of Operations Department, or about 90% of the entire personnel, were coached in that field. The aggregate portfolio of LEAN initiatives accepted in 2016 stood at RUB 90 mln , and more than 200 ideas, including projects bolstering the efficiency of employees collecting past-due debts, were approved. As a result, the non-productive time of employees placing phone calls decreased by 20%.

Operations Department units were moved from Moscow and regions to operating centers in Ulyanovsk and Barnaul in 2016. The third center opened in Yekaterinburg; and FOREX control centers were unveiled in St. Petersburg and Nizhny Novgorod. The concentration effort was profitable: we expect to save 40-50% of payroll funds after the migration, while service remains good.

Specifically, the projects related to the introduction of new technologies have raised the efficiency of Operations Department by 14% and have saved more than RUB 750 mln for the Bank.
information display and a knowledge database were created, operating risks were assessed, and even videos were specially made for the unit. The targeted approach was fruitful: the encashment unit reached the general operational maturity level of the entire Operations Department over the year. A mobile application was developed for encashment employees in Moscow, and the practice will be shared with our regions of Bank presence in 2017.

Reduction of past-due debt

Last year Operations Department posted the maximal rate of collection of past-due debts from retail clients, more than 96%. A number of factors made that achievement possible: on the one hand, the Bank's risk management strategy became stricter — loans were given to clients who could repay the money with a high degree of probability; on the other hand, more work was done with employees collecting past-due debts. The employees received a new motive and were invited to a game in which the best of them scored points for taking a training course or demonstrating quality interaction with clients. It was a useful and interesting experience, and we realized that the method worked well with the contemporary generation.

Work with Operations Department's employees

A training program titled ‘The Art of Impressing’ kicked off at Operations Department last year: it is notable that many of our employees interact with clients either on the phone or personally wherever encashment is involved. The course was customized for our specialists, and half of them were trained by year end. Employees spoke well of the program and said they understood the essence of their work better.

The knowledge database was expanded into the entire Alfa-Bank in 2016. Prior to that, knowledge databases were implemented only in particular blocks; now every major business line of the Bank has one. This is important, because the demand for knowledge databases is obvious. For instance, about 80% of Operations Department employees use the knowledge database on a monthly basis. About 300 documents were added to the knowledge databases last year. Some of them were added after employees answered the question regarding what additional information they might need. The polls go on. The knowledge databases have created professional communities: these are not closed clubs but platforms that could be visited by any employee to ask a question or to make suggestions for a particular process.

For the purpose of greater convenience of the knowledge database, we have added another modern instrument — the Alfa-tube video platform where any employee can post a video they made themselves, for example, to share the best available practice. Centers of expertise are using this service for classic purposes — dissemination of information essential for Bank employees. One

had to contact the IT Department for posting a video in the past, now it will only take a minute to post a video in the general-access mode.

Interaction with business units

Our relationships with business units developed very rapidly in 2016. For instance, Mass Business Block implemented the value-stream concept and we worked together to understand its implications for Operations Department. The same block launched the ‘client research’ project, which presented clients’ opinions on Alfa-Bank services. It was an important experience, as we learned about the pros and cons of our services directly from their consumers. Following the separation of Medium and Regional Corporate Business Block, we had to build a relationship with another business line, and that mission was also successfully accomplished. Besides, special platforms were created for monthly meetings with every business line to discuss current affairs, interaction models and outstanding problems.

IT Department

The significance of information technologies for modern banking business can hardly be overstated nowadays. The Bank’s operations are intertwined with state-of-the-art technological solutions, so we would like to say a few words about IT Department’s projects. Lots of important projects have been implemented in this area, and some of them are unique on the Russian banking market.

Procurement of Equation codes from Misys

In 2016, Alfa-Bank closed the deal with British company Misys to procure the source codes of the Equation core banking system, consisting of more than 33,000 objects. IT specialists rapidly developed instruments for verifying the software’s correctness and fullness. They checked and analyzed every purchased object using their own innovative solutions and invaluable lengthy experience of operating the Equation automated banking system (ABS), recompiled and implemented the objects to meet the Bank’s needs.

In fact, the Bank started using the Equation 3.9 system in 2011, yet the lack of access to the Equation program code was hindering rapid updates of the system functionalities. Hence, Alfa-Bank decided to purchase all Equation source codes. It was the first time Misys agreed to cooperate in this format.

Now IT Department has a chance to rapidly analyze and correct Equation software errors, to quickly make any upgrades without using expensive vendor services, to optimize and boost ABS problem zones, to lift native software architecture limitations; to use modern programming languages for
Equation development, to directly integrate upgrades into the ABS core, and to accelerate training and engagement of new employees in the Equation support or development process. The Bank can save a lot of money on the system’s support and development by doing so.

Importantly, despite the purchase of the source codes IT Department did not have problems with the accessibility of the ABS and key banking systems, which remain on a very high level.

Flexible design culture

In 2016 we made a big step towards DevOps culture (culture of flexible design and integration of operation and design procedures) and instilled a total automation ideology into IT Department.

The use of the best available global DevOps practices significantly increased the number of modifications in the focus group’s IT system and accelerated preparations for every modification made over the year. The speed of design and implementation in focus areas increased 60-fold. Four key product teams of the Bank created fully automated end-to-end pipelines for commissioning business product updates, which significantly reduced the period of delivery of updates to clients. Everyone — from product owners to administrations — took part in the effort. In the most successful teams, the automatic “conveyor” makes it possible to deliver changes to the industrial environment in one day at most, taking into account all the necessary tests and operations. Automation administrators and testers took the place of administrators and testers. In 2017, we expect to instill the DevOps thinking into another 21 product teams, to form a full-value corporate DevOps community, and to apply this successful practice to other Bank projects.

Integrated client service (SFA) and MDM systems

SFA (Sales Force Automation) and MDM (Master Data Management) systems are two projects crucial for Alfa-Bank as a whole.

The Bank needs to know all about clients in order to attract them and to develop relationships. Sales Force Automation (SFA), an integrated client service system based on the Pega unified platform, has been developed and put on a trial run to promote sales and interaction with clients. The system contains basic and additional information about a client, the product this client uses and history of his/her communication with the Bank; it is possible to make appointments and calls and to indicate tasks, goals and events in the system. SFA helps sell products needed by clients, which means the establishment of a lasting and strong relationship. Importantly, the system creates a single life cycle of sales and selling motivation. So far, SFA incorporates 14 A-Club offices whose personnel are being tested and coached. A-Club is closely connected to every major business client of the Bank, as its target audience is not just individuals; most of them are company owners or top managers — target clients of big and medium corporate business units. Given that circumstance, a platform providing a unified view of the client and efficient management of the Bank-client relationship has a strategic meaning. Besides, time is a factor for the client service, and full information and quality analysis of transactions and portfolios by the SFA system can help our financial consultants and the back office accommodate client needs at a much faster speed.

There are plans to implement SFA in every retail office by the end of 2017; the system will also be used to sell products to legal entities in the future. This way, we will develop a unified view of the client, irrespective of the time the client enters into a relationship with the Bank, and the client’s status — either retail or corporate. The project is based on Scrum methods and supports Agile values, which provides rapid processing and constant feedback from users.

MDM (Master Data Management) is a system for centralized input and storing of client data and operative delivery of consolidated data packages to office employees. Client managers operating in the Affluent and A-Club segments are already using the consolidated client ‘golden card’, comprising data from 15 channels in the Bank’s SFA system. Client data consolidation in the MDM system provided that opportunity.

MDM is also being actively used in the Medium and Regional Corporate Business segment. Since October 2016 segment managers have been rapidly receiving information about limitations imposed on clients by the Compliance Directorate. MDM now receives the data from several sources and delivers it to segment managers; in the past, the Directorate informed client managers about limitations via their superiors. Those practices caused time delays and created additional risks: Medium and Regional Corporate Business managers were unable to act promptly and to warn clients about looming problems, and the Bank ran the risk of losing a client. Now the response is fast, which reduces the client outflow ratio and prevents negative sentiment about the Bank. In addition, problem diagnostics and reporting become easier for managers.

As to the MDM implementation in retail business, the first stage of this project has been implemented: servers have been provided for viewing, creating and modifying data of debit cardholders and for automatically collecting client data from external systems for profiling purposes. Now we have an opportunity for centralized storage and processing of debit cardholder data accessed by offices; we can also see the process of transformation of potential clients into current ones and make an objective analysis of this indicator. Besides, the Bank can prepare interesting offers for cardholders and inform clients about new possibilities and ways of their realization.

We aspire to forming a complete client profile, the so-called 360 view, which requires expanded interaction with business lines in the near future. Mass business projects will be actively fostered in 2017, and the scope of tasks will broaden in relation to retail clients. Another task for the next year is higher client data quality.
In 2016, Alfa-Bank’s compliance with the international standard of IT service quality management, ISO/IEC-20000-1:2011, was successfully confirmed. The audit was performed by Russian Register, the biggest national independent entity certifying management, product and HR systems. The auditors checked the IT service risk evaluation system, the applied procedures and the compliance with the standard. They focused on the responsibility of service managers, as well as the competency and knowledge of employees, and document flow management principles.

Alfa-Bank demonstrated a high level of organizing the service management system, which runs smoothly thanks to the newest ITIL processes, constant monitoring, and timely adjustments and upgrades, when necessary.

The Bank started up many of the processes required by the standard a long time ago. Besides, new interrelated processes — Capacity Management, Release Management, Configuration Management and Document Flow Management — were built over the past year to provide integrated operation of the service management system and to comply with the international standard.

All Alfa-Bank units involved in the project and the IT team pooled their efforts to achieve the common objective amid the ongoing economic transformations. The certification confirmed the high level of the Bank’s expertise in IT process management. It also proved the high quality of our IT systems, which we will continue to develop for maintaining the status as the most technologically advanced and innovative Bank.

Work with IT team

This year most employees in development units were taught to use flexible software development methods; we also continued to recruit and develop young specialists. A Pega platform training course was launched in 2016 after the IT team had developed its own specialist training program. The course was based on practical and methodological materials and included a corporate exam. As a result, 12 employees joined Mass Business teams of the Bank.

Interaction with Operations Department, business lines

Joint projects with Operations Department are an important part of our activity. For instance, exchange of documents with the Federal Bailiff Service was automated by joint efforts in 2016. The project was complicated from technological and organizational angles, as the uncooperative attitude of the Federal Bailiff Service was a factor. Our team succeeded despite all the difficulties, the mission was accomplished ten days in advance, and 13% of the budget funds were saved. A unique multi-level algorithm was designed to fully automate processing of all types of documents in every kind of retail accounts. It was a truly unique event for the Russian banking market: Alfa-Bank was the first to implement nationwide e-document flow with the Federal Bailiff Service.

In addition to data processing complex algorithms, the project team initiated the development of a number of additional functions for clients’ convenience, such as automatic SMS notifications of freezes put on accounts, withdrawals from deposits without deposit cancellation and interest loss, as well as foreclosure order control to avoid execution of foreclosure orders in case they are cancelled before the orders are received.

There are a number of other 2016 projects assisting business lines. For instance, Retail Banking finalized the FLEX project — a lending process, which ensures the sustainable development of this business. Corporate Banking automated the process of settling pre-overdue loans, which considerably improved the corporate lending portfolio.

2017 forecasts and plans

The first and foremost task of Operations Department and IT Department in 2017 will be to support the growth strategy. We expect robotized and automated processes to keep the growth of Operations Department in check and to prevent its enlargement proportionately to the scope of client business. We will carry on our joint work with business lines to optimize processes, for instance, lending, which the Bank sees as a priority. We intend to maintain collection of past-due debts at a high level amid the rapidly expanding lending business. As to the projects which started in 2016, we prioritize the rapid opening of accounts for legal entities and payroll accounts, in addition to broader remote client service opportunities. It is planned to automate our interaction with Mass Business in the consumer loan segment in 2017. Profound adjustments will be made to cash operations.

We will also focus on pilot projects, such as the ones developed in 2016, especially in robotizing routine process and the machine learning and voice and document recognition initiatives.

Today, quality banking service is unthinkable without modern technologies, a flexible approach to client needs, and constant improvement of the efficiency of every process and every Bank division. We understand how important the accurate and flawless work of every employee of our blocks under these circumstances is, as we are not only responsible for our own performance, we also insure business lines against possible errors. The Operations and IT Departments form the cornerstone of Alfa-Bank, and we will do our best to enable it to work better and be more efficient day by day.
Alfa-Bank places emphasis on proper financial risk management. The primary objective of Alfa-Bank risk management is an optimal level of risk-return, including an acceptable level of risk maintained within the limits of risk appetite. In 2016, the Bank continued to improve risk management as a key element of its strategy. The Bank develops its risk management system on principles consistent with Russian laws, international standards and best available practices. It implemented Internal Capital Adequacy Assessment Process (ICAAP) on solo level and Banking Group level. The Bank performs stress testing of its capital adequacy taking into account significant risks’ stress tests.

The Bank’s risk management system is oriented on the improvement of internal risk management methodology and processes in order to maintain and strengthen its position on the banking market. The Bank develops and improves approaches to risk and capital management using internal credit risk models, providing necessary infrastructure and IT systems.

The risk management practice based on management of financial risks (especially non-retail credit risk, counterparty credit risk, retail credit risk, market risk, operational risk, liquidity risk, interest rate risk in banking book and concentration risk within non-retail credit risk) applies to every product line. Risk management includes risk assessment, establishment of risk limits, monitoring, control, reporting, and establishment of internal risk management processes and procedures. The Bank manages risks on the basis of a concept of three lines of defense, compliant with the requirement to avoid a conflict of interest.

ICAAP implementation in Bank and Banking Group

The Bank implemented ICAAP on solo level and the level of Banking Group in accordance with Central Bank Regulation No 3624-U dated 15.04.2015 “On the Requirements for the Risk and Capital Management System of a Credit Institution or a Banking Group”.

ICAAP is a regular cyclic process executed on the level of a Bank Group member and the Bank Group as a whole, and includes the following stages: identification of inherent and significant risks, assessment of significant risks, aggregation of significant risks, capital allocation and planning, monitoring, control, minimization, reporting, and monitoring of efficiency.

The Bank's fundamental ICAAP documents on solo level are the Risk and Capital Management Strategy, the Significant Risk Management Procedure, the Risk Appetite Statement and the Financial Stability Recovery Plan approved by the Bank Board of Directors, and the Significant Risk Identification Methodology, the Procedure of planning regulatory and internal capital, Internal capital methodology, and the Stress Testing Methodology approved by the Executive Board.

On the Banking Group level Risk and Capital Management Strategy of Banking Group and the Risk Appetite Statement for Banking Group are approved by the Board of Directors, while the Executive Board approves the Methodology of significant risks identification of Banking Group, the procedure of planning regulatory and internal capital of Banking Group, Internal capital of Banking Group methodology and Procedure and methodology of stress-testing of Banking Group.

Stress testing

The Bank constantly modifies reviews and expands its risk management practices, including stress testing procedures, and conducts stress tests on a regular basis at the required frequency. The purpose of stress testing is to assess a potential impact of stress changes in external or internal factors under exceptional but probable circumstances on the Bank’s financial stability. Stress-tests assess the Bank’s ability to maintain financial stability during economic crises or stress events — the occurrence of significant risks that may affect the Bank’s financial stability. The Bank assesses sufficiency of capital to cover significant risks under stress and capital adequacy. The Bank aggregates outcomes of stress tests of significant risks to assess internal capital adequacy.

The Bank establishes a stress testing procedure for every type of significant risks, taking into account characteristics of Bank operations, capital requirements for covering risks, etc. Based on the stress-testing results the Bank defines potential actions in case of stress scenarios. By the end of 2016, the annual stress testing process resulted in the modification and improvement of the stress testing methodology for credit and market risks, and the stress test on the 2017 horizon was performed.

Risk management: organizational structure

The Bank's system of the risk management bodies includes the Board of Directors, the Board of Directors’ Audit Committee, the Board of Directors’ Staff and Remuneration Committee, the Executive Board, the Strategic Risk Committee, the Asset and Liability Management Committee, credit committees, including the Mail Credit Committee, the Small Credit Committee and the Retail Credit Committee, the Default Committee of Corporate and Investment Bank, the Operational Risk Steering Committee, and others.

The Board of Directors oversees the capital and risk management system, control of the risk management process taking into account ICAAP reports, and approves the Bank’s strategy,
the risk and capital management strategy, the significant risk management procedure, and risk appetite.

The Board of Directors’ Audit Committee oversees the efficiency of risk management and internal control processes, controls reliability of the risk management system and internal control, and submits proposals for their improvement to the Board of Directors.

The Board of Directors’ Staff and Remuneration Committee oversees initial consideration, analysis and elaboration of proposals to the Board of Directors on regulation of remuneration and recruitment of employees, which are significant for the Bank’s risk management policy, it also reviews and develops the Bank’s remuneration documents.

The Executive Board specifies the Bank’s risk management policy on the basis of the Risk and Capital Management Strategy, approves risk and capital management and stress testing procedures, oversees monitoring and risk mitigation based on optimal balance between the Bank’s objectives, profitability required by shareholders, and risk appetite, ensures ICAAP implementation and compliance with the required capital adequacy higher than minimal requirements, and considers ICAAP reports.

The Strategic Risk Committee is the senior risk management committee. It regulates the risk management system, sets up the Bank’s policy and general risk strategy, considers and adjusts risk management principles and systems for the purpose of greater efficiency, approves internal models and validation reports, and controls validation of internal risk assessment models.

The system of risk management committees, as well as the Risk Management Department (including the Chief Risk Officer) and the Treasury builds an efficient risk management and control system.

The Risk Management Department oversees the implementation of risk management procedures and the operation of the risk management system, overall risk management to ensure the application of principles and methods of risks identification, assessment, management and reporting of risk information to the management. The Risk Management Department consists of the Non-retail Risk Department, the Retail Risk Department, Basel office, Market Risk Management Division, the Operational Risk Management Division, Risk Reporting and Control Department.

The Corporate problem Loans Department is fully independent from the Risk Management Department; it elaborates proposals for managing bad debts, including the collection strategy, and suggests ways of collecting corporate problem debts to the Main Credit Committee. The

Corporate problem Loans Department implements the approved strategy. It is a part of the Executive Board Chairman’s Block and reports to the Main Credit Committee. The Bank’s Default Committee of Corporate and Investment Bank is organised to consider recognition of defaults consistent with the Bank’s procedure.

The Retail Risk Department develops decision making rules for the delinquent Retail portfolio. The Collection division of the Operational Department executes the bad debt management actions aimed at recovery and return of good credit payment performance, collection of past-due debts and identification of deals to be written-off as non-performing loans. Default process is mainly automated, methodology is approved by the Retail Credit Committee. An external debt collection agency may be involved in the process of debt recovery with under the special agreement. Retail Default definition criteria are determined by the Methodology of Retail Default and Recovery Definition approved by the Retail Credit Committee.

Risk identification
The Bank puts special emphasis on the development of the risk identification system in order to monitor risk factors and to assess the sufficiency of risk management procedures and manages them within its organizational structure.

Risk assessment and minimization
The risk assessment and mitigation mechanisms vary depending on the risk type. Internal methodology is regularly reviewed and updated.

Monitoring and control
Risk monitoring and control is performed by the Risk Management Department, the Internal Control Department (as the second line of defense) and the Internal Audit Department (as the third line of defense).

Reporting
Risk reports are prepared to inform management about significant risks, risk appetite and capital. Regular risk reports include assessment of risks and capital, stress testing results, and other information.
Credit risk

Alfa-Bank undertakes the credit risk — the risk of Bank losses arising out of failure to perform, late or incomplete performance of the borrower’s financial obligations to the Bank consistent with terms of the agreement. The credit risk is divided into non-retail credit risk, counterparty risk and retail credit risk.

Non-retail credit risk. General management principles

Credit risks are structured depending on the product, the borrower, the industry, etc. There is a limit to every risk. The limits are constantly controlled and regularly revised.

The Bank defines rules of borrowing by approving the Credit Policy, which specifies the level of risk authorities by committees and a system for special approval of large transactions. The Credit Policy is regularly revised. Quality borrowers — Russian companies are the target lending segment.

The Credit Policy establishes a system of limits for non-retail credit risk (including different limits of credit risk concentration, credit limits for particular borrowers/groups of interrelated borrowers, limits for transactions with counterparties, administrative limits), set up control over the limits performance, and establishes action plans in case of a possible breach of limit or limit trigger values.

Alfa-Bank credit committees approve credit risk limits. Depending on the amount of credit risk, credit risk decisions are made either by the Main Credit Committee or the Credit Committee. In some cases, limits/transactions approved by the Main Credit Committee are also subject to approval by the Executive Board.

Non-retail credit risk. Credit process and risk assessment

The corporate lending approaches are based on the standard underwriting procedure (depending on the borrower’s segment), including verification of the potential borrower’s creditworthiness, quality of the proposed collateral, and compliance of the transaction structure with the Bank’s policy and limits; internal ratings are assigned on the basis of statistical models and in accordance with internal procedures based on Basel II standards.

Basel II standards are implemented in every essential stage of the corporate lending process: (a) solvency assessment, collateral management, pricing, improvement of internal methodology; (b) development of approaches to segmentation; (c) integration of internal rating models into the creditworthiness assessment and the credit decision process; (d) credit and internal procedure monitoring; (e) recognition of default; (f) distressed debt management process.

The Bank has the following rating categories: first class borrower, good and standard borrower, acceptable borrower, weak borrower, and impaired borrower.

The Risk Management Department analyzes credit requests and correctness of rating assigned and provide its conclusion. The opinion of the Risk Management Department and the financial profile of a borrower are submitted for consideration of the relevant credit committee. Credit committees analyze credit requests for approval of a credit limit on the basis of the available information.

Non-retail credit risk. Monitoring

The credit risk is subject to constant monitoring. In case the borrower’s creditworthiness deteriorates and there are a number of warning signals, the client is put on the watch list for monitoring the possible worsening of its credit quality. The dynamics of borrowers’ quality is submitted to the relevant credit committee for analysis and control. Compliance with Credit policy limits and signal values is regularly verified.

For the purpose of higher efficiency of credit risk management, the Bank divides the non-retail credit portfolio into the following pools:

- Current loans pool, including technical and less than 14 days overdue.
- Watch-list loans pool includes loans which demonstrated early signs of possible future deterioration of credit quality.
- Problem loans pool includes loans, which are considered to be impaired and loans overdue for more than 14 days.
- Defaulted borrowers with 90+ days overdue or having other unlikely to pay criteria.

The Bank puts special emphasis on problem loans management and provides relevant information to the Main Credit Committee on a weekly basis. The Corporate Problem loans Department analyzes bad loans on a weekly basis. This analysis includes perspectives of payment, debt collection claims, restructuring terms, and claims for additional credit collateral.

Non-retail credit risk. Control

The Bank has developed a risk control system for processing all transactions related with credit risk. The purpose of this control is strict compliance with internal policies and procedures.
The Bank applies control mechanisms for the purpose of efficient risk management. Such mechanisms include regular reports on the condition of portfolios and regular submission of such reports to relevant committees, elaboration of main principles of the credit policy, regular analysis of the need to revise policy principles, elaboration of lending principles based on the consistent and focused decision process, use of the decision procedure based on statistical data, and constant monitoring by the Risk Management Directorate and the Internal Audit Department of the current lending process for assessment of its efficiency and relevant adjustment.

Non-retail credit risk. Credit risk alleviation

The Bank uses a broad range of techniques for the credit risk mitigation by managing loss factors, such as the default probability, the default loss, and the default probability ratio on both individual transaction and portfolio level.

The ability of a borrower to service the debt is assessed on the level of transaction. The Bank mitigates the risk by accepting various kinds of collateral, sureties of legal entities and individuals, and bank guarantees.

The existing methods of credit portfolio quality control aim at active credit risk management and provide timely identification of the risk and proper response to transactions showing signs of deterioration. These measures include decline of limit amount, procurement of additional collateral, restructuring, and other measures depending on the situation.

The credit risk premium calculated on the basis of the client default's probability is included in the risk assessment and pricing processes. The risk premium ensures fair compensation for the size of credit risk assumed by the Bank.

Counterparty risk

The analysis of credit risks in transactions with counterparties is done by the Counterparty Risks Division within the Non-Retail Risk Department. The counterparty risk is managed by system of concentration limits and limits on particular counterparties and groups of counterparties depending on the type of transactions, amount of risk, and maturity of transaction. Decisions are made under the current decision processes of the Bank.

A key factor for setting a counterparty risk limit is the financial statement of the counterparty. The financial statement of counterparties is assessed by use of internal rating models consistent with the Basel requirements and by expert analysis based on financial reports, market quotations and information in the media. In the case of securities transactions, the assessment of the counterparty’s financial position is supplemented with the analysis of the provided collateral. Also the counterparty risk is mitigated by legal agreements, which apply liquidation netting. Decisions on large transactions involving financial derivatives, which require approval by the Bank’s collegial bodies, are based on positive correlation between the exposure to credit risk and the probability of the counterparty’s default.

Retail credit risk. General management principles

Retail credit risk is managed via the Retail Risk Department, the Retail Credit Committee and the Chief Credit Committee in regard to Mass Business Block clients.

The Retail Risk Department of the Risk Management Department supervises credit risk of such products as credit cards, cash loans, consumer loans, car loans, mortgage loans, and products offered to mass business (such as individual entrepreneurs and legal entities formed compliant with Russian laws and posting annual revenue of less than RUB 350 mln).

The Retail Credit policy and the Credit policy for Mass Business Block clients establish principles of retail risk management, risk identification, assessment, monitoring and control, including portfolio management and division of retail risk management responsibility. The Bank's retail credit risk management policy aims at forming a portfolio with the least degree of volatility and with the target level of risk-return.

The Retail Credit Committee approves the Retail Credit policy, parameters of retail credit products and pricing conditions (interest rates, commission rates, and penalties), as well as credit product lending process, and main procedures to control retail business risks.

Retail credit risk. Lending process and risk assessment

The credit decision process in retail lending is based on the principles of standardization and automation of procedures, including manual verification of information about the applicant and automated risk assessment processes.

The automated risk assessment is done, in particular, by use of statistical models (scoring) based on the analysis of the current credit portfolio and borrowers’ characteristics. The scoring estimates use information from the application form, the history of the bank-client relationship, and information from external data sources (such as Credit Bureaus). Credit risk is assessed by internal models developed on the basis of internal rating in line with the internal rating-based approach g, as well as scoring models of other types (such as fraud prediction model, etc.).
Retail credit risk. Monitoring

The Retail Risk Department monitors credit portfolios on a regular basis. The department monitors the following indicators: approval rates by product/segment; delinquency levels (both long-term and short-term), migration (past due balance roll rates into various delinquency buckets), execution of promised payments for monitoring collection efficiency; actual credit losses for the previous periods by product and issue dates; special pilot programs, write-off indicators in each product portfolio; recoveries for each credit portfolio, stability of risk assessment procedures, results based on these assessments by product, and efficiency of segmentation procedures. In this monitoring the Bank pays a special attention to the risk-adjusted margin in order to optimize the profitability of retail portfolios.

Retail lending procedures are adjusted from time to time due to changes of the economic conditions and validation recommendations. As a result of such calibration cut-off criteria, credit limits, debt burden ratios, verification standards, and minimal criteria for approval of borrowers may be adjusted.

Retail credit risk. Control

For the purpose of the efficient monitoring of the retail credit risk, the Bank sets up limits and performs their monitoring on a regular basis. Reports are presented to executive bodies and relevant Bank committees so that they can make medium- and long-term decisions regarding the retail credit portfolio with the goal of keeping the indicators within the limits.

Retail credit risk. Credit risk mitigation

In order to increase the efficiency of retail loan recoveries and delinquency levels control, the Retail Risk Department uses statistical models to at various stages of debt collection procedure. The efficiency of applied statistical models and debt collection procedures is monitored by the Retail Risk Department as a part of retail credit risk monitoring on the basis of regular internal reports.

Market risk in the Bank's trading book is assessed consistently with the Bank of Russia Regulations No 511-P dated 03.12.2015 'On the Procedure for Calculating the Market Risk Value by Banking Institutions' (hereinafter referred to as Regulations No 511-P) for the purpose of compliance with the Instruction No 139-I (regulatory ratios and capital requirements).

Market risk assessment methods are laid down by the following internal documents:
- Methodology of Preparation and Submission of Market Risk Reports in compliance with Regulations No511-P;
- Methodology of Market Risk Stress Testing by AO Alfa-Bank's Internal Capital Adequacy Assessment Process (ICAAP);
- Methodology of AO Alfa-Bank's Value-at-Risk Assessment based on the historical method.

The Bank manages market risks by the principles of its internal documents, including the Market Risk Management Policy.

Banking book market risk

The Asset and Liability Management Committee sets limits for restricting market risk to the banking book, among them limits on interest risk metrics, the open currency position limit.

Currency risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in the foreign exchange rates and/or precious metal positions.

For the purpose of limiting currency risk consistent with Bank of Russia Instruction No 178-I dated 28.12.2016 'On Establishing Values (Limits) of Open Currency Positions, Methods for their Calculation and Specifics of Supervision over their Compliance by Credit Institutions', the Bank set up limits on the amount of open currency positions at 20% of the Bank's equity and on each currency and the balancing position in Russian rubles at 10% of the Bank's equity. Open currency positions are estimated and controlled by the Treasury and daily verified by the Risk Management Department consistent with the Regulations on Monitoring of the Bank's Open currency Positions, Preparation and Submission of Open currency Position Reports by form 0409634.

The Assets and Liabilities Committee set up the following internal limits the Bank's currency position either directly or indirectly:
- Limits and signal values are established for the VaR market risk metrics (one-day horizon, 99% VaR), the calculation of which includes the Bank's currency position;
• Limits and signal values are established for the market risk metrics ‘Risk Value Consistent with Regulations No 511-P’, the calculation of which includes the Bank’s currency position.

The aforesaid internal limits are verified with the established periodicity by the authorized units of the Risk Management Department and the Treasury.

Interest rate risk in banking book

The Bank is exposed to interest rate risk arising from loans to clients and other banks with fixed interest rates, the amounts and terms differing from the amounts and terms of deposits and other borrowed funds with fixed or variable interest rates. The main sources of interest rate risk are the risk of change in the value of positions due to temporal differences in maturity for a fixed interest rate and a change in the value of balance sheet and off-balance sheet claims and liabilities for a floating interest rate, the risk of a yield curve change, basic risk, and option risk.

For the purpose of control of interest rate risk associated with the risk of deterioration in the financial position caused by a decrease in net interest income as a result of changes in interest rates on the financial market, the Bank regularly estimates the change in net interest income on the assumption of a change (increase or decrease) in the interest rate level.

The Bank’s interest rate risk is managed by the Treasury and the Risk Management Directorate consistent with limits set by the Asset and Liability Management Committee in Russian rubles, U.S. dollars and euros, and the overall amount of Alfa-Bank’s risk.

There are two families of interest rate risk metrics: metrics of sensitivity of the Bank’s value to changing interest rates (PV metrics) and the indicator of sensitivity to the expected net interest income in the 1 year horizon to changing interest rates (EaR metrics).

The limits and signal levels are established by the Asset and Liability Management Committee; they are calculated weekly for assets and liabilities with the date no more than seven business days from the calculation date per currency. The Asset and Liability Management Committee approves methodology and essential assumptions for calculating interest rate risk metrics.

Consistent with the current Interest Rate Policy, the Bank applies adjustment measures if interest rate risk exceeds the statutory values. The interest rate risk level is adjusted in case interest rate risk limits may be breached.

For its part, the Treasury closes financial market deals for the purpose of compliance with the limits; changes Funds transfer pricing rates (FTP) and external rates; and takes other measures envisaged by the Asset and Liability Management Committee. In case of insufficient authority, the Treasury submits the issue for the Asset and Liability Management Committee’s consideration.

In addition, the risk of change in the value of particular debt instruments of the Bank related to the traditional position of investment business is covered with a limit on the amount of an open position and a VaR limit.

Liquidity risk

The liquidity risk is defined as the risk of the Bank’s inability to finance its activity, i.e. to increase assets and to meet its mature liabilities without incurring losses in an amount threatening the Bank’s financial stability. The Treasury and the Risk Management Department manage liquidity risk. The Asset and Liability Management Committee (ALCO) controls liquidity risk.

The Bank maintains a stable funding ratio, including, first and foremost, the amounts payable on corporate and retail deposits, debentures, and payments due to other banks, as well as relevant and diversified portfolios of liquid assets so that it could react swiftly and calmly to unforeseen claims for liquidity.

The Bank manages liquidity risk on the basis of constant analysis of the amount of liquid assets needed for meeting mature liabilities; access to a variety of funding sources; adjustment of plans in case of financing problems, and control over compliance of balance sheet ratio regulations.

The Bank manages liquidity risk through control over compliance with various limits and liquidity metrics established by the Central Bank and Alfa-Bank (recommendations of the Basel Committee on Banking Supervision are taken into account):

- The Central Bank’s liquidity ratios on a daily basis.
- The Liquidity coverage ratio on a monthly basis.
- A relevant portfolio of short-term liquid assets, mostly consisting of liquid marketable securities from the Central Bank’s Lombard List (HTM and HFS securities portfolios), bank deposits, and other interbank instruments;
- Control over the amount of short-term inter-bank loans for managing maturity gaps between assets and liabilities;
- Control of the daily liquidity position and regular liquidity stress tests for various scenarios featuring standard and crisis market environments.
- Compliance with Net Stable Funding targets. The Net Stable Funding indicator is based on the Bank’s methodology and the Basel III Net Stable Funding Ratio (NSFR);
- Assessment of the Bank’s market position by the cost of funding metrics — comparison with principal rival banks;
• Compliance of concentration of funding sources with targets; control over compliance with limits as a share of total balance in various scenarios of attraction of corporate clients and bank products.

The Bank manages liquidity risk on the level of Alfa-Bank Group. For Group level the Bank complies with The Liquidity coverage ratio (H26) for the purpose of liquidity risk control.

Operational risk

Operational risk is the risk of losses the Bank may incur from unreliable or flawed internal management procedures, mala fide employees, failure of information or other systems, or external events. Operational risk includes legal and regulatory risks yet exclude strategic and reputational risks.


Operational risk management is a set of procedures identifying assessing, monitoring, controlling and/or minimizing operational risk.

The following mechanisms are used for identification and assessment of operational risk:
• Analysis of processes,
• Data collection and analysis of Bank operational risk events,
• Data collection and analysis of operational risk events of other financial institutions,
• Risk control self-assessment (RCSA),
• Key risk indicators (KRI),
• Scenario analysis of operational risk (stress testing).

Analysis of processes identifies and assesses new potential operational risks in Bank processes, products or systems at the stage of their development and implementation.

The purpose of data collection and analysis of Bank operational risk events is objective assessment of losses the Bank may incur from operational risks. The outcome of analysis of causes of operational risk events is used to develop and implement measures minimizing operational risk, preventing recurrence of operational risk events, improving internal processes, raising efficiency or implementing new control mechanisms.

Data collection and analysis of operational risk events in other financial institutions make it possible to monitor new operational risks in banking and provides additional information for assessment of the Bank’s operational risks.

Operational risk self-assessment is conducted by Bank divisions for identification and assessment of operational risks in their activity, for assessment of efficiency of current mechanisms of control over identified operational risks, and for development and implementation of action plans to minimize identified operational risks.

The system of key risk indicators enables the Bank to control and forecast the level of main operational risks, to rapidly identify and respond to events, escalating the level of operational risk, and to prevent occurrence of operational risks and Bank losses.

Scenario analysis (stress testing) of operational risks is performed to identify the potential impact on the Bank of rare and highly unlikely events of operational risk, which may inflict substantial damage on the Bank. Scenario analysis helps take timely measures to prevent the scenario from taking place at the Bank or minimize the consequences of this scenario.

Bank division supervisors are responsible for operational risk management to the limit of their duties. The Operational Risk Management Division of the Risk Management Department analyzes and assesses performance of the operational risk management system in Bank divisions, organizes implementation of the operational risk management system of the Bank as a whole, controls the operational risk management system, provides skilled assistance to employees of Bank divisions at various stages of operational risk management (identification, assessment, minimization, control and monitoring), and provides methodological support to divisions and operational risk management training to employees.

The Operational Risk Steering Committee considers operational risk issues and makes related decisions. It sets the Bank’s Operational Risk Management Policy and approves measures, procedures and methods used to identify, assess, control, prevent and minimize operational risks.
Alfa-Bank complies with the principles of the Corporate Governance Code recommended by the Bank of Russia (Letter of the Bank of Russia No. 06-52/2463 of 10 April 2014 “About the Corporate Governance Code”).

In accordance with the standards of corporate governance and in order to improve the system in late 2013, the Extraordinary General Meeting of Shareholders approved the Corporate Governance Code of the Bank (Minutes No. 02-2013 of 02 December 2013) developed in accordance with the provisions of the applicable laws of the Russian Federation, regulations of the Bank of Russia, and the Corporate Governance Code recommended by the Letter of the Bank of Russia.

Alfa-Bank’s Corporate Governance Code is an internal regulatory instrument that defines the basic principles, rules and standards of corporate governance by which the Bank is guided in its activities, including those governing the following areas: protection of rights and legitimate interests of shareholders, organization of the Board of Directors and executive bodies, implementation of strategic management, coordination of risk management and internal control, prevention and settlement of conflicts of interest, disclosure of information and procedure for taking significant corporate actions.

Under the Code, the Bank is guided in its activities according to the following general principles of corporate governance:

- Compliance with laws, other regulations, the Articles of Association and internal instruments of the Bank;
- Enforcement and protection of the rights of the Bank’s shareholders;
- Equal (subject to the requirements of regulations) treatment of the Bank’s shareholders;
- Accountability of the Board of Directors to the Bank’s shareholders;
- Strategic management of the Bank by the Board of Directors;
- Effective control by the Board of Directors of the activities of the Bank’s executive bodies;
- Provision of scope for executive bodies to carry out effective management of the current activities of the Bank reasonably, in good faith and solely for the benefit of the Bank, including accountability of executive bodies to the Board of Directors and shareholders of the Bank;
- Ensuring establishment and effective functioning of a system for risk management and internal control;
- Ensuring timely disclosure of full and accurate information about the Bank; and
- Openness and transparency of the major corporate actions, subject to enforcement and protection the Bank’s shareholders rights.

Shareholder rights and equality

The Bank ensures shareholder rights and equal conditions for their use. The procedure for the convocation, preparation and holding of a general meeting of shareholders is regulated by the Rules for General Shareholders’ Meeting approved by a general meeting of Bank shareholders (Protocol No. 01-2016 of the Extraordinary General Meeting of Shareholders dated 29 June 2016).

The shareholders enjoy an equal and fair opportunity to participate in the attribution of profits by means of dividends. The Bank does not pay dividends in the case that this decision, although formally not violating legal restrictions, is infeasible and may create a false impression about Bank operations.

Protection of shareholders’ proprietary rights and freedom to use one’s shares are guaranteed by the Bank’s choice of its registrar, Independent Registrar Company JSC, a highly reputed entity possessing calibrated, reliable technologies for the efficient account of proprietary rights and use of shareholders’ rights.

Bank Board of Directors

The Board of Directors exercises strategic control over the Bank, supervises Bank risk management and the preparation and performance of efficient internal control, oversees the activities of Bank executive bodies, and executes other key functions. The Board of Directors is accountable to the General Shareholders’ Meeting.
The Regulations on the Board of Directors approved by a general meeting of Bank shareholders (Protocol No. 02-2015 of the Extraordinary General Shareholders’ Meeting dated 21 October 2015) define the rights and obligations of the Board of Directors’ members, the procedure for preparation and holding of the Board of Directors’ meetings and requirements for members of the Board of Directors, including their high professional and business reputation, competence and professional experience, enabling them to assess information about Bank activities and the market environment for making professional judgment on Bank operations.

At the end of 2016 year the Board of Directors was comprised of 10 members, one of whom (Marey A.A.) was also a member of the Bank Executive Board, three of whom (Fridman M.M., Aven P.O. and Kosogov A.N.) were the Bank’s ultimate beneficiaries, and one of whom (Kaufman E.S.) was an independent member of the Board of Directors by the criteria prescribed by the Corporate Management Code recommended by the Central Bank. In the opinion of the Board of Directors, this balance prevents a conflict of interest between the Bank, its shareholders and clients.

The Board of Directors’ activity is overseen by the Chairman, who organizes its work, convenes and presides at meetings of the Board of Directors, signs protocols of the Board of Directors’ meetings, determines their agenda and form, presides at general meetings of shareholders, signs contracts with the Executive Board Chairman on behalf of the Bank and executes other functions prescribed by Federal Law on Joint Stock Companies, the Bank Charter and the Regulations on the Board of Directors. In the absence of the Chairman of the Board of Directors, his functions are exercised by the First Deputy Chairman of the Board of Directors, and if the latter is also absent, by a member of the Board of Directors at the discretion of the Board of Directors.

For the purposes of initial consideration of major aspects of Bank activity, the Board of Directors formed two (2) theme committees in 2014; namely, the Audit Committee, tasked with assisting in the Board of Directors’ efficient control over financial and economic operations of the Bank, and the Staff and Remuneration Committee, promoting the engagement of competent personnel in Bank management and the creation of incentives for their successful work.

The Board of Directors sets long-term objectives for the Bank; in particular, approving the Bank’s strategy and monitoring its implementation. In 2016, the Bank was guided by the strategy for the period of 2016-2017, approved at a meeting of the Board of Directors on 28 December 2015 (Protocol No. 22-2015 dated 28 December 2015). In October 2016 the Bank’s strategy for 2017-2019 was approved (Protocol No. 14-2016 of the Board of Directors’ meeting dated 21 October 2016).

The Board of Directors plays a key role in the prevention, detection and settlement of internal conflicts between management, shareholders and employees of the Bank. The Board of Directors has approved the Bank’s Procedure for the Prevention of Conflicts of Interest, which prescribes measures intended to prevent a conflict of interest in the Bank’s activity. For the same purposes, at the proposal of the Board of Directors, annual general meetings of shareholders approve related party transactions that might be performed by the Bank in the course of its routine activity with permanent partners and managerial bodies which involve members of the Bank’s management.

The Board of Directors approved the Alfa-Bank Corporate Ethics Code (Protocol No. 21-2015 of the Board of Directors’ meeting dated 15 December 2015) to spell out standards of Bank activity and conduct of its employees for the sake of maintaining ethical standards, quality service, client convenience and increasing profitability, financial stability and efficiency of the Bank and its subsidiaries and affiliates. The Code is available to the general public on the Bank’s website. Bank employees and management have been personally informed about the Code. The Compliance Directorate monitors the fulfillment of the Code in the Bank. In furtherance of the Code, the Bank has prepared and approved the Regulations on Terms and Procedure of Related Party Transactions Executed by Employees of Alfa-Bank JSC and/or Affiliates (Appendix No. 1 to Bank Order No. 1206 dated 3 December 2010), Bank Order No. 980 dated 24 August 2012 regarding the participation of Alfa-Bank JSC employees in management of any legal entities unaffiliated with Alfa-Bank Bank Group and Regulations against Corruption and Bribery (Appendix No. 1 to the Bank’s Order No 1704 dated 30 December 2015).


Remuneration for members of the Board of Directors, management and other key senior employees

The Bank’s principles of short- and long-term remuneration are linked to the general profitability of the Bank, while the size of remuneration is sufficient for recruiting and retaining competent personnel.

In 2015, the Board of Directors (Protocol No. 02-2015 of the Board of Director’s meeting dated 16 March 2015) approved the Human Resources Policy, a system of principles and
The Board of Directors also approved the Regulations on Remuneration and Reimbursement of members of the Board of Directors, which laid down general principles, criteria and procedures for remuneration of members of the Board of Directors and reimbursement of expenditures related to the performance of their duties.

Risk management and internal control

The Bank has created an efficient system of risk management and internal control tasked with providing reasonable confidence in the achievement of the Bank’s objectives.

Acting in compliance with the Bank Charter and the Regulations on the Board of Directors, the Board of Directors oversees bank risk management, provision and execution of efficient internal control, and approves major operations putting sizable capital at risk. An efficient system of risk management and internal control needs to be built at various executive levels.

The Board of Directors builds the system of risk management, approves the risk and capital management strategy, risk tolerance regulations and a procedure for major risk management, controls the implementation of this procedure and endorses a procedure for using bank risk management methods and risk qualitative assessment models, including assessment of assets and liabilities, off-balance requirements and obligations of a credit institution, scenarios and results of stress testing.


The Executive Board, acting in accordance with the Charter and the Executive Board Regulations, provides the implementation of decisions made by the Board of Directors, sets the bank risk management and maximal profitability policy, and approves regulations and rules for Bank committees and other collegial bodies. The Executive Board is responsible for the monitoring and reduction of risks and controls the compliance with prescribed risk parameters.

The system of risk management committees (the Strategic Risk Committee, the Chief Credit Committee, the Credit Committee, the Default Committee of Corporate Investment Bank, the Retail Credit Committee, the Asset and Liability Management Committee, the Management Committee on Operational Risk and others), the Risk Management Department (including Chief Risk Officer) and the Treasury efficiently control and manage risks.

The Strategic Risk Committee is the senior committee of the risk management system, which establishes and regulates the risk management system, determines the Bank’s general risk management policy and strategy, and considers and modifies principles of the risk management system for the purposes of higher efficiency.

The Management Committee on Operational Risk was set up on the orders of the Executive Board to lay down the general operational risk management policy of the Bank. Its priority is maximum security of assets and capital through minimization of possible operational losses.

The Risk Management Department operating under relevant regulations provides functioning of the risk management system, ensures the fulfillment of general bank risk management principles, detection and containment of risks, and notification of higher collegial bodies.

The Risk Management Department monitors and evaluates the level of bank risks, proposes measures for their containment and minimization, and implements such measures within the areas of its units. For these purposes, the Department develops bank risk management policies and its executives participate in relevant committees and other collegial bodies.

Credit, market and interest risks of bank operations and liquidity risks at the level of portfolio and transactions are managed and controlled by the system of credit committees and the Asset and Liability Management Committee.

In line with the powers prescribed by the Bank’s constituent and internal documents, internal control is exercised by:
- Management bodies (the General Shareholders’ Meeting, the Board of Directors, the Executive Board, and the Executive Board Chairman);
- The Audit Commission;
- Collegial bodies created under decisions of the Bank’s Board of Directors and Executive Board;

The Board of Directors oversees bank risk management, provision and execution of efficient internal control, and approves major operations putting sizable capital at risk. An efficient system of risk management and internal control needs to be built at various executive levels.

The Board of Directors builds the system of risk management, approves the risk and capital management strategy, risk tolerance regulations and a procedure for major risk management, controls the implementation of this procedure and endorses a procedure for using bank risk management methods and risk qualitative assessment models, including assessment of assets and liabilities, off-balance requirements and obligations of a credit institution, scenarios and results of stress testing.

• Heads (their deputies) of functional units created within the Bank’s organizational structure under decisions of the Bank’s Executive Board and orders of the Executive Board Chairman (hereinafter referred to as the Bank management);
• The Bank’s chief accountant (his deputies);
• Heads (their deputies) of functional units created within the organizational structure of the Bank’s branches under decisions of the Bank’s Executive Board and orders of the Executive Board Chairman, branch head (his deputies) and chief accountant (his deputies);
• Heads (their deputies) of operations and credit and cash offices of the Bank;
• Units and employees exercising internal control in accordance with their powers prescribed by the Bank’s internal documents, including:
  • The Internal Audit Service — a structural unit of the Bank operating in accordance with the Charter, the Regulations on the Internal Audit Service and provisions of Chapter 4 of Central Bank Regulations No. 242-P dated 16 December 2003 “On Internal Control in Credit Institutions and Bank Groups”;
  • The Internal Audit Service — structural units of the Bank operating in accordance with the Charter, the Regulations on the Internal Audit Service and provisions of Chapter 4.1 of Central Bank Regulations No. 242 dated 16 December 2003 “On Internal Control in Credit Institutions and Bank Groups”;
  • Employee (structural unit) authorized to prevent legalization (laundering) of illegal earnings and financing of terrorism, appointed (created) and operating in accordance with Clause 2 Article 7 of Federal Law No. 115-FZ dated 7 August 2001 “On Countering Legalization (Laundering) of Proceeds of Crime and Financing of Terrorism”;
• Controller — securities market professional, an employee controlling the compliance of the Bank as a professional securities market actor with Russian security market laws, including normative acts of the Central Bank, normative legal acts of the federal securities market authority, Russian laws protecting rights and lawful interests of securities market investors, Russian advertisement laws and internal documents of the professional actor related to the activity on the securities market;
• Structural unit exercising control over compliance with Federal Law No. 224-FZ dated 27 July 2010 “On Countering Misuse of Insider Information and Market Manipulation and on Adjusting Individual Legislative Acts of the Russian Federation”; and
• other units and employees within the limits of their duties specified by the Bank’s internal documents.

The Bank organized an internal audit for the purposes of systematic independent appraisal of the reliability and efficiency of the risk management and internal control system and corporate management practices.

An internal audit is organized by the designated structural unit, the Internal Audit Department accountable to the Board of Directors.

The Internal Audit Department operates under the principles of independence, impartiality, competence and professional attitude to work and continuous and unbiased activity, as well as Russian laws, normative acts of the Central Bank, and internal audit standards set by the international professional standards of internal audit and the ethics code of the Institute of Internal Auditors. The head of the Internal Audit Department is appointed, discharged and transferred on orders from the Bank’s Executive Board Chairman, under a decision of the Board of Directors. The Board of Directors approves work plans and reviews reports.

Disclosure of Bank information, Bank’s information policy

The Bank discloses information about its activity in accordance with Russian laws, on the principles of reliability, regularity and timeliness, and a balance between the Bank’s transparency and provision of its lawful interests.

For the purposes of transparency, timeliness and fullness of the disclosure of Bank information, unhindered access of shareholders to the Bank’s documents, and assignment of persons responsible for the disclosure of information, the Bank uses the following package of information policy documents:

• Regulations on interaction between units in the disclosure of Alfa-Bank information as an issuer of securities;
• List of the Bank's insider information;
• Regulations on interaction between units in the disclosure of the Bank’s insider information;
• Regulations on commercial and bank secrets and proprietary information of limited distribution;
• List of information constituting commercial and bank secrets, proprietary information of limited distribution in compliance with legislative requirements.


The Bank provides information and documents at the request of shareholders on the principles of equal and unhindered access.

**Significant corporate actions**

The Bank’s Corporate Management Code defines the following as significant corporate actions:
- Bank reorganization;
- Modification (reduction or enlargement) of the Bank’s charter capital;
- Essential amendments to the Bank Charter;
- Major transactions;
- Related party transactions; and
- Listing and delisting of the Bank’s shares.

Separation of powers between the Bank’s management bodies in decisions pertaining to significant corporate actions is a key element of the corporate management system aimed at protecting lawful interests and rights of Bank shareholders and security of Bank assets.

The Bank’s management bodies ensure shareholders’ participation in decisions on significant corporate actions, in accordance with Russian laws and the Bank Charter.

The Bank has created a system of interaction between its units in significant corporate actions. The Bank’s units do their best to ensure compliance with the transaction procedure and duly present transactions for approval by relevant management bodies of the Bank.

Information about significant corporate actions performed in the course of Bank operations is disclosed as prescribed by Russian laws.

Control over the compliance with procedures in making decisions on significant corporate actions is exercised by the Bank’s Audit Committee.

The Bank’s Internal Audit Service, assessing the efficiency of the internal control system, may hold spot checks of the compliance with procedures for decisions on significant corporate actions.

**PARTNERS**

**AlfaStrakhovanie Group**

AlfaStrakhovanie Group is one of the largest Russian insurance companies with a universal portfolio of services both for business and private clients. AlfaStrakhovanie is licensed to offer more than 100 insurance services (including life insurance).

AlfaStrakhovanie Group includes AlfaStrakhovanie PLC, AlfaStrakhovanie-Life LLC, AlfaStrakhovanie-OMS LLC, PLC Ugoria-Med, Medicine AlfaStrakhovanie LLC. AlfaStrakhovanie is widely represented in Russian regions. The regional network of AlfaStrakhovanie Group includes about 270 regional departments nationwide. More than 24.8 mln private customers and over companies are use the Group’s services.

AlfaStrakhovanie Group bolstered its presence in the market and ranked fourth amongst national insurance majors in 2016, posting premiums of RUB 250.9 bn and the market share of 9.2%.


AlfaStrakhovanie Group has the reputation of a stable and reliable company. AlfaStrakhovanie Group guarantees its liabilities with a consolidated charter capital of RUB 11.8 bn.
Alfa Health Center is a network of medical centers launched by AlfaStrakhovanie Group in 2009 to provide quality medical services to people in 12 Russian cities; namely Moscow, Nizhny Novgorod, Yekaterinburg, Tyumen, Rostov-on-Don, Kirov, Saratov, Samara, Yaroslavl, Murmansk, Perm and Berezniki.

Fitch rating agency confirmed the international BB rating with a stable outlook for the AlfaStrakhovanie insurer in November 2016. Russia’s leading rating agency, Expert RA, confirmed in October 2016 the top reliability rating of A++ (top reliability and stable outlook) awarded to AlfaStrakhovanie in 2003. In 2015, RAEX (Expert RA) ranked AlfaStrakhovanie-OMS as A+++, the top reliability and quality service rating, and confirmed this ranking in September 2016. Agency experts lauded the high quality and reliability of the company’s performance.

AlfaStrakhovanie passed international certification in May 2015 and received ISO 9001-2011 international management quality certificate. In October 2016, AlfaStrakhovanie General Director Vladimir Skvortsov and AlfaStrakhovanie-OMS General Director Andrey Ryzhakov joined the presidium of the self-regulatory organization established on the basis of the all-Russia Insurers Association (ARIA), while AlfaStrakhovanie Deputy General Director, Aircraft Insurance Director Ilya Kabachnik became a member of the Public Council of the Federal Air Transport Agency.

AlfaStrakhovanie Group won a series of professional awards and prizes in 2015-2016. Corporate managers have been ranking high in the acclaimed annual rating, TOP-1000 Russian Managers, a joint project of the Russian Managers Association and the Kommersant Publishing House, for 13 years in a row.

AlfaStrakhovanie Group has established a long-term business relationship with the world’s biggest reinsurers and Russian insurance companies. Cooperation is being developed directly and via international brokers, among them Willis Towers Watson, Marsh Limited and AON Benfield.

Foreign reinsurance partners of AlfaStrakhovanie are Swiss Re, Hannover Re, SCOR, Munich Re, GenRe, Partner Re, Lloyd’s of London market actors, and some other major international insurance and reinsurance companies.

For the third time and for two years in a row, AlfaStrakhovanie was declared the best Russian insurance company of the year by the British journal World Finance. The company was listed as the 168th in the RBC rating of largest national companies; it was one of the TOP-600 Russian companies and the TOP 5 insurers listed by RAEX and Kommersant Publishing House. In addition, the company won the fifth annual award Travelers’ Choice of the TripAdvisor portal in the nomination of best travel insurance company and ranked third amongst successful insurers of legal entities in 2015, according to the Sravni.ru portal. The Expert RA rating agency recognized AlfaStrakhovanie as the travel and banking risk insurance market leader, while the Tripsta international online travel agency confirmed its leading status and described AlfaStrakhovanie as the company enjoying the highest confidence of Russian travelers. The AlfaStrakhovanie Mobile application has won three awards of the top Ru.net mobile application contest, 2016 Golden Application.

In addition, AlfaStrakhovanie is listed amongst the TOP-1000 suppliers of B2B-Center, Russia’s largest online corporate procurement system.

The company won official status of Reliable Partner and the Novosibirsk Trade Mark award for stability and professionalism as an acknowledgement of its business in Siberia.

**Alfa-Capital Asset Management**

Established in 1996, Alfa-Capital Management Company LLC (“ACM”) is one of the largest asset management companies in the Russian market. ACM’s key businesses include individual trust asset management for individuals and corporate clients (including Individual Investment Account (IIA) strategies), asset management of mutual investment funds, institutional clients, non-state pension funds, insurance companies, endowment funds and pension funds.

As of 31 December 2016, Alfa Capital Management had 355 offices and branches across Russia. Today, Alfa Capital Management serves more than 1 mln clients. ACM’s assets under management amounted to more than RUB 178.3 bn as of 31 December 2016.

In 2016 Alfa Capital Management was the first management company to become a bidder on the Moscow Stock Exchange. Now the company is able to perform exchange transactions with the securities and foreign currency independently, without intermediaries. Direct access to the stock exchange has enhanced convenience and operational efficiency as well cutting operating expenses and client fees on a number of products. It may also provide new opportunities to expand the product range.

Additionally, in 2016 Alfa Capital Management became the first asset management company in Russia to launch Alfa Click online sales of Individual Investment Account (IIA) strategies and ACM’s mutual funds. In the same year, Alfa Capital Management also launched a number of new trust management strategies, such as capital protection strategies. In 2016, ACM launched Alfa Capital, a convenient mobile application for iPhones and iPads. This app serves as a full-service user account for Alfa Capital’s clients.
ACM at a Glance

- ACM has been the leader in asset management in Russia for more than 20 years;
- ACM is in the Top-12 asset management companies in terms of total assets under management, ranks first in terms of total assets of individuals under trust management, and ranks third in mutual funds’ assets under management list, according to Expert RA data;
- ACM unites a highly qualified team with lengthy experience in both Russian and foreign capital markets, including emerging capital markets;
- ACM’s product range consists of 15 mutual investment funds: 7 traditional mutual investment funds, 5 industry mutual investment funds and 3 specialized mutual investment funds;
- ACM manages the funds of 3 non-state pension funds, the funds of 2 insurance companies and 8 endowment funds;
- ACM became one of three largest companies with net asset value of retail mutual investment funds in the amount of RUB 17.2 bn as of 31 December 2016;
- The number of clients of Alfa Capital Wealth has increased by more than 30% and amounted to 1,400 persons in 2016;
- ACM was awarded an AAA rating (maximum reliability) by National Rating Agency and an А++ rating (exceptionally high/highest level of reliability and service quality) by Expert RA rating agency;
- Irina Krivosheeva, CEO of Alfa-Capital Management Company LLC, became a laureate of the “Financial Sphere” award in the “Investment Management Person” nomination. Also, in 2016 ACM was recognized as “Best Individual Trust Asset Management Company” according to NAUFOR research.

FINANCIAL STATEMENTS

Extracts from the Auditor’s Report

To the Shareholders and Board of Directors of ABH Financial Limited:

We have audited the accompanying consolidated financial statements of ABH Financial Limited and its subsidiaries (the “Group”) which comprise the consolidated statement of financial position as at 31 December 2016 and the consolidated statement of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Responsibilities of management and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the financial reporting process of the Group.

Auditor’s responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 of the Group.
• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

• Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on ability of the Group to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Group to cease to continue as a going concern.

• Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

• Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Opinion

In our opinion, the consolidated financial statements of ABH Financial Limited (the “Company”) and its subsidiaries (the “Group”) present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (“IFRS”).

9 March 2017
Moscow, Russian Federation

ABH FINANCIAL LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

<table>
<thead>
<tr>
<th>In millions of US Dollars</th>
<th>31 December 2016</th>
<th>31 December 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>ASSETS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>4 344</td>
<td>3 145</td>
</tr>
<tr>
<td>Mandatory cash balances with central banks</td>
<td>263</td>
<td>151</td>
</tr>
<tr>
<td>Trading securities</td>
<td>1 840</td>
<td>802</td>
</tr>
<tr>
<td>Repurchase receivables relating to trading securities</td>
<td>29</td>
<td>157</td>
</tr>
<tr>
<td>Due from other banks</td>
<td>3 000</td>
<td>1 347</td>
</tr>
<tr>
<td>Loans and advances to customers</td>
<td>22 762</td>
<td>20 239</td>
</tr>
<tr>
<td>Investments</td>
<td>3 691</td>
<td>3 403</td>
</tr>
<tr>
<td>Repurchase receivables relating to investments</td>
<td>243</td>
<td>188</td>
</tr>
<tr>
<td>Other financial assets</td>
<td>1 219</td>
<td>1 330</td>
</tr>
<tr>
<td>Other assets</td>
<td>331</td>
<td>267</td>
</tr>
<tr>
<td>Premises and equipment</td>
<td>524</td>
<td>441</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>1</td>
<td>—</td>
</tr>
<tr>
<td>TOTAL ASSETS</td>
<td>38 247</td>
<td>31 470</td>
</tr>
<tr>
<td>LIABILITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due to other banks</td>
<td>3 428</td>
<td>2 094</td>
</tr>
<tr>
<td>Customer accounts</td>
<td>21 721</td>
<td>17 748</td>
</tr>
<tr>
<td>Debt securities issued</td>
<td>3 580</td>
<td>4 029</td>
</tr>
<tr>
<td>Syndicated and other debt</td>
<td>323</td>
<td>242</td>
</tr>
<tr>
<td>Subordinated debt</td>
<td>1 534</td>
<td>1 533</td>
</tr>
<tr>
<td>Other financial liabilities</td>
<td>1 479</td>
<td>907</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>417</td>
<td>256</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>31</td>
<td>317</td>
</tr>
<tr>
<td>TOTAL LIABILITIES</td>
<td>32 513</td>
<td>27 126</td>
</tr>
<tr>
<td>EQUITY</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td>1 265</td>
<td>1 265</td>
</tr>
</tbody>
</table>
### ABH Financial Limited

**Summary Consolidated Statement of Profit or Loss and Other Comprehensive Income**

<table>
<thead>
<tr>
<th>In millions of US Dollars</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>2,705</td>
<td>3,189</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(1,335)</td>
<td>(1,868)</td>
</tr>
<tr>
<td>Expenses directly attributable to leasing and deposit insurance</td>
<td>(45)</td>
<td>(42)</td>
</tr>
<tr>
<td>Net margin</td>
<td>1,325</td>
<td>1,279</td>
</tr>
<tr>
<td>Provision for loan impairment</td>
<td>(296)</td>
<td>(777)</td>
</tr>
<tr>
<td>Net margin after provision for loan impairment</td>
<td>1,029</td>
<td>502</td>
</tr>
<tr>
<td>Fee and commission income</td>
<td>905</td>
<td>805</td>
</tr>
<tr>
<td>Fee and commission expense</td>
<td>(271)</td>
<td>(220)</td>
</tr>
<tr>
<td>Gains less losses arising from trading securities</td>
<td>(44)</td>
<td>9</td>
</tr>
<tr>
<td>Gains less losses arising from interest based derivatives</td>
<td>(4)</td>
<td>(5)</td>
</tr>
<tr>
<td>Gains less losses arising from foreign currencies</td>
<td>17</td>
<td>336</td>
</tr>
<tr>
<td>Gains less losses arising from investments</td>
<td>54</td>
<td>1</td>
</tr>
<tr>
<td>Gains less losses arising from acquisition of own debts</td>
<td>(30)</td>
<td>(7)</td>
</tr>
<tr>
<td>Other provisions</td>
<td>37</td>
<td>58</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>(957)</td>
<td>(971)</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>763</td>
<td>567</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(236)</td>
<td>(87)</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>527</td>
<td>480</td>
</tr>
<tr>
<td>Other comprehensive income/(loss):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments available for sale:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value gains less losses</td>
<td>31</td>
<td>102</td>
</tr>
<tr>
<td>Reclassification adjustments for gains included in profit or loss</td>
<td>(54)</td>
<td>(1)</td>
</tr>
<tr>
<td>Effect of translation of the financial statements of foreign operations</td>
<td>820</td>
<td>(1,199)</td>
</tr>
<tr>
<td>Net change in hedge of net investment in foreign operations</td>
<td>(820)</td>
<td>787</td>
</tr>
<tr>
<td>Income tax on items that may be reclassified to profit or loss</td>
<td>166</td>
<td>(177)</td>
</tr>
<tr>
<td>Other comprehensive income/(loss) for the year</td>
<td>143</td>
<td>(488)</td>
</tr>
<tr>
<td>Total comprehensive income/(loss) for the year</td>
<td>670</td>
<td>(8)</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>527</td>
<td>480</td>
</tr>
<tr>
<td>Total comprehensive income/(loss) is attributable to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Company’s owners</td>
<td>676</td>
<td>(2)</td>
</tr>
<tr>
<td>Non-controlling interests</td>
<td>(6)</td>
<td>(6)</td>
</tr>
<tr>
<td>Total comprehensive income/(loss) for the year</td>
<td>670</td>
<td>(8)</td>
</tr>
</tbody>
</table>
## ABH FINANCIAL LIMITED
### SUMMARY CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

<table>
<thead>
<tr>
<th>In millions of US Dollars</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>1,265</td>
<td>1,265</td>
</tr>
<tr>
<td>Perpetual loan participation notes</td>
<td>(55)</td>
<td>(55)</td>
</tr>
<tr>
<td>Fair value reserve for investments available for sale</td>
<td>73</td>
<td>73</td>
</tr>
<tr>
<td>river reserve for premium</td>
<td>(868)</td>
<td>(868)</td>
</tr>
<tr>
<td>Cumulative translation reserve</td>
<td>3,868</td>
<td>3,868</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>4,283</td>
<td>4,283</td>
</tr>
<tr>
<td>Total equity</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>- Non-controlling interests</td>
<td>4,296</td>
<td>4,296</td>
</tr>
<tr>
<td>Total equity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Balance as at 1 January 2015**

<table>
<thead>
<tr>
<th>In millions of US Dollars</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Other comprehensive loss</td>
<td>(82)</td>
<td>(82)</td>
</tr>
<tr>
<td>Total comprehensive loss for the year</td>
<td>(570)</td>
<td>(570)</td>
</tr>
<tr>
<td>Realised revaluation reserve</td>
<td>486</td>
<td>486</td>
</tr>
<tr>
<td>Dividends declared</td>
<td>(2)</td>
<td>(2)</td>
</tr>
<tr>
<td>Contribution from shareholder</td>
<td>133</td>
<td>133</td>
</tr>
<tr>
<td>Acquisition of non-controlling interests</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Disposal of non-controlling interest</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Balance as at 31 December 2015</td>
<td>1,265</td>
<td>1,265</td>
</tr>
</tbody>
</table>

**Profit**

<table>
<thead>
<tr>
<th>In millions of US Dollars</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest received</td>
<td>2,647</td>
<td>3,109</td>
</tr>
<tr>
<td>Interest paid, other than on debt securities issued, syndicated and other debt and subordinated debt</td>
<td>(889)</td>
<td>(1,360)</td>
</tr>
<tr>
<td>Expense directly attributable to leasing and deposit insurance paid</td>
<td>(45)</td>
<td>(42)</td>
</tr>
<tr>
<td>Fees and commissions received</td>
<td>898</td>
<td>803</td>
</tr>
<tr>
<td>Fees and commissions paid</td>
<td>(243)</td>
<td>(215)</td>
</tr>
<tr>
<td>Net income received from trading securities</td>
<td>(28)</td>
<td>334</td>
</tr>
<tr>
<td>Net income received from trading in foreign currencies</td>
<td>168</td>
<td>145</td>
</tr>
<tr>
<td>Net income received from interest rate derivatives</td>
<td>(4)</td>
<td>(9)</td>
</tr>
<tr>
<td>Other operating income received</td>
<td>20</td>
<td>58</td>
</tr>
<tr>
<td>Staff costs paid</td>
<td>(519)</td>
<td>(487)</td>
</tr>
<tr>
<td>Other operating expenses paid</td>
<td>(285)</td>
<td>(295)</td>
</tr>
<tr>
<td>Income tax paid</td>
<td>(298)</td>
<td>(93)</td>
</tr>
<tr>
<td>Cash flows from operating activities before changes in operating assets and liabilities</td>
<td>1,422</td>
<td>1,948</td>
</tr>
</tbody>
</table>

**Changes in operating assets and liabilities**

<table>
<thead>
<tr>
<th>In millions of US Dollars</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net change in mandatory cash balances with central banks</td>
<td>(84)</td>
<td>89</td>
</tr>
<tr>
<td>Net change in trading securities and repurchase receivables</td>
<td>(790)</td>
<td>(418)</td>
</tr>
<tr>
<td>Net change in due from other banks</td>
<td>(1,490)</td>
<td>2,154</td>
</tr>
<tr>
<td>Net change in loans and advances to customers</td>
<td>(1,156)</td>
<td>2,286</td>
</tr>
<tr>
<td>Net change in other financial assets and other assets</td>
<td>88</td>
<td>30</td>
</tr>
<tr>
<td>Net change in due to other banks</td>
<td>1,184</td>
<td>(5,844)</td>
</tr>
<tr>
<td>Net change in customer accounts</td>
<td>2,236</td>
<td>724</td>
</tr>
<tr>
<td>Net change in other financial liabilities and other liabilities</td>
<td>487</td>
<td>(118)</td>
</tr>
<tr>
<td>Net cash from operating activities</td>
<td>1,897</td>
<td>851</td>
</tr>
</tbody>
</table>
## FINANCIAL STATEMENTS

<table>
<thead>
<tr>
<th>Cash flows from investing activities</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition of investments available for sale</td>
<td>(1,121)</td>
<td>(1,911)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from disposal and redemption of investments available for sale</td>
<td>1,727</td>
<td>1,305</td>
<td></td>
</tr>
<tr>
<td>Acquisition of investments at fair value through profit or loss</td>
<td>—</td>
<td>(2)</td>
<td></td>
</tr>
<tr>
<td>Disposal of investments at fair value through profit or loss</td>
<td>(2)</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Acquisition of investments held to maturity</td>
<td>(1,164)</td>
<td>(219)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from redemption of investment held to maturity</td>
<td>298</td>
<td>95</td>
<td></td>
</tr>
<tr>
<td>Acquisition of premises, equipment and intangible assets</td>
<td>(183)</td>
<td>(119)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from disposal of premises and equipment</td>
<td>9</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Dividend income received</td>
<td>—</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Net cash from/(used in) investing activities</td>
<td>(436)</td>
<td>(844)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash flows from financing activities</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution from shareholder</td>
<td>—</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Repayment of syndicated and other debt</td>
<td>(22)</td>
<td>(3)</td>
<td></td>
</tr>
<tr>
<td>Interest paid on syndicated and other debt</td>
<td>(4)</td>
<td>(5)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from debt securities issued</td>
<td>685</td>
<td>1,113</td>
<td></td>
</tr>
<tr>
<td>Repayment of debt securities issued</td>
<td>(1,297)</td>
<td>(918)</td>
<td></td>
</tr>
<tr>
<td>Interest paid on debt securities in issue</td>
<td>(285)</td>
<td>(356)</td>
<td></td>
</tr>
<tr>
<td>Repayment of subordinated debt</td>
<td>(157)</td>
<td>(146)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from subordinated debt</td>
<td>57</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Interest paid on subordinated debt</td>
<td>(123)</td>
<td>(130)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from perpetual loan participation notes</td>
<td>701</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Dividends paid</td>
<td>—</td>
<td>(100)</td>
<td></td>
</tr>
<tr>
<td>Net cash from financing activities</td>
<td>(445)</td>
<td>(1,495)</td>
<td></td>
</tr>
<tr>
<td>Net increase in cash and cash equivalents</td>
<td>1,016</td>
<td>(1,488)</td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents at the beginning of the year</td>
<td>3,145</td>
<td>4,999</td>
<td></td>
</tr>
<tr>
<td>Effect of exchange rate changes on cash and cash equivalents</td>
<td>183</td>
<td>(366)</td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents at the end of the year</td>
<td>4,344</td>
<td>3,145</td>
<td></td>
</tr>
</tbody>
</table>
Investor Relations

Deputy Chief Financial Officer
Svetlana Demyashkevich

Phone: +7 495 795 36 41
E-mail: mail@alfabank.ru

Macro Insights

Ph.D., Chief Economist —
Head of Macro Insights
Natalia Orlova

Phone: +7 495 795 36 76
E-mail: mail@alfabank.ru

International and
Trade Finance

Managing Director
Dina Merkulova

Phone: +7 495 792 58 46
E-mail: DMerkulova@alfabank.ru

Media and Public Relations

Director
Leonid Ignat

Phone: +7 495 788 69 79
Fax: +7 495 788 69 81
E-mail: mail@alfabank.ru