

Annual Report of Živnostenská banka for the period ended 30 September 2006

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COMPOSITION OF THE SUPERVISORY BOARD AND BOARD OF DIRECTORS

THE SUPERVISORY BOARD

Mr Carmine Ferraro, Chairman
Mr Alberto Devoto, Deputy Chairman (since 27 April 2006)
Mr Massimiliano Moi, Deputy Chairman (until 20 March 2006)
Ms Marie Bartošová (since 15 June 2006)
Ms Ivana Burešová
Ms Elena Goitini (since 27 April 2006)
Mr Uwe Kruschinski (until 27 April 2006)
Marco Iannaccone
Carlo Marini (since 27.4.2006)
Mr Carmelo Mazza (since 27 April 2006)
Ms Eva Mikulková
Ms Helena Špaňhelová (until 20 March 2006)
Mr Giuseppe Vovk (until 21 March 2006)

THE BOARD OF DIRECTORS

Mr Jiří Kunert, Chairman
Mr Aleš Barabas, Deputy Chairman
Mr Massimiliano Fossati

SUPERVISORY BOARD REPORT

The Supervisory Board has reviewed the extraordinary statutory financial statements prepared as at 30 September 2006 together with the Auditor's Report provided by the company KPMG Česká republika Audit, s.r.o., which is the independent auditor of Živnostenská banka, a.s. for the accounting period ended 30 September 2006 and the proposal for distribution of profit. The Supervisory Board acknowledge the conclusion drawn in the Auditor's Report that the extraordinary financial statements clearly evidence the financial situation of Živnostenská banka, a.s. as at 30 September 2006 and its results for the above mentioned accounting period. Considering the Auditor's Report, the Supervisory Board declare that the extraordinary financial statements truly reflect the assets, liabilities and the financial situation of Živnostenská banka, a.s. in all substantial matters and have been prepared in accordance with the relevant laws and regulations. Additionally, the proposal for the distribution of profit complies with all relevant laws and regulations and the Articles of Association of Živnostenská banka, a.s.

In compliance with Czech law, the relevant Provisions of the CNB and the Articles of Association of the Bank, the Supervisory Board has supervised the implementation of the Bank's business policy and the exercise of authority by the Board of Directors. The Supervisory Board held seven sessions and always asked for information from all spheres of the Bank's activities which had a relevant impact on the financial position and the financial management of the Bank. It also approved, among other things, the Bank's budget and credit policy in 2006.

The Supervisory Board further state that, based on the extraordinary financial statements and other documents provided to the Supervisory Board in the accounting period, it did not identify any material deficiencies or inaccuracies which could lead to the conclusion that the Bank's bookkeeping was not maintained in accordance with relevant regulations or did not properly reflect the situation of Živnostenská banka, a.s.

The Supervisory Board reviewed the report on relations between the Controlling Person and the Controlled Person and on relations between the Controlled Person and other persons controlled by the same Controlling Person as prepared by the Board of Directors of Živnostenská banka, a.s. and provided to the Supervisory Board. The Supervisory Board have no material objections to the Report.

January 2007



Carmine Ferraro
Chairman of the Supervisory Board

FOREWORD BY THE CHAIRMAN OF THE BOARD OF DIRECTORS

Dear Shareholders, Ladies and Gentlemen,

We are releasing the Annual Report of Živnostenská banka at an unusual time, and the reason which has led us to do this is also unusual. This is the merger of Živnostenská banka with HVB Bank Czech Republic, which is the result of the integration of our parent companies within the European UniCredit Group.

The merger of Živnostenská banka with HVB Bank Czech Republic, the largest change in the Czech banking market since 2000, has provoked the greatest interest and expectations on the part of shareholders, clients and business partners, the banks' employees of course, and the general public. It is impacting on our day-to-day work and will accompany us into the second half of 2007, when both banks will be integrated into the new UniCredit Bank.

The merger of two banks is a complicated process placing great demands on time. In February 2006 we took our place on the starting line and the integration teams began their work, and since that time we have travelled a long way down the road towards the complete integration of both banks. However, a lot of work remains to be done. I would draw particular attention to the completion, thorough testing, and putting into operation of an integrated IT system, the integration and fine-tuning of the entire portfolio of banking products, the successful management of the staffing process, and the regular provision of information to clients, employees and the general public.

Despite the enormous efforts going into our integration with HVB Bank, Živnostenská banka could not afford to slacken off in the area of its everyday banking activities. I am convinced that our clients only experienced minimum disruption due to the demands of the merger process. The financial results of Živnostenská banka for the first nine months of 2006 confirm that we managed to attain our targets in relation to the main indicators, which is without doubt a huge success which we could scarcely have achieved without the commitment, efforts and loyalty of our employees.

All of our endeavours at present are focused on one objective, the successful merger of Živnostenská banka and HVB Bank and the complete incorporation of the new UniCredit Bank Czech Republic into the European UniCredit Group. I am convinced that we are heading down the right route towards achieving this objective.

November 2006



Jiří Kunert
Chairman of the Board of Directors

DIRECTORS' REPORT

Dear Clients and Business Partners,

We would like to take this opportunity to present you with the Živnostenská banka, a.s. Annual Report for the accounting period January to September 2006.

The Czech economy in 2006

Economic growth in the Czech Republic gradually slowed down during 2006, though it maintained a healthy tempo when compared with other EU countries. The gross domestic product increased by 6.1% in the first three quarters of the year, the same as over the whole of the previous year. Bearing in mind the record economic expansion at the end of 2005, which will impact negatively on the year-on-year growth for the final quarter of last year, it is expected that the economy will have grown by some 5.9 percent over the whole of 2006.

Despite the slow down, the economy remained strong and only when compared to the other countries of the Visegrad four did the Czech economy slip to second place, behind that of Slovakia, whose economy grew by a respectable 7.7% over the first nine months of last year.

The fall in economic activity was the result of a reduction in the positive contribution of foreign trade and the sharp drop in government consumption compared to the previous year, when the government leased the Jas-39 Gripen fighter planes. Although the foreign trade surplus will very probably exceed the level of 2005 (CZK 38.6 billion), the year-on-year improvement will not be as marked as during the period immediately prior to the accession of the CR to the EU. The key components of growth remain household consumption and the creation of capital (including reserves), which confirms original forecasts that domestic demand would be the growth driver in the economy, while the contribution of net exports would gradually decrease. The resurgence in household spending is linked to the increase in disposable incomes, on the one hand prompted by a reduction in taxes, on the other by an increase in wages and pensions. The drop in unemployment and the continuing boom in consumer credit have also played a positive role.

During the first nine months of 2006 inflation fluctuated around the three-percent target of the Czech National Bank (CNB), driven by an increase in administrative costs and a rise in the price of foodstuffs. However, even stripped of the changes in the prices of foodstuffs, petroleum, regulated prices and tax changes, inflation still rose beyond expectations, which is an important factor when the CNB is deciding on interest rates. For this reason, and also due to the deteriorating state of the public finances, the CNB twice increased its key interest rate (each time by 25 basis points). However, contrary to expectations, the year-on-year increase in prices fell sharply in October, which had the effect of postponing expectations regarding a further tightening of monetary policy to 2007. The abrupt slowdown in inflation was mainly caused by the surprising drop in the price of oil, which made the prices of gas and fuel cheaper. The strengthening crown also weakened pressure on prices. At the end

of the year the crown broke further records when it reached its historical maximum against both the euro and the American dollar.

However, the considerable strengthening of the Czech currency in December of last year was very surprising in light of several unfavourable factors. Firstly, the political crisis lasting from June's parliamentary elections posed a significant threat to the country's fiscal objectives, including the plan to adopt the euro. The worsening budgetary outlook and the almost zero progress in the reforms of public finances may have serious consequences for the reputation of the CR amongst foreign investors and international rating agencies. Secondly, the negative interest differential against the euro rose to a historical maximum of a full one percent. And thirdly, information regarding the Czech balance of payments from the last few months showed that the current account deficit had worsened as a consequence of the increasing outflow of the profits of foreign companies and an insufficient inflow of capital to the financial account to cover this deficit.

Financial and business results

Assessing the results for 2006, one can conclude that the targets set by shareholders have been met, both in terms of both revenues and profit. A more detailed look at the bank's results shows that there was an increase in revenues in all business segments, and the cost and revenue structure is developing in a positive direction.

The net profit calculated according to the CNB methodology increased year-on-year by more than 17 percent, reaching CZK 229 million (at 30.9.2005: CZK 195 million). Total revenues for the same period amounted to CZK 1,496 million according to Czech Accounting Standards. These revenues extrapolated linearly for 12 months have increased by more than 8 percent as compared to 2005. Net interest income, extrapolated by the same methodology, has grown by more than 9 percent and total costs, as compared to 2005, have fallen by 7 percent and amounted to CZK 1,114 million.

The total assets of Živnostenská banka have grown to CZK 52.4 billion, i.e. an increase of 7 percent as compared to the balance at 31.12.2005.

In 2006 Živnostenská banka implemented the new EuroSIG information system, which is also to become the main IT platform of UniCredit Bank, the result of the integration of Živnostenská banka and HVB Bank Czech republic.

In the area of human resource management we concentrated on improving the MBO (Management of Objective) employee remuneration system, and the TRS (Team Rewards System). The bank organised many training programmes, focusing especially on motivation and change management, including the expansion of e-learning through new training courses.

Private and retail banking

In the area of retail banking, the bank continued with its growth strategy in 2006, which is based on the acquisition of new clients and the development of the existing client portfolio. During the course of the year the bank opened 3 new commercial outlets and increased the number of its ATMs – the bank's commercial network now includes 45 retail branches and 50 ATMs.

The bank introduced several product innovations onto the market – a new direct banking application called Smart Bank, a new package of services for entrepreneurs starting up, residential cooperatives and owner's associations, and new regular investment savings programmes entitled Rytmus and Rentier prepared in cooperation with the bank's affiliate investment company Pioneer Investments. The bank won acclaim for its product innovation in the prestigious consumer competitions Golden Crown and Bank of the Year.

Thanks to the long-term quality of our services, the higher accessibility of the commercial network, and a proactive business approach, in the first nine months of the year the bank acquired 10,000 new clients, a year-on-year increase of 15 percent. The bank's activities accelerated, especially in terms of business clientele. The volume of new loans for small business clients was CZK 646.5 million, a year-on-year increase in the volume of new loans of more than 22 percent.

A focus on performance and quality was confirmed above all by the increased volume and number of loans made to businesses and by the continued growth in the other main business indicators.

Corporate banking

The first nine months of 2006 in the area of corporate banking were given over to the implementation of a new IT solution. Our aim was not only to continue the good business and financial results of the segment in an ever more competitive environment leading to a reduction in interest margins and bank charges, but above all to master the implementation of a new information system. After successfully converting to the new IT solution, at the end of September we managed to attain the target volume of assets and segmental revenue indicators, and also to meet our objectives in respect of the acquisition of new clients.

As well as continuing to increase the share of the middle corporate sub-segment in total segmental revenues, we contributed positively to the upswing in the construction sector, something which is evident from the increase in the financing of development projects with a focus on medium-sized residential projects.

Despite an increase in domestic transactions, there was stagnation in the total volume of payments made. Nevertheless, in correlation with the pro-export nature of the Czech economy we recorded an increase in the indicators of foreign payment systems, where there was an increase of nearly 3 percent in the volume of payments and an increase in frequency of as much as 6 percent.

The ongoing strengthening of the Czech currency increased demand for financial derivatives, especially products hedging the client against currency risk.

During the course of the year many new business contracts and strategic partnerships were realised, which provide a good base for increased revenues in future years. Negotiations were successfully concluded, for instance, on financing for the refurbishment of Prague's Central Station by the company Grandi Stazioni, and cooperation was successfully expanded with CAC Leasing of the UniCredit group in terms of short and medium-term financing.

Risk management

Živnostenská banka traditionally pays special attention to risk management processes. The timely identification of risks, their monitoring, a high quality of measurement, as well as a sophisticated structure of individual limits for individual types of risk and products successfully reduces individual risks to an acceptable level. This can be seen from the ongoing low volume of threatened loans, which is well below the average for the banking sector, and the bank's overall business results.

Since 2003 the bank has been intensively preparing for regulatory changes in light of the requirements of the Basel Committee on Banking Supervision, and preparations will continue in the coming years. Bank representatives will participate on the joint Basel II project with representatives of the CNB, the Czech Banking Association, and other banks.

The basic methodology for the management of market risks is the Value at Risk method, which the bank has been using since 2003.

In the area of operating risk, the Bank has developed a special-purpose database of operating risk events. As well as monitoring and evaluating the operating risk events arising in 2005 the bank carried out a self-evaluation of potential operating risk events. In 2006 it updated the risk management methodology in accordance with new UniCredit Group standards.

Charity and sponsoring

Živnostenská banka has long run a charitable and sponsorship programme in which it concentrates on supporting projects in the area of culture, sports and education.

In 2006 we continued our cooperation with the Tereza Maxová Foundation, which during the course of its activities has successfully completed a host of projects assisting abandoned children, which corresponds with the philosophy of Živnostenské banka to focus its support on projects in the area of social welfare.

In 2006 the bank became a partner of the Economic Chamber and, with its cooperation, implemented projects for the support of small and medium-sized businesses.

During the course of 2006 the bank supported many smaller charity and publicly beneficial activities in the area of healthcare, care for the handicapped, and education.

Conclusion

The favourable results of 2006 confirm that the good name and high quality services of Živnostenská banka provide a sound platform for the further development and successful operation of the bank in the Czech market in the future. We firmly believe that the merger of Živnostenská banka and HVB Bank in the Czech Republic, the completion of which we anticipate in the second half of 2007, will confirm these expectations.

January 2007

Board of Directors of Živnostenská banka





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This document is an English translation of the Czech auditor's report.
Only the Czech version of the report is legally binding.

Auditor's report to the shareholders of Živnostenská banka, a.s.

Financial statements

On the basis of our audit, on 13 December 2006 we issued an auditor's report on the Company's statutory financial statements, which are included in this annual report, and our report was as follows:

"We have audited the accompanying extraordinary financial statements of Živnostenská banka, a.s. as of 30 September 2006. These extraordinary financial statements are the responsibility of the bank's management. Our responsibility is to express an opinion on these extraordinary financial statements based on our audit.

We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing and the relevant guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the extraordinary financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the extraordinary financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the bank's management, as well as evaluating the overall extraordinary financial statement presentation. We believe that our audit provides a reasonable basis for the auditor's opinion.

In our opinion, the extraordinary financial statements present, in all material respects, a true and fair view of the assets, liabilities, equity and financial position of Živnostenská banka, a.s. as of 30 September 2006 and expenses, revenues and the results of its operations for the nine-month period then ended in accordance with the Czech accounting legislation."

Report on relations between related parties

We have also reviewed the factual accuracy of the information disclosed in the report on relations between related parties of Živnostenská banka, a.s. for the nine-month period ended 30 September 2006. This report on relations between the related parties is the responsibility of the Company's management. Our responsibility is to express our view on the report on relations based on our review.

We conducted our review in accordance with International Standards on Auditing and the relevant guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the review to obtain moderate assurance that the report on relations is free of material factual misstatement. A review is limited primarily to inquiries of Company personnel and analytical procedures and examination, on a test basis, of the factual accuracy of information, and thus provides less assurance than an audit. We have not conducted an audit of the report on relations and, accordingly, we do not express an audit opinion.



Nothing has come to our attention based on our review that indicates that the information disclosed in the report on relations between related parties of Živnostenská banka, a.s. for the nine-month period ended 30 September 2006 contains material factual misstatements.

Annual report

We have audited the consistency of the annual report with the audited extraordinary financial statements. This annual report is the responsibility of Company's management. Our responsibility is to express our opinion on the consistency of the annual report with the audited extraordinary financial statements based on our audit.

We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing and the relevant guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance that the information disclosed in the annual report describing matters that all also presented in the extraordinary financial statements is, in all material respects, consistent with the audited extraordinary financial statements. We believe that our audit provides a reasonable basis for the auditor's opinion.

In our opinion, the information disclosed in the annual report is, in all material respects, consistent with the extraordinary audited financial statements.

Prague
30 January 2007

KPMG Česká republika Audit

KPMG Česká republika Audit, s.r.o.
Licence number 71

Vladimír Dvořáček
Partner

Pavel Závitkovský
Partner
Licence number 69

STATUTORY FINANCIAL STATEMENTS AUDITED BY CZECH ACCOUNTING STANDARDS

BALANCE SHEET AS AT 30 SEPTEMBER 2006

<u>Assets:</u>	<u>Note</u>	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
1. Cash and deposits with central banks	3	803	1,165
2. State treasury and other bills eligible for CNB refinancing	6	354	344
a) issued by government institutions		354	344
3. Due from banks	4	8,976	9,468
a) repayable on demand		99	49
b) other receivables		8,877	9,419
4. Due from customers – members of savings banks	5	35,122	30,863
a) repayable on demand		3	13
b) other receivables		35,119	30,850
5. Debt securities	6	5,185	5,162
b) issued by other entities		5,185	5,162
6. Shares, mutual shares and other interests	6	29	29
9. Intangible fixed assets	8	15	83
10. Tangible fixed assets	8	1,126	1,238
of which: land and buildings for operating activities		962	998
11. Other assets	9	775	519
13. Prepayments and accrued income		<u>25</u>	<u>27</u>
Total assets		<u>52,410</u>	<u>48,898</u>

The notes set out on pages 17 to 64 constitute a part of these financial statements.

<u>Liabilities:</u>	<u>Note</u>	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
1. Due to banks	11	6,881	5,512
a) repayable on demand		57	278
b) other payables		6,824	5,234
2. Due to customers-members of savings banks	12	36,672	34,204
a) repayable on demand		15,665	14,367
b) other payables		21,007	19,837
3. Liabilities from debt securities	13	2,435	3,346
a) issued debt securities		2,435	3,346
4. Other liabilities	15	1,843	1,460
5. Accruals and deferred income		2	1
6. Provisions	10,17	24	29
a) provisions for pensions and similar liabilities		2	2
c) other provisions		22	27
7. Subordinated liabilities	14	1,000	1,000
8. Share capital	16	1,360	1,360
a) share capital paid up		1,360	1,360
10. Reserve funds and revenue reserves		1,083	1,083
a) statutory reserve funds and risk funds		272	272
b) other revenue reserves		811	811
13. Gains (losses) from revaluation		- 27	- 17
14. Retained earnings from previous periods		908	722
15. Profit for the accounting period		<u>229</u>	<u>198</u>
Total liabilities		<u>52,410</u>	<u>48,898</u>

OFF-BALANCE SHEET AS AT 30 SEPTEMBER 2006

<u>Assets:</u>	<u>Note</u>	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
1. Commitments and guarantees given	17	17,308	16,969
3. Receivables from spot transactions		1,107	203
4. Receivables from term instruments	26	25,565	19,909
5. Receivables from option instruments	26	8,654	6,992
6. Receivables written-off		<u>123</u>	<u>133</u>
Total off-balance sheet assets		<u>52,757</u>	<u>44,206</u>
 <u>Liabilities:</u>			
9. Commitments and guarantees received	5	7,356	5,227
10. Collaterals received and pledges	5	32,406	30,632
of which: Collaterals - securities	17	2,724	6,645
11. Payables from spot transactions		1,108	203
12. Payables from term instruments	26	25,541	19,858
13. Payables from option instruments	26	8,654	6,992
14. Assets under management	17	<u>68,341</u>	<u>49,187</u>
Total off-balance sheet liabilities		<u>143,406</u>	<u>112,099</u>

**INCOME STATEMENT
 FOR THE NINE-MONTH PERIOD ENDED 30 SEPTEMBER 2006**

	<u>Note</u>	1.1.-30.9. <u>2006</u> MCZK	1.1.-31.12. <u>2005</u> MCZK
1. Interest and similar income	18	1,259	1,532
of which: interest income from debt securities		146	199
2. Interest and similar expense	19	- 466	- 566
of which: interest expense on debt securities		- 51	- 48
Interest margin		793	966
3. Income from shares and other interests		6	0
4. Fee and commission income	20	402	508
5. Fee and commission expense	20	- 41	- 67
Gains or losses from fee and commission		361	441
6. Net gain from financial transactions	21	236	275
7. Other operating income	22	100	158
Net income		1,496	1,839
8. Other operating expense	23	- 108	- 164
9. Administrative expense	23	- 820	- 1,101
of which: a) staff costs		- 360	- 582
of which: aa) wages and salaries		- 270	- 435
ab) social and health insurance		- 90	- 147
b) other administrative expenses		- 460	- 519
11. Depreciation, additions and utilization of provisions for long-term tangible and intangible fixed assets	8	- 186	- 284
Net operating expense		- 1,114	- 1,549
12. Release of provisions and reserves for loans and guarantees, income from receivables already written-off	10	219	466
13. Write-offs, additions and utilization of provisions and reserves for loans and guarantees	10	- 287	- 486
16. Release of other specific provisions	10	5	10
17. Additions and utilization of other specific provisions	10	0	- 6
Additions, usage and release of provisions		- 63	- 16
19. Profit on current activities before taxation		319	275
Profit on current and extraordinary activities for the year before taxation		319	275
23. Income tax	24	-90	-77
24. Profit for the year after taxation		229	198

**STATEMENT OF CHANGES IN EQUITY
 FOR THE NINE-MONTH PERIOD ENDED 30 SEPTEMBER 2006**

	Share <u>capital</u> MCZK	Reserve <u>fund</u> MCZK	Revaluation <u>gains (losses)</u> MCZK	Retained <u>earnings</u> MCZK	Profit <u>(loss)</u> MCZK	<u>Total</u> MCZK
Balance as at 1 January 2005	1,360	1,083	0	534	195	3,172
Undistributed profit				188	- 188	0
Social fund contributions					- 7	- 7
Exchange and revaluation gains (losses) not included in the income statement			- 17			- 17
Net profit for the accounting period					198	198
Balance as at 31 December 2005	1,360	1,083	- 17	722	198	3,346
Balance as at 1 January 2006	1,360	1,083	- 17	722	198	3,346
Undistributed profit				186	- 186	0
Social fund contributions					- 12	- 12
Exchange and revaluation gains (losses) not included in the income statement			- 10			- 10
Net profit for the accounting period					229	229
Balance as at 30.9.2006	1,360	1,083	- 27	908	229	3,553

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED 31 DECEMBER 2006

1 GENERAL INFORMATION

Živnostenská banka was founded in 1868 for the purpose of financing small and medium-sized Czech companies. It was the first bank in the Austro-Hungarian Empire with only Czech capital. It was nationalized in 1945 as were the other banks in the Czech Republic. Živnostenská banka existed as a legal entity during the years 1950 - 1956 but its activities were very limited. Later Živnostenská banka started to provide special services to individuals in connection with income denominated in foreign currencies.

Živnostenská banka, a.s. (hereinafter referred to as “the Bank”) was incorporated on 1 March 1992 as the legal successor of the original Živnostenská banka. The Bank has its registered office at Praha 1, Na Příkopě 858/20, and it is organised as eight domestic regional branches. The representative office in Bratislava, Slovak Republic was closed as at 30 June 2003.

The Bank’s operations primarily consist of:

- providing Czech and foreign currency loans and guarantees;
- accepting and placing deposits in Czech and foreign currency;
- accepting current and deposit accounts denominated in Czech and foreign currency;
- rendering of general banking services through a network of branches and agencies;
- executing foreign exchange transactions in inter-bank money market;
- providing foreign trade finance and related banking services;
- trading in securities and portfolio management.

Since 11 February 2003 the Bank has been controlled by UniCredito Italiano SpA (hereinafter referred to as “UCI”). Until then the Bank had been controlled by Bankgesellschaft Berlin AG (hereinafter referred to as “BGB”).

2 ACCOUNTING POLICIES

(a) Basis of preparation

Extraordinary final accounts for nine month period comprising a balance sheet, statements of income and of changes in equity and accompanying notes, are prepared in accordance with the Act on accounting, the applicable accounting rules and regulations set by the Ministry of Finance of Czech Republic. The financial statements are prepared under the historical cost convention as modified by the revaluation of selected financial instruments at fair values.

The financial statements are rounded to millions of Czech Crowns (MCZK) unless otherwise stated and are not consolidated.

The Bank decided not to include comparative information for the period ended 30 September 2005 in the extraordinary financial statements as this cannot be effectively determined and these figures had not been audited. Instead, the Bank included information and disclosures from the audited financial statements as at 31 December 2005.

(b) Foreign currencies

Financial assets and liabilities denominated in foreign currencies are translated to Czech Crowns at the exchange rate announced by the Czech National Bank (hereinafter “CNB”) effective at the balance sheet date. All resulting foreign exchange gains and losses are recognised in the income statement.

(c) Transaction date

Depending on the type of transaction, the transaction date is defined as the date of payment or collection of cash; the date of purchasing or selling of foreign currency or securities; date of payment or collection from a customer's account; date of order to correspondent to make a payment, settlement date of the bank's payment orders with the ČNB clearing centre, the value date according to a statement received from a bank's correspondent (statement means SWIFT statement, bank's notice, received media, bank statement or other documents); the trade date and settlement date of transactions with securities, foreign currency, options or other derivatives; the date of issue or receipt of a guarantee or opening credit commitment; the date of acceptance of values into custody.

Accounting transactions involving the purchase or sale of financial assets with a usual term of delivery (spot transactions), as well as fixed term and option contracts, are recorded in off-balance sheet accounts from the trade date until the settlement date.

(d) Fair value of securities

The fair value of a security is determined as the market value quoted by a relevant stock exchange or other active public market. In other cases the fair value is estimated by:

- the share in the issuer's equity for equities or units;
- the risk adjusted net present value for debt securities and notes.

(e) Securities**(i) Securities valued at fair value through profit and loss**

Securities valued at fair value through profit and loss include securities held for trading and securities which were determined as such by the Bank when recognized. Trading securities were either acquired to generate profit from short-term fluctuations in the price or in the dealer's margin, or included in a portfolio in which a pattern of short-term profit taking exists. Trading securities valued at fair value through profit and loss are initially recognised at cost, which includes expenses incurred in connection with their acquisition, and they are subsequently measured at fair value. All related gains and losses are included in the income statement as "Net gain from financial transactions". Spot purchases and sales are recognised on a settlement date basis. Forward trades are treated as derivatives. Interest earned on trading securities is reported as "Interest income on securities".

(ii) Available-for-sale securities

Available-for-sale securities are neither securities valued at fair value through profit and loss nor securities held to maturity. They comprise mainly shares in companies other than in subsidiaries and associates and debt securities held for the purpose of liquidity management. Available-for-sale securities are valued at fair value and gains (losses) from this revaluation are recognised in equity as "Revaluation gains (losses) not included in the income statement". On sale the relevant gain (loss) is recorded in the income statement as "Net gain from financial transactions". Non-securitised shares other than shares in subsidiaries and associates are measured at cost less impairment.

(iii) Securities held-to-maturity

Securities held-to-maturity are securities with fixed maturity where the Bank has both the intent and the ability to hold them to maturity.

Securities held-to-maturity are measured at amortised cost less impairment.

(f) Transfers between portfolios of securities

Transfers between portfolios are generally allowed if management intentions are changed, except as follows:

- Securities valued at fair value through profit and loss cannot be transferred to and from other portfolios;
- on sale or transfer of any securities held-to-maturity, the Bank must transfer the rest of the portfolio of securities held-to-maturity to available-for-sale securities and no securities can be classified as held-to-maturity within the two following accounting periods. Exceptions to this rule are allowed within the last three months before maturity or in the case of a significant deterioration in an issuer's creditworthiness.

(g) Operations in securities carried on for clients

Securities accepted by the Bank for custody or deposition are generally valued by their real value at the moment of their takeover and posted in the off-balance sheet in the item "Values taken over for custody and deposit". Securities taken over by the Bank for the purpose of their management are accounted for in their market value and registered in an off-balance sheet in the item "Values taken over for management". Bank's liabilities toward clients, mainly those from the cash received from clients and designed for the purchase of securities, cash designed to be returned to the client, etc., are accounted for in liabilities of the balance sheet.

(h) Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Bank, which means that the Bank has the power to govern the financial and operating policies as to obtain benefits from its activities.

An associated undertaking is an enterprise where the Bank has significant influence, which is the power to participate in the financial and operating policy decisions, but not control.

Investments in subsidiary and associated undertakings are measured at cost less any impairment other than temporary.

(i) Securities financing arrangements

Securities borrowed or purchased under agreements to resell (resale or reverse repo agreements) are not recognised on the balance sheet. Securities lent or sold under agreements to repurchase (repo agreements) are retained in their original portfolio. The underlying cash-flows are recorded as loans and borrowings respectively on a settlement date basis.

(j) Derivative financial instruments and hedging

Derivative financial instruments including term foreign exchange contracts, forward rate agreements, currency and interest rate swaps, currency and interest rate options and other derivative financial instruments are recognized at the date of purchase at their notional value in off-balance sheet and from the settlement date they are re-measured at their fair value in the balance sheet. Fair values are obtained from quoted market prices and discounted cash-flow models. All derivatives are presented in "Other assets" or in "Other liabilities" when their fair value is positive or negative respectively.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value.

Changes in the fair value of derivatives held for trading are included in the income statement as "Net gain from financial transactions".

The Bank designates prospectively certain derivatives as either a hedge of the fair value of a recognised asset or liability (fair value hedge). Hedge accounting is used for derivatives designated in this way provided the following criteria are met:

- (i) formal documentation of the general hedging strategy, hedged risk, hedging instrument, hedged item and their relationship is prepared before hedge accounting is applied;
- (ii) the hedge documentation proves that it is expected to be highly effective in offsetting the risk in the hedged item at inception and throughout the reporting period;
- (iii) the hedge is effective on an ongoing basis.

Changes in the fair value of derivatives that qualify as effective fair value hedges are recorded in the income statement, along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

(k) Interest income and expense

Interest income and expense are recognised for all interest bearing instruments on an accrual basis. Interest income includes accrued coupons, discount and premium on all fixed income instruments.

Income on non-performing loans is also accrued and capitalised into the related loan balance. Such amounts are considered in estimating the provision for non-performing loans.

(l) Penalty interest

Penalty interest income is suspended or forgiven and excluded from interest income until received.

(m) Fee and commission income

Fixed fee income for arrangement of loans, guarantees and other activities is recognised immediately, whereas commission is accrued over the period to maturity.

(n) Receivables

Receivables are stated at nominal value less specific allowances for watched and doubtful receivables and less allowances for portfolio of standard receivables, in the amount of impairment of standard loans. Irrecoverable receivables are written off upon completion of bankruptcy proceedings against the debtor. If a receivable is purchased, the purchase price includes all expenses connected with the purchase, e.g. expenses for specialist valuation of purchased receivables, fees to lawyers and commissions.

(o) Provisions

Specific provisions are recognised when the Bank has a present obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. In addition, general provisions for banking risk recorded prior to 1 January 2002 were recognised in the balance sheet as at 31 December 2004, however, these were utilised or written back to income as required by law by 31 December 2005. All provisions are presented in liabilities.

Additions to provisions are recognised in the income statement, their utilisation is recognised together with expenses or losses, for which purpose they were created in the income statement. Release of provisions in case they are no longer necessary is recognised in the income.

Provisions are set aside in the currency, in which the settlement is expected to be made, so that related exchange differences arising are also recognised in the same way as the provision.

(p) Allowances

Allowances are deducted from the cost of each impaired asset. The amount of allowance for impaired loans and other assets is based on appraisals of these assets at the balance sheet date.

Additions to allowances are recognised in the income statement, their utilisation is recognised together with expenses and losses, connected with the decrease of assets, in the income statement. The release of allowances no longer considered necessary is recognised in the income.

Allowances for assets denominated in foreign currency are created in foreign currency.

(q) Tangible and intangible fixed assets

Tangible and intangible fixed assets are recorded at cost. Fixed assets are depreciated/amortised by applying the straight-line basis over the estimated useful lives:

	<u>Depreciation period</u> (years)
Buildings and constructions	50
Technical improvement on buildings classified as historical monuments	15
Technical improvement on leasehold buildings	10
Energy equipment	12
Machinery and equipment	6
Furniture and fittings	6
Motor vehicles	4
Software and other intangible property	2 – 5
IT Equipment	4

Repair and maintenance expenditures are charged to expense as incurred. Expenditures enhancing the value of the asset are capitalised and depreciated.

(r) Value added tax

The Bank is registered for value added tax (hereinafter “VAT”). The bank claims full and reduced deduction of input VAT since 2005. Acquired fixed assets with no claimed deduction of input VAT are recorded including VAT in the appropriate fixed asset accounts. Purchased supplies with no claimed deduction of input VAT are recorded including VAT in the purchased supplies accounts. Acquired fixed assets where reduced input VAT deduction was claimed are recorded including the unclaimed part of the VAT in the appropriate fixed asset accounts. Purchased supplies where reduced input VAT deduction was claimed are recorded including the unclaimed part of the VAT in the purchased supplies accounts.

(s) Deferred tax

Deferred tax is determined at the tax rate effective for the period, when its realisation is expected.

Deferred tax liability is recognised on all temporary differences between the carrying amount of an assets or liabilities in the balance sheet and its tax base using the full liability method. Deferred tax asset is recognised to the extent that it is probable that future taxable profit will be available against which this asset can be utilised.

(t) Staff costs and pensions

Staff costs are included in Administrative expenses and they include also board and management emoluments.

The Bank provides to its employees contributions to a defined pension plan. Contributions paid by the Bank are reflected directly as an expense.

Regular contributions are made to the state budget to fund the national pension plan.

The Bank creates social fund. The social fund contributions are not charged to the income statement in accordance with Czech accounting rules and are presented in other liabilities.

(u) Related parties

Related parties are defined in accordance with the Act on Banks as follows:

- members of Board of Directors, Supervisory board, senior management and their relatives;
- corporates controlling the Bank and their shareholders holding more than 10% of capital, their senior management and its relatives;
- corporates in which board members of the Bank or senior management hold at least 10% shareholding;
- corporates in which entities controlling the Bank or their shareholders hold at least a 10% shareholding (thereinafter “related parties”);
- subsidiaries of the Bank.

In accordance with the Czech accounting rules the following related party balances and transactions are disclosed in Notes 4, 5, 6, 7, 9, 11, 12, 14, 15, 16, 17 and 23:

- total amount of loans provided by the Bank to members of Board of Directors, Supervisory Board, and to employees participating in the management of the Bank and related parties;
- total amount of deposits received by the Bank from the members of the Board of Directors, Supervisory Board, and from employees participating in the management of the Bank and related parties;
- total amount of guarantees issued by the Bank for the members of Board of Directors, Supervisory Board, and to employees participating in the management of the Bank and related parties;
- name and the place of incorporation of the Bank’s shareholders holding more than 10% of share capital or voting rights;
- all salaries and remuneration of members of Board of Directors, Supervisory Board in aggregated amounts for each body, and of employees participating in the management of the Bank.

(v) Subsequent events

The effects of events, which occurred between the balance sheet date and the date of signing the financial statements, are reflected in the financial statements in the case that these events provide further evidence of conditions, which existed at the balance sheet date.

Where significant events occur subsequent to the balance sheet date prior to signing of the financial statements, which are indicative of conditions, which arose subsequent to the balance sheet date, the effects of these events are disclosed, but are not themselves reflected in the financial statements.

3 CASH AND DEPOSITS WITH CENTRAL BANKS

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Cash on hand	650	651
Obligatory reserves	66	507
Current accounts with central banks	<u>87</u>	<u>7</u>
	<u>803</u>	<u>1,165</u>

Obligatory reserves are mandatory deposits with the CNB and they are not available for use in the Bank's day-to-day operations. These deposits bear interest at the CZK repo rate, which was 2.50 % p.a. as at 30 September 2006 (31 December 2005: 2.00 % p.a.).

4 DUE FROM BANKS

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Current accounts with banks	99	49
Term deposits with other banks	5,818	2,908
Standard loans to banks	278	278
Loans provided in reverse REPO transactions with CNB	<u>2,781</u>	<u>6,233</u>
	<u>8,976</u>	<u>9,468</u>

Loans to related parties	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Parent company (UCI)	4	5
Companies in the group (UCI)	<u>560</u>	<u>70</u>
Loans to related parties	<u>564</u>	<u>75</u>
Total		

In 2006 and 2005, the Bank did not restructure any of its receivables from banks. In 2006 and 2005 the Bank classified all claims from banks as standard.

5 DUE FROM CUSTOMERS

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Public sector	52	86
Financial sector	1,871	2,133
Non-financial sector - legal persons	27,138	24,138
Physical persons	<u>6,858</u>	<u>5,300</u>
	<u>35,919</u>	<u>31,657</u>
Allowance for portfolio of standard receivables (Note 10)	-135	- 117
Allowance for impaired loans (Note 10)	<u>-662</u>	<u>- 677</u>
	<u>-797</u>	<u>- 794</u>
	<u>35,122</u>	<u>30,863</u>

The bank recognized an allowance for the portfolio of standard receivables of MCZK 135 as at 30 September 2006 (31 December 2005: MCZK 117). The methodology and principles for calculating this allowance are stated in Note 26(b).

The Bank restructured MCZK 6 of its loans and receivables in 2006 (31 December 2005: MCZK 101). Loans and other receivables are considered as restructured in case that the Bank grants relief to clients because it is likely that the Bank would incur losses if acting otherwise. Roll-over of a short-term loan is not considered to be restructuring of the loan in the case where the client has fulfilled all requirements of loan agreements.

As at 30 September 2006 the Bank did not lead any syndicate loan.

(a) Quality of loan portfolio

Loans are categorised in accordance with the definitions issued by the CNB in five categories (standard, watch, substandard, doubtful, loss). Impaired loans include substandard, doubtful and loss loans and represent total outstanding principal and accrued interest receivable with service payments overdue more than 90 days or other defaults in contractual terms or financial performance. Watch loans are usually overdue between 30 – 90 days or other risks characteristic are presented. Administration of impaired receivables, including their recovery, is performed by a separate department in the Bank.

The Bank additionally applies a portfolio approach to the categorisation of homogenous standard receivables, for which impairment on individual basis was not identified but where objective evidence of impairment on portfolio basis exists. Each receivable is considered individually, as is also the case for the creation of provisions.

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Standard	30,636	27,179
Watch	4,739	3,983
Substandard	111	147
Doubtful	212	97
Loss	<u>221</u>	<u>251</u>
	<u>35,919</u>	<u>31,657</u>

The Bank accepts collaterals for loans, but they are usually not taken into account for categorisation of the loans and creation of allowances.

Book value of pledges accepted to secure client's loans:

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Accepted undertakings	7,356	5,227
Cash	604	561
Securities	2,420	18
Land and buildings	23,624	18,022
Other assets	<u>5,342</u>	<u>5,386</u>
	<u>39,346</u>	<u>29,214</u>

(b) Loans to related parties and major shareholders

Standard loans to companies and individuals include the following loans to related parties:

Loans to related parties	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Companies in the group (UCI)	644	651
Board of Directors of the Bank	0	10
Supervisory Board of the Bank	0	2
Other members of management	<u>4</u>	<u>19</u>
Total loans to related parties	<u>648</u>	<u>682</u>

All loans to related parties were made in the ordinary course of business on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavourable features.

6 SECURITIES

	State treasury and other bills eligible for CNB refinancing		Debt securities		Shares, mutual share and other interests	
	30	31	30	31	30	31
	September <u>2006</u> MCZK	December <u>2005</u> MCZK	September <u>2006</u> MCZK	December <u>2005</u> MCZK	September <u>2006</u> MCZK	December <u>2005</u> MCZK
Valued at fair value through profit and loss	<u>354</u>	<u>344</u>	<u>4,518</u>	<u>4,453</u>	<u>0</u>	<u>0</u>
<i>of which Trading:</i>	<u>354</u>	<u>344</u>	<u>3,854</u>	<u>3,751</u>	<u>0</u>	<u>0</u>
- issued by government	354	344	0	0	0	0
- issued by financial sector	0	0	3,854	3,751	0	0
- issued by non-financial sector	0	0	0	0	0	0
<i>of which Determined as such on first recognition:</i>	<u>0</u>	<u>0</u>	<u>664</u>	<u>702</u>	<u>0</u>	<u>0</u>
- issued by financial sector	0	0	477	521	0	0
- issued by non-financial sector	0	0	187	181	0	0
Available-for-sale:	<u>0</u>	<u>0</u>	<u>667</u>	<u>709</u>	<u>29</u>	<u>29</u>
- issued by financial sector	0	0	667	709	29	29
- issued by non-financial sector	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	<u>354</u>	<u>344</u>	<u>5,185</u>	<u>5,162</u>	<u>29</u>	<u>29</u>

The Bank decided in accordance with current legislation to reclassify selected available-for-sale securities into portfolio of securities valued at fair value through profit and loss with effect from 1 January 2005. The Bank transferred debt securities of MCZK 552.

(a) Securities valued at fair value through profit and loss
State treasury bills and other securities accepted by Central bank for re-financing

	<u>30 September 2006</u> MCZK	<u>31 December 2005</u> MCZK
State treasury bills	106	100
Main or auxiliary market of recognised domestic stock exchanges	<u>248</u>	<u>244</u>
	<u>354</u>	<u>344</u>

Other debt securities

	<u>30 September 2006</u> MCZK	<u>31 December 2005</u> MCZK
Main or auxiliary market of recognised foreigner stock exchanges	4,460	4,453
Non-listed	<u>58</u>	<u>0</u>
	<u>4,518</u>	<u>4,453</u>

Securities valued at fair value through profit and loss as at 30 September 2006 include MCZK 428 of bonds issued by the related parties (31 December 2005: MCZK 503).

(b) Securities available-for-sale
Bonds and similar debt securities

	<u>30 September 2006</u> MCZK	<u>31 December 2005</u> MCZK
Main or auxiliary market of recognised foreigner stock exchanges	<u>667</u>	<u>709</u>
	<u>667</u>	<u>709</u>

Shares and similar equity securities

	<u>30 September 2006</u> MCZK	<u>31 December 2005</u> MCZK
<u>Traded on main or auxiliary market of recognised stock exchanges</u>		
Open mutual funds	14	14
<u>Not traded on main or auxiliary market of recognised stock exchanges</u>		
Joint stock companies	<u>15</u>	<u>15</u>
Net value	<u>29</u>	<u>29</u>

Securities available-for-sale as at 30 September 2006 include securities at fair value of MCZK 14, which were issued by related company Pioneer investiční společnost, a.s. (at 31 December 2005: MCZK 14).

(c) Securities held-to-maturity

At 30 September 2006 and 31 December 2005 the Bank did not have any securities in a held to maturity portfolio.

7 INVESTMENTS IN SUBSIDIARY AND ASSOCIATED UNDERTAKINGS

(a) Investments in associated undertakings

At 30 September 2005 and 31 December 2005 the Bank did not have any investments in associated undertakings.

(b) Investments in subsidiary undertakings

At 30 September 2006:

Name, registered office and major business MCZK	Number of shares pieces	At cost MCZK	Nominal value MCZK	Equity MCZK	Share capital MCZK	Shareholding %
Zivnostenska Finance B. V. Haaksbergweg Zuidoost, The Netherlands; Financial and investment services	n/a*	1	1	0	1	100%
Allowance for diminution in value (Note 10)		<u>-1</u>				
Net value		<u>0</u>				

As 31 December 2005:

Name, registered office and major business	Number of shares pieces	At cost MCZK	Nominal value MCZK	Equity MCZK	Share capital MCZK	Shareholding %
Zivnostenska Finance B. V. Haaksbergweg Zuidoost, The Netherlands; Financial and investment services	n/a*	1	1	0	1	100
Allowance for diminution in value (Note 10)		<u>-1</u>				
Net value		<u>0</u>				

* n/a – not applicable

Investments in subsidiary and associated undertakings comprise solely investments in common stock. Voting rights are equal to the shareholders in each company.

(c) Movements in investments in subsidiary and associated undertakings

The movements in investment in subsidiary and associated undertakings during 2006 and 2005 can be analyzed as follows

	<u>Subsidiary undertakings</u>		<u>Associated undertakings</u>	
	<u>At cost</u>	<u>Nominal value</u>	<u>At cost</u>	<u>Nominal value</u>
	MCZK	MCZK	MCZK	MCZK
At 1 January 2005	0	1	0	0
At 31 December 2005	0	1	0	0
At 30 September 2006	0	1	0	0

8 INTANGIBLE AND TANGIBLE FIXED ASSETS

Intangible fixed assets

	<u>Software</u> MCZK	<u>Other</u> MCZK	<u>Total</u> MCZK
<u>Cost</u>			
At 1 January 2005	694	18	712
Additions	48	2	50
Disposals	- 30	0	- 30
At 31 December 2005	712	20	<u>732</u>
As 1 January 2006	712	20	732
Additions	20	5	25
Disposals	- 611	0	611
At 30 September 2006	121	25	<u>146</u>
<u>Depreciation and adjustments</u>			
At 1 January 2005	588	16	604
Charge for the year	74	1	75
Disposals	- 30	0	- 30
K 31 December 2005	632	17	<u>649</u>
At 1 January 2006	632	17	649
Charge for the year	56	1	57
Disposals	-575		-575
At 30 September 2006	113	18	<u>131</u>
<u>Net book value</u>			
At 31 December 2005	80	3	<u>83</u>
At 30 September 2006	8	7	<u>15</u>

The Bank wrote-off software in the amount of MCZK 22.9 as at 31 December 2005 due to planned replacement of this software in April 2006. The extraordinary depreciation is part of the "Charge for the year 2005".

Tangible fixed assets

	<u>Land and works of art</u> MCZK	<u>Buildings</u> MCZK	<u>Equipment</u> MCZK	Tangible FA not yet in use and advanced <u>payments</u> MCZK	<u>Total</u> MCZK
<u>Cost</u>					
At 1 January 2005	45	1,661	1,240	74	3,020
Additions	0	81	108	0	189
Other changes	0	0	0	- 67	- 67
Disposals	- 10	- 182	- 121	0	- 313
At 31 December 2005	35	1,560	1,227	7	<u>2,829</u>
At 1 January 2006	35	1,560	1,227	7	2,829
Additions	0	16	42	11	69
Other changes	0	0	0	-7	-7
Disposals	0	- 8	- 547	0	- 555
At 31 September 2006	35	1,568	722	11	<u>2,336</u>
<u>Depreciation and adjustments</u>					
At 1 January 2005		560	1,004		1,564
Charge for the year		100	109		209
Disposals		- 66	- 116		- 182
At 31 December 2005		594	997		<u>1,591</u>
At 1 January 2006		594	997		1,591
Charge for the year		48	81		129
Disposals		-8	-502		-510
At 31 September 2006		634	576		<u>1,210</u>
<u>Net book value</u>					
At 31 December 2005	35	966	230	7	<u>1,238</u>
At 30 September 2006	35	934	146	11	<u>1,126</u>

The Bank wrote-off operating buildings of MCZK 32.5 as at 31 December 2005 due to the permanent impairment of these buildings. The extraordinary depreciation is part of the "Charge for the year 2005".

The Bank wrote-off hardware in the amount of MCZK 13.9 as at 31 December 2005 due to the planned replacement of this hardware in April 2006. The extraordinary depreciation is part of the "Charge for the year - Equipment".

Fixed assets held under finance lease contracts

The Bank does not hold any assets under finance lease contracts.

Pledged assets

At 30 September 2006 and 31 December 2005 no long-term fixed assets were provided by the Bank as security.

Significant changes in structure of fixed assets

There were two significant changes in the structure of tangible and intangible assets in 2006. The Bank implemented a new information system in May 2006 and the system used up to that date was disposed of. The Bank also transferred part of its administrative operations to a special purpose service organization within the UCI group that now provides these services to the Bank in exchange for the appropriate payment. All relevant IT equipment was sold to the service organization.

9 OTHER ASSETS

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
Receivables from securities transactions	2	1
Operating advances granted	58	37
Positive fair value of derivative instruments (Note 26(d))	314	273
Deferred tax asset (Note 24)	103	40
Receivables from tax authorities	0	36
Receivables from equity option instruments	101	83
Other assets	<u>197</u>	<u>49</u>
	<u>775</u>	<u>519</u>

The item Positive fair value of derivative instruments as at 30 September 2006 includes MCZK 194 due from related parties (31 December 2005: MCZK 131).

10 ALLOWANCES, PROVISIONS AND WRITE OFFS

The Bank had the following provisions and allowances for assets at risk:

	<u>30 September 2006</u>	<u>31 December 2005</u>
	MCZK	MCZK
<u>Provisions</u>		
General provisions for loans (Note 10)	0	0
Specific provisions for guarantees (Note 17)	0	0
Other provisions including provisions for lawsuits (Note 17)	<u>24</u>	<u>29</u>
	<u>24</u>	<u>29</u>
<u>Allowances</u>		
Impaired loans to customers (Note 5)	662	677
Homogenous standard loans to customers (Note 5)	135	117
Equity investments (Note 7)	1	1
Other non-loan receivables	<u>1</u>	<u>0</u>
	<u>799</u>	<u>795</u>

The movements in provisions can be analysed as follows:

	General provisions for loans MCZK	Specific provisions for guarantees MCZK	Others provisions MCZK	Total provisions MCZK
At 1 January 2005	256	4	33	293
Creation	0	0	6	6
Usage	- 2	0	0	- 2
Release	<u>- 254</u>	<u>- 4</u>	<u>- 10</u>	<u>- 268</u>
At 31 December 2005	<u>0</u>	<u>0</u>	<u>29</u>	<u>29</u>
At 1 January 2006	0	0	29	29
Creation	0	0	1	1
Usage	0	0	-1	- 1
Release	<u>0</u>	<u>0</u>	<u>-5</u>	<u>- 5</u>
At 30 September 2006	<u>0</u>	<u>0</u>	<u>24</u>	<u>24</u>

Since 1 January 2006 the bank doesn't create general provisions for loans in accordance with Czech legislation.

The movements in allowances can be analysed as follows:

	Impaired loans to customers MCZK	Homogenous standard loans to customers MCZK	Investments in subsidiary undertakings MCZK	Other non-loan receivables MCZK	Total MCZK
At 1 January 2005	621	0	1	0	622
Creation	365	117	0	0	482
Usage	- 102	0	0	0	-102
Release	<u>- 207</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>-207</u>
At 31 December 2005	<u>677</u>	<u>117</u>	<u>1</u>	<u>0</u>	<u>795</u>
At 1 January 2006	677	117	1	0	795
Creation	267	18	0	1	286
Usage	- 81	0	0	0	- 81
Release	- 195	0	0	0	- 195
FX difference	<u>- 6</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>- 6</u>
At 30 September 2006	<u>662</u>	<u>135</u>	<u>1</u>	<u>1</u>	<u>799</u>

Write-offs and recovery of amounts written off previously

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Amounts due from clients written off	- 83	- 108
Recovery of amounts written off previously	<u>24</u>	<u>1</u>
Net loss amounts written off	<u>- 59</u>	<u>- 107</u>

Bad debts are written off against established general provisions, specific allowances or directly expensed in the case that management asserts their recoverability as being remote.

11 DUE TO BANKS

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Due to other banks	<u>6,881</u>	<u>5,512</u>
Liabilities to related parties	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Parent company (UCI)	80	231
Companies in UCI group	<u>1,228</u>	<u>600</u>
Deposits from related parties Total	<u>1,308</u>	<u>831</u>

Management considers that deposits from related parties were accepted on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal interest rate and liquidity risk or present other unfavourable features.

12 DUE TO CUSTOMERS

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Amounts due to governmental entities	1,673	1,275
Amounts due to municipalities	20	89
Amounts due to private customers	<u>34,979</u>	<u>32,840</u>
	<u>36,672</u>	<u>34,204</u>
	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Liabilities repayable on demand	15,665	14,367
Term accounts for fixed term	19,058	18,095
Term accounts with fixed notice period	1,207	1,362
Other	<u>742</u>	<u>380</u>
	<u>36,672</u>	<u>34,204</u>
Liabilities to related parties	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Companies in UCI group	533	390
Board of Directors	18	11
Supervisory Board	2	3
Other management	<u>18</u>	<u>19</u>
Deposits from related parties Total	<u>571</u>	<u>423</u>

Except for certain bona fide employee deposits at preferential interest rates, management considers that deposits from related parties were accepted on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal interest rate and liquidity risk or present other unfavourable features.

13 LIABILITIES FROM DEBT SECURITIES

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Mortgage backed securities	1,814	1,811
Promissory notes and bills of exchange	433	1,345
Bonds	<u>188</u>	<u>190</u>
	<u>2,435</u>	<u>3,346</u>

14 SUBORDINATED DEBT

On 29 December 2004 the Bank repay a subordinated debt of EUR 1 milliard from UCI, and the same day receive a subordinated debt from parent company UCI in the same amount. The subordinated debt bears interest at the Prague Interbank Offered Rate (“PRIBOR”) plus a margin of 60 basis points until 29 December 2009 and 120 basis points thereafter. The interest is payable quarterly in arrears. The principal is repayable by 29 December 2014, with no repayment being possible before 29 December 2009 and without the consent of the CNB. The debt, which is unsecured, is subordinated to all other liabilities of the Bank and forms a part of the tier two capital of the Bank as defined by the CNB for the purposes of determination of its capital adequacy.

15 OTHER LIABILITIES

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Settlement clearance accounts	1,096	785
Negative fair value of derivative instruments (Note 26(d))	306	310
Liabilities from equity option instruments	188	152
Estimates	167	211
Current income tax liability	80	0
Social fund	<u>6</u>	2
	<u>1,843</u>	<u>1,460</u>

The item “Negative fair value of derivative instruments” as at 30 September 2006 includes balances with related parties of 20 MCZK (31 December 2005: MCZK 30).

16 EQUITY AND PROFIT DISTRIBUTION

Share capital

Issued and paid share capital of MCZK 1,360 is represented by 1,360,410 shares of a nominal value of CZK 1,000 per share.

Issues of shares

<u>ISIN</u>	<u>Date of issue</u>	<u>Date of registration</u>	<u>Nominal value of share</u> Pieces	<u>Number of shares</u> Pieces	<u>Nominal value</u> MCZK
CZ0008002557	17 April 1992	24 May 1993	1,000	633,407	633
CZ0008002557	17 April 1992	30 August 1993	1,000	727,003	<u>727</u>
					<u>1,360</u>

Shareholders and shares

<u>Name and registered office</u>	<u>30 September 2006</u> %	<u>31 December 2005</u> %
Unicredito Italiano SpA	100.00	96.63
Other shareholders holding individually less than 5% of share capital	<u>0.00</u>	<u>3.37</u>
	<u>100.00</u>	<u>100.00</u>

In compliance with the Act on operations on capital market, the Bank squeezed out the shares of minority shareholders. All remaining shares were transferred to Unicredito Italiano Spa on 9 January 2006, which became the 100% owner of Živnostenská banka.

Bank shares owned by members of the Board of Directors, Supervisory Board and members of management can be summarised as follows:

	30 September <u>2006</u> pieces	31 December <u>2005</u> pieces
Board of Directors	0	0
Other management	<u>0</u>	<u>137</u>
	<u>0</u>	<u>137</u>

Profit distribution

The following table shows the distribution of net profit in 2005 and the proposed distribution of net profit for 2006:

	30 September <u>2006</u> MCKZ	31 December <u>2005</u> MCKZ
Social fund contributions	0	12
Retained earnings	<u>229</u>	<u>186</u>
	<u>229</u>	<u>198</u>

Social fund contributions are not charged to the income statement in accordance with Czech accounting rules.

As the balance of the statutory reserve fund reached 20% of registered capital, the bank is not obliged to contribute 5% of the profit for accounting period to the statutory reserve fund. This fund cannot be used for dividends payout.

Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the number of ordinary shares in issue during the year.

	30 September <u>2006</u> MCKZ	31 December <u>2005</u> MCKZ
Net profit attributable to shareholders (in MCZK)	229	187
Number of ordinary shares in issue (in thousand pieces)	1,360	1,360
Basic earnings per share (in CZK)	168.40	137.50

17 CONTINGENCIES AND COMMITMENTS

Commitments to provide a loan, loan guarantees to third parties, guarantees from acceptance of bills of exchange and letters of credit expose the Bank to credit risk and to loss in the event of a client's inability to meet his obligations. Various commitments and contingent liabilities arise in the normal course of business involving elements of credit, interest rate and liquidity risk.

The Bank is the subject of several legal disputes. At 30 September 2006 a provision of MCZK 22 (31 December 2005: MCZK 21) was made on the basis of the Bank's assessment of the expected outcome of these legal disputes.

Contingent liabilities include:

	30 September <u>2006</u> MCKZ	31 December <u>2005</u> MCKZ
Commitments	<u>14,926</u>	<u>14,152</u>
<u>Guarantees granted on behalf of:</u>		
Customers	2,181	2,456
Letters of credit	<u>201</u>	<u>361</u>
Total value of guarantees	<u>2,382</u>	<u>2,817</u>
Total commitments and guarantees	<u>17,308</u>	<u>16,969</u>

Provisions for guarantees and commitments as at 31 December 2005 was released in full amount (31 December 2004: MCZK 4) (Note 10).

All guarantees and commitments are irrevocable.

Contingent assets with related parties	<u>Loan commitments</u>		<u>Guarantees granted</u>	
	30 September	31 December	30 September	31 December
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	MCZK	MCZK	MCZK	MCZK
Management	1	2	0	0
Companies in UCI group	<u>48</u>	<u>0</u>	<u>10</u>	<u>10</u>
	<u>49</u>	<u>2</u>	<u>10</u>	<u>10</u>

At 30 September 2006 and 31 December 2005 the Bank had no assets placed in custody or under management of a third party.

Potential liabilities can be divided as follows:

	30 September	31 December
	<u>2006</u>	<u>2005</u>
	MCZK	MCZK
<u>Assets under custody</u>		
Shares and mutual shares	1,475	1,451
Other	<u>643</u>	<u>1,570</u>
	<u>2,118</u>	<u>3,021</u>
<u>Assets under management</u>		
Shares and mutual shares	8,382	6,341
Bonds	<u>57,840</u>	<u>39,825</u>
	<u>66,223</u>	<u>46,166</u>

These assets are generally measured at fair value at the inception date.

Management considers that no present obligations were associated with these fiduciary duties as at 31 December 2006.

The Bank acts as depository for certain mutual, investment and pension funds. The aggregate net asset value of these funds as at 30 September 2006 was MCZK 53,998 (31 December 2005: MCZK 47,546). Management considers that no present obligations were associated with these fiduciary duties as at 30 September 2006.

Assets purchased under resale agreements (Reverse Repo transaction)

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Bonds	<u>2,724</u>	<u>6,645</u>

Receivables from Reverse repo transactions are included in Due from banks (Note 4).

At 30 September 2006, the Bank sold under repurchase agreement debt securities in the fair value of MCZK 506 (2005: MCZK 610) recognized as purchased under resale agreement.

Capital expenditures

At 30 September 2006, the Bank had contractual commitments for capital expenditure of MCZK 1.34 (31 December 2005: MCZK 27).

18 INTEREST AND SIMILAR INCOME

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Interest on inter-bank transactions	67	253
Interest on loans to customers and state	1,046	1,080
Interest and discount on debt securities	<u>146</u>	<u>199</u>
	<u>1,259</u>	<u>1,532</u>

In 2006 the penalty interest from impaired loans at amount of 6 MCZK was included to revenues. In 2005, overdue penalty interest income of MCZK 14 (2004: MCZK 6) was not accrued to revenues.

In 2006 the sum of penalty interest at total amount of MCZK 1 had been forgiven.

19 INTEREST AND SIMILAR EXPENSE

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Interest on inter-bank transactions	88	159
Interest on deposits from customers and state	327	359
Interest and discount on issued certificates of deposit	6	12
Interest and discount on issued mortgage backed securities	42	32
Interest from financial derivatives	<u>3</u>	<u>4</u>
	<u>466</u>	<u>566</u>

20 COMMISSION AND FEE INCOME AND EXPENSES

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Commission and fee income		
Domestic and foreign countries payments and maintenance of accounts	143	218
Loans	118	115
Transactions with cards	30	41
Custody and administrative fee	49	56
Cash and checks	8	21
Guarantees	18	23
Direct banking	7	9
Brokerage from purchase and sale of securities and derivatives	20	10
Trade finance activities	6	10
Other	<u>3</u>	<u>5</u>
	<u>402</u>	<u>508</u>
Assets under management fee		
Cost fees and commissions		
Transactions in payment cards	14	24
Domestic and foreign countries payments	8	12
Deposition of, custody of and trading in securities	14	24
Other cost fees and commissions	<u>5</u>	<u>7</u>
	<u>41</u>	<u>67</u>
Net profit on fees and commission	<u>361</u>	<u>441</u>

21 NET GAIN FROM FINANCIAL TRANSACTIONS

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Realised gains less losses from the sale of securities held for trading	-1	21
Gains less losses from foreign currency transactions and foreign exchange differences	236	286
Realised gains less losses from other transactions derivatives	<u>1</u>	<u>-32</u>
	<u>236</u>	<u>275</u>

22 OTHER OPERATING INCOME

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Income from sale of fixed assets	88	139
Income from written off liabilities	6	14
Other income	<u>6</u>	<u>5</u>
	<u>100</u>	<u>158</u>

23 ADMINISTRATIVE EXPENSES

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Staff costs	360	582
Advertising & representation	59	93
Information technology	172	75
Telecommunications	24	80
Rent and lease charges	56	72
Consumption of material, fuel & energy	28	34
Stationery and similar expenses	44	44
Audit, tax and legal advisory services	13	13
Other administration expenses	<u>64</u>	<u>108</u>
Total	<u>820</u>	<u>1,101</u>
Insurance of clients' deposits and contribution to Guarantee fund	25	34
Loss from transfer of fixed assets	81	130
Other operating expenses	<u>2</u>	<u>0</u>
Total other operating expenses	<u>108</u>	<u>164</u>

During 2006 the Bank transferred part of its administrative operations to a service organization within the UCI group that now provides these operation services to the Bank in exchange for the appropriate payment. This contributed to the significant increase in "Information technology expenses".

Staff costs can be analysed as follows:

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Emoluments of Board of Directors	23	27
Emoluments of Supervisory board	1	1
Management	31	34
Other wages, personnel costs and emoluments of employees	215	373
Social security and health insurance	<u>90</u>	<u>147</u>
	<u>360</u>	<u>582</u>

Staff statistics

	30 September <u>2006</u>	31 December <u>2005</u>
Average number of employees	755	790
Number of members of the Board of Directors	3	3
Number of members of the Supervisory Board	8	9

The significant reduction in personnel costs reflects the fact that the Bank paid out 30 MCZK less in salary bonuses than the estimated bonuses recognized in the 2005 financial statements. The incidental release of the estimated bonuses is included in "Personnel costs" for 2006.

The average number of employees decreased due to the transfer of some of the Bank's employees to the service organization within the UCI group. The services provided by this organization are purchased by the Bank based on concluded service agreements.

24 TAXATION

	30 September <u>2006</u> MCZK	31 December <u>2005</u> MCZK
Profit before taxation	319	275
Permanent differences between profit and tax base:		
Non-taxable income	- 108	- 249
Non-deductible expenses	<u>370</u>	<u>228</u>
Net taxable profit/(loss)	581	254
Deductible gifts	<u>- 1</u>	<u>- 1</u>
Adjusted tax base	580	253
26 % (28 %) corporate tax charge	<u>139</u>	<u>66</u>
Additional tax charge for the year 2005 (resp.2004)	10	5
Deferred income tax assets	<u>-59</u>	<u>6</u>
Total	<u>90</u>	<u>77</u>
<u>Deferred income tax liabilities</u>		
Accelerated tax depreciation	0	- 4
Deductible revenues	<u>- 1</u>	<u>0</u>
	<u>- 1</u>	<u>- 4</u>
<u>Deferred income tax assets</u>		
Loan loss provisions	90	28
Revaluation of available-for-sale securities	9	5
Accounting and tax provision differences	2	0
Other provisions	0	1
Expenses tax-deductible on cash flow basis	<u>3</u>	<u>10</u>
	<u>104</u>	<u>44</u>
Potential net deferred tax asset	<u>103</u>	<u>40</u>

On the basis of revenue authority control the Bank created an estimate for additional income tax for period 1999-2002 at the amount of 21 MCZK in 2004. Actual additional tax was paid in July 2006.

A net deferred tax asset of MCZK 103 was recognized as at 31 December 2005 (2005: MCZK 40). This amount includes deferred tax asset in total amount MCZK 104 (2005: MCZK 44) and also deferred tax liabilities of MCZK 1 (2005: MCZK 4), which comprise the difference between the accounting and tax depreciation of fixed assets and revenues taxable at time of the payment. The change in deferred tax presented in income statement does not include deferred tax asset from revaluation of available-for-sale securities, which is presented in Equity within “Revaluation gains (losses)”.

25 BUSINESS SEGMENTATION

Assets	Private and	Corporate	<u>Other</u>	<u>Total</u>
	retail	banking		
	<u>banking</u>	<u>banking</u>	MCZK	MCZK
	MCZK	MCZK	MCZK	MCZK
30 September 2006				
Cash and balances with central bank	0	0	803	803
Due from banks	0	0	8,976	8,976
Due from customers	7,243	27,879	0	35,122
Trading securities	0	0	4,872	4,872
Securities available-for-sale	0	0	696	696
Investments	0	0	0	0
Other assets	<u>22</u>	<u>111</u>	<u>1,808</u>	<u>1,941</u>
	<u>7,265</u>	<u>27,990</u>	<u>17,155</u>	<u>52,410</u>
31 December 2005				
Cash and balances with central bank	0	0	1,165	1,165
Due from banks	0	0	9,468	9,468
Due from customers	5,548	25,315	0	30,863
Trading securities	0	0	4,798	4,798
Securities available-for-sale	0	0	737	737
Investments	0	0	0	0
Other assets	<u>101</u>	<u>41</u>	<u>1,725</u>	<u>1,867</u>
	<u>5,649</u>	<u>25,356</u>	<u>17,893</u>	<u>48,898</u>

26 FINANCIAL RISKS

(a) Strategy in using financial instruments

The Bank's activities are principally related to the use of financial instruments. The Bank accepts deposits from customers at both fixed and floating rates and for various periods and seeks to earn above average interest margins by investing these funds in high quality assets. The Bank seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates whilst maintaining sufficient liquidity to meet all claims that might fall due.

The Bank also seeks to raise its interest margins by obtaining above average margins, net of provisions, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances but the Bank also enters into guarantees and other commitments such as letters of credit and other contractual liabilities.

The Bank also trades in financial instruments where it takes positions in traded and over the counter instruments including derivatives. The Bank policy allows to use derivatives only for hedge Bank's position or for clients deals. The Board places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions.

(b) Credit risk

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and business segments. Such risks are monitored on a revolving basis and are subject to an annual or more frequent review. Limits on the level of credit risk by industry sector and by country are approved by the Board of Directors.

In the course of 2004, the Bank implemented a new internal rating system for corporate banking segment. The internal rating system was developed in cooperation with the Bank's parent company. The internal rating system takes regard both to the client's financial system and to qualitative indices, such as the quality of management or position of the respective person on the market.

Individual entities are classified into nine classes. Based on the internal rating system, clients classified from 6 to 8 are included into the group of followed loans. Class 9 has been reserved for threatened loans.

The Bank creates allowances for watched and doubtful receivables in accordance with CNB notice No. 9. The Bank further creates allowance in the amount of any impairment of standard receivables. Objective evidence of impairment is any information that indicates a reduction in the expected future cash flows, although the reduction cannot be attributed to individual receivables. Portfolio allowances were created as at 31 December 2005 for the first time.

Geographical segmentation

	<u>Domestic</u> MCZK	European <u>union</u> MCZK	Other <u>Europe</u> MCZK	<u>Other</u> MCZK	<u>Total</u> MCZK
30 September 2006					
Cash and balances with central bank	803	0	0	0	803
Due from banks	7,512	1,024	75	365	8,976
Due from customers	33,577	934	346	265	35,122
Trading securities	598	2,800	57	1,417	4,872
Securities available-for-sale	29	667	0	0	696
Investments	0	0	0	0	0
Other assets	<u>1,907</u>	<u>12</u>	<u>10</u>	<u>12</u>	<u>1,941</u>
	<u>44,426</u>	<u>5,437</u>	<u>488</u>	<u>2,059</u>	<u>52,410</u>

31 December 2005

Cash and balances with central bank	1,165	0	0	0	1,165
Due from banks	8,573	484	147	264	9,468
Due from customers	28,668	1,264	392	539	30,863
Trading securities	526	2,722	58	1,492	4,798
Securities available-for-sale	28	709	0	0	737
Investments	0	0	0	0	0
Other assets	<u>1,677</u>	<u>188</u>	<u>0</u>	<u>2</u>	<u>1,867</u>
	<u>40,637</u>	<u>5,367</u>	<u>597</u>	<u>2,297</u>	<u>48,898</u>

(c) Market risk

The Bank takes on exposure to market risks which arise from open positions in interest rate, currency and equity products.

The Bank started been using "Value at Risk" ("VaR") during the second half of year 2003 as a tool for estimating market risk of all open positions and the highest expected loss. The estimation is based on several assumptions of changes of market conditions. The Board of Directors sets the limits of maximum acceptable risk. The limits are monitored on a daily basis.

Daily VaR is considered to be an estimate of the potential loss with a 99% confidence level on the assumption that the actual position will not be changed in the following working day. The value of VaR is thus the value of loss, which the Bank can incur within one day and with a 99% probability the loss will not be higher than the VaR calculated. The Bank uses a methodology based on historical simulation for the VaR calculation. The calculation is set up in such a way, that a daily loss exceeding the VaR will not occur (on average) more frequently than each 100th working day. Daily revaluation of portfolios is compared to VaR on a daily basis (so-called “back testing”) with the purpose of potential re-calibration of parameters of the VaR model.

The Bank performs stress testing for main trading currencies (CZK, USD, EUR) on parallel shift of the yield curve by 1%. The Bank also performs stress testing describing foreign currency shocks, if exchange rates change by 3%.

(d) Derivative financial instruments

The Bank has outstanding derivative financial instruments contracts, which can be analysed as follows:

I. Trading derivatives

	<u>30 September 2006</u>			<u>31 December 2005</u>		
	<u>Nominal value</u> MCZK	<u>Fair value positive</u> MCZK	<u>Fair value negative</u> MCZK	<u>Nominal value</u> MCZK	<u>Fair value positive</u> MCZK	<u>Fair value negative</u> MCZK
<u>Interest rate derivatives</u>						
Forwards	87	0	1	501	2	1
Swaps	<u>3,482</u>	<u>18</u>	<u>19</u>	<u>4,362</u>	<u>7</u>	<u>69</u>
	<u>3,569</u>	<u>18</u>	<u>20</u>	<u>4,863</u>	<u>9</u>	<u>70</u>
<u>Foreign exchange derivatives</u>						
Forwards	2,572	5	11	1,151	2	22
Swaps	18,771	65	46	13,243	103	36
Option purchased	5,289	35	0	749	4	0
Option sold	<u>5,289</u>	<u>0</u>	<u>35</u>	<u>749</u>	<u>0</u>	<u>4</u>
	<u>31,921</u>	<u>105</u>	<u>92</u>	<u>15,892</u>	<u>109</u>	<u>62</u>
<u>Credit derivatives</u>						
Option purchased	3,365	191	0	2,747	155	0
Option sold	<u>3,365</u>	<u>0</u>	<u>184</u>	<u>2,747</u>	<u>0</u>	<u>151</u>
	<u>6,730</u>	<u>191</u>	<u>184</u>	<u>5,494</u>	<u>155</u>	<u>151</u>
Total	<u>42,220</u>	<u>314</u>	<u>296</u>	<u>26,249</u>	<u>273</u>	<u>283</u>

Changes in fair value of trading derivatives are recognised in the income statement.

Certain derivative transactions, while providing effective economic hedges under the Bank's risk management positions, do not qualify for hedge accounting under the specific Czech accounting rules and are therefore presented above as trading derivatives. Gains and losses from fair value changes of these derivatives are recognised in the income statement.

II. Fair value hedging derivatives

<u>30 September 2006</u>			<u>31 December 2005</u>		
<u>Nominal</u>	<u>Fair value</u>	<u>Fair value</u>	<u>Nominal</u>	<u>Fair value</u>	<u>Fair value</u>
<u>Value</u>	<u>positive</u>	<u>negative</u>	<u>value</u>	<u>positive</u>	<u>negative</u>
MCZK	MCZK	MCZK	MCZK	MCZK	MCZK

Interest rate derivatives

Swaps	<u>629</u>	<u>0</u>	<u>10</u>	<u>652</u>	<u>0</u>	<u>27</u>
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Changes in fair value of the above qualifying fair value hedging instruments are recognised in the income statement together with corresponding changes in the fair value of the hedged items as a result of the hedged risk. In case of hedged loans the changes in fair value of derivatives are recognised as "Interest on loans to customers and state" (Note 18). In case of hedged debt securities valued at fair value through profit and loss, which were determined as such by the bank at recognition, the changes in fair value of the derivative are recognised in "Net gain from financial transactions".

(e) **Currency risk**

The Bank takes on exposure resulting from fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The table below summarises the Bank's exposure to the currency risk. Included in the table are the Bank's foreign currency denominated assets and liabilities at carrying amounts, categorised by currency.

Other assets include also prepayments and accrued income. The item Other liabilities include Other liabilities, Accruals and deferred income and Provisions.

The VaR amount for foreign currency risk for all open foreign currency positions was MCZK 0.71 as of 30 September 2006 (31 December 2005: MCZK 0.35).

The average VaR amount for foreign currency risk for the period from 1 January 2006 to 30 September 2006 was MCZK 0.5 (2005: MCZK 0.4).

(f) Interest rate risk

The Bank takes on exposure resulting from fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

The Board of Directors sets limits on the level of mismatch of interest rate reprising that may be undertaken, which is monitored daily.

The VaR amount for interest rate risk of the trading book was MCZK 3.8 as of 30 September 2006 (31 December 2005: MCZK 2.4). The average VaR amount for interest rate risk of the trading book for the period from 1 January 2006 to 30 September 2006 was MCZK 3.9 (2005: MCZK 2.9).

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual reprising or maturity dates.

(g) Liquidity risk

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

In case of unexpected outflow of liquid resources, the Bank has a back up portfolio of highly liquid government bonds and back up liquidity line with its main shareholder.

The table below analyses assets and liabilities of the Bank into relevant maturity bands based on the remaining period at the balance sheet date to the contractual maturity date.

Debt securities can be realised on financial markets prior to their contractual maturity.

At 30 September 2006

Assets	Within <u>3 months</u> MCZK	3 – 12 <u>months</u> MCZK	1 – 5 <u>years</u> MCZK	Over <u>5 years</u> MCZK	<u>Unspecified</u> MCZK	<u>Total</u> MCZK
Deposits with central bank	737	0	0	0	66	803
Due from banks	8,792	71	113	0	0	8,976
Due from customers	10,310	3,972	7,683	13,502	- 345*	35,122
Trading securities	148	815	3,551	358	0	4,872
Securities available-for-sale	0	255	0	412	29	696
Investments	0	0	0	0	0	0
Other assets	<u>62</u>	<u>27</u>	<u>115</u>	<u>3</u>	<u>1,734</u>	<u>1,941</u>
	<u>20,049</u>	<u>5,140</u>	<u>11,462</u>	<u>14,275</u>	<u>1,484</u>	<u>52,410</u>
Liabilities						
Due to banks	6,251	528	102	0	0	6,881
Due to customers	34,313	609	1,508	0	242	36,672
Liabilities from debt securities	330	103	935	1,067	0	2,435
Subordinated liabilities	0	0	0	1,000	0	1,000
Provisions	0	0	0	0	24	24
Other liabilities	<u>56</u>	<u>31</u>	<u>211</u>	<u>8</u>	<u>5,092</u>	<u>5,398</u>
	<u>40,950</u>	<u>1,271</u>	<u>2,756</u>	<u>2,075</u>	<u>5,358</u>	<u>52,410</u>
Net financial assets/(liabilities)	<u>- 20,901</u>	<u>3,869</u>	<u>8,706</u>	<u>12,200</u>	<u>- 3,874</u>	<u>0</u>

* MCZK - 345 is stated net of an amount of MCZK - 797 representing allowance for impaired loans (note 5)

At 31 December 2005

Assets	Within <u>3 months</u> MCZK	3 – 12 <u>months</u> MCZK	1 – 5 <u>years</u> MCZK	Over <u>5 years</u> MCZK	<u>Unspecified</u> MCZK	<u>Total</u> MCZK
Deposits with central bank	658	0	0	0	507	1,165
Due from banks	8,886	442	140	0	0	9,468
Due from customers	8,473	7,040	8,231	7,484	- 365*	30,863
Debt securities	552	93	3,302	851	0	4,798
Other assets	0	0	281	428	28	737
Deposits with central bank	0	0	0	0	0	0
Due from banks	<u>100</u>	<u>8</u>	<u>139</u>	<u>0</u>	<u>1,620</u>	<u>1,867</u>
	<u>18,669</u>	<u>7,583</u>	<u>12,093</u>	<u>8,763</u>	<u>1,790</u>	<u>48,898</u>
Liabilities						
Due to banks	5,311	101	100	0	0	5,512
Due to customers	32,043	587	1,194	0	380	34,204
Liabilities from debt securities	1,342	0	922	1,082	0	3,346
Subordinated liabilities	0	0	0	1,000	0	1,000
Provisions	0	0	0	0	29	29
Other liabilities	<u>52</u>	<u>20</u>	<u>172</u>	<u>41</u>	<u>4,522</u>	<u>4,807</u>
	<u>38,748</u>	<u>708</u>	<u>2,388</u>	<u>2,123</u>	<u>4,931</u>	<u>48,898</u>
Net financial assets/(liabilities)	<u>- 20,079</u>	<u>6,875</u>	<u>9,705</u>	<u>6,640</u>	<u>- 3,141</u>	<u>0</u>

* MCZK - 365 is stated net of an amount of MCZK - 794 representing allowance for impaired loans.

27 SUBSEQUENT EVENTS

During 2005 the merger of UniCredito Italiano Spa and Bayerische Hypo- und Vereinsbank AG, Mnichov was approved and the sole shareholder acquired a 100% share in HVB Bank Czech Republic a.s. Subsequently the plan for the merger of HVB Bank Czech Republic a.s. and Živnostenská banka, a.s. was completed, however the name of the successor bank is not known as at the date of issue of the auditor's report. The effective day of the merger has been set as 1 October 2006 therefore the extraordinary financial statements will be prepared as at 30 September 2006. The relevant application will be submitted to the CNB by the end of 2006.

Date



13 December 2006

Signature of the statutory representative

EVENTS SUBSEQUENT TO THE DATE OF THE EXTRAORDINARY FINANCIAL STATEMENTS

Prior to the date of publishing this Annual Report, the following significant operations were carried out, which were not known as at the date of preparing the extraordinary financial statements and are therefore not included therein.

Based on the decision of the Board of Directors dated 14 December 2006, the Bank accounted for the following items:

- Due to the planned merger with HVB Bank Czech Republic, a.s., twelve branches of Živnostenská banka, a.s. will be closed no later than by 30 June 2007. The Bank therefore accounted for extraordinary depreciation of selected assets in the amount of TCZK 54,500.
- In connection with the closure of branches the Bank expects additional costs in the amount of TCZK 44,100, for which the Bank has already created a provision.
- The Bank also expects other costs in the amount of TCZK 25,000 related to re-branding in connection with the merger with HVB Bank Czech Republic, a.s., for which it has already created a provision.

REPORT ON RELATIONS BETWEEN THE CONTROLLING PERSON AND THE CONTROLLED PERSON AND ON RELATIONS BETWEEN THE CONTROLLED PERSON AND OTHER PERSONS CONTROLLED BY THE SAME CONTROLLING PERSON

Under Section 66a (9) of Act No. 513/1991 Coll., the Commercial Code as amended, the Board of Directors of Živnostenská banka, a.s., with its registered office in Prague 1, Na Příkopě 858/20, identification number 00001368 and incorporated in the Commercial Register kept by the Municipal Court in Prague, Part B, entry No. 1350 ("Živnostenská banka" or "ŽB") has prepared this **report on relations between the Controlling Person and the Controlled Person and on relations between the Controlled Person and other persons controlled by the same Controlling Person for the accounting period from 1.1.2006 to 30.9.2006.**

Throughout the 2006 accounting period Živnostenská banka was controlled by **UniCredito Italiano S.p.A.** ("UCI"), with its registered office at Via Dante 1, 16121 Genoa, Italy, entered in the Register of Companies under No. 1812 and in the Companies Register under the number GE025-22 maintained at the Commercial, Industrial, Handicraft and Agricultural Chamber for Genoa.

Živnostenská banka controls the company **Zivnostenska Finance B.V.**, Haaksbergweg Ziudoost, the Netherlands. It is a dormant company which did not engage in any activity within the respective accounting period.

In the accounting period 2006, other relations with other interconnected persons existed, in particular with the following companies: **UniCredit Banca, UBM S.p.A., UniCredit Banca SA, UniCredit Banca d'Impresa, UniCredit Banca d'Impresa SA, UniCredit Factoring S.p.A., UniCredit Global Information Services S.p.A., Banking Transaction Services s.r.o., Zagrebacka Banka DD, Bank Pekao SA, IKB Deutsche Industriebank AG, UniBanka, a.s., UniCredit Leasing Romania SA, KOC Banka AS, HVB Bank AG, HVB Bank Czech Republic, a.s., HVB Bank SR a.s., Hypovereinsbank Finance NV, HYPO Stavební spořitelna a.s., Bank Austria Creditanstalt AG, CAC Leasing a.s., Fiat ČR s.r.o., Pioneer Global Asset Management S.p.A., Pioneer česká investiční společnost, a.s., Pioneer česká finanční společnost, a.s., Pioneer Global Funds Distributor, Ltd and Pioneer – Asset Management, a.s.**

The Board of Directors of Živnostenská banka hereby declares that relationships between above mentioned companies (and persons interconnected to them) and Živnostenská banka existed within the accounting period from 1.1.2006 to 30.9.2006.

- 1. Contracts** concluded between Živnostenská banka and interconnected persons in the accounting period from 1.1.2006 to 30.9.2006:

1.1. Živnostenská banka and **HVB Bank Czech Republic a.s.** entered into the following contracts within the accounting period 1.1.2006 - 30.9.2006:

Name of the contract	Subject-matter	Date of entering into the contract
Contract to process personal data of employees	Processing of employees' personal data	28.8.2006

1.2. Živnostenská banka and the **Pioneer Group** entered into the following contracts within the accounting period 1.1.2006 - 30.9.2006:

Name of the contract	Subject-matter	Date of entering into the contract
Contract to process personal data	Personal data processing	1.1.2006
Contract + Schedules A-C	Activities executed in connection with distribution of mutual fund certificates	1.1.2006
Annex to Contact Bank Contract dated 26.3.2004 + Schedule 1	Annex to the Contact Bank Contract	24.3.2006
Annex No. 1 to Contract for Activities Executed in Connection with Distribution of Mutual Fund Certificates	Annex to Contract for Distribution of Mutual Fund Certificates	11.9.2006

1.3. Živnostenská banka and **UniCredit Global Information Services** entered into the following contracts within the accounting period 1.1.2006 - 30.9.2006:

Name of the contract	Subject-matter	Date of entering into the contract
Agreement to Outsource Information Systems and other IT services + Schedules A-C	Agreement to Outsource Information Systems and other IT services	28.4.2006
Agreement to Transfer Rights and Obligations from Labour Relations + schedule 1-3	Transfer of rights and obligations arising from labour relationship	31.5.2006
Agreement to Outsource Information Systems and other IT services + Schedules A-B	Outsourcing of information systems and IT services	31.5.2006
Purchase Contract + Schedule 1 - Expert Opinion No. 2092/2006	Contract of purchase	1.6.2006
Lease Contract for foreign representation + schedule 1-3	Lease contract for foreign representations	1.6.2006
Annex 1 to Agreement to Transfer Rights and Obligations from Labour Relations	Annex to agreement on the transfer of rights and obligations from labour relations	30.6.2006
Purchase Contract, ŽB reg. No.: HSO0608/00/00001 + Schedule 1-4	Contract of purchase	4.9.2006

1.4. Živnostenská banka and **CAC Leasing, a.s.** entered into the following contracts within the accounting period 1.1.2006 - 30.9.2006:

Name of the contract	Subject-matter	Date of entering into the contract
Agreement to Cooperate + Schedule 1-6	Searching for potential clients of CAC leasing	7.4.2006

1.5. Živnostenská banka and **Banking Transaction Services s.r.o.** entered into the following contracts within the accounting period 1.1.2006 - 30.9.2006:

Name of the contract	Subject-matter	Date of entering into the contract
Service level Agreement	Agreement on back-office services	30.5.2006
Coordination Agreement	Coordination agreement	30.5.2006
Lease Contract for Non-resident Premises + Schedule 1-7	Lease contract for non-resident premises	1.6.2006
Agreement on Transfer of Holidays of Employees	Agreement on transfer of employees' holidays	10.8.2006

1.6. In addition to the above mentioned contracts and agreements, within the accounting period 1.1.2006 – 30.9.2006 Živnostenská banka entered into interbank, derivative and other business deals contracts under standard market conditions.

1.7. No contracts between Živnostenská banka and other interconnected persons were entered into during the accounting period 1.1.2006 – 30.9.2006.

2. Payments provided by Živnostenská banka to interconnected persons and **considerations** within the accounting period 1.1.2006 – 30.9.2006:

The Board of Directors declares that within the accounting period 1.1.2006 – 30.9.2006, all payments and considerations between Živnostenská banka and its interconnected persons were made within the scope of ordinary trade relations, i.e. under standard business conditions.

3. Other legal actions taken by Živnostenská banka in the interest of interconnected persons:

The Board of Directors of Živnostenská banka, a.s. declares that during the accounting period 1.1.2006 – 30.9.2006, Živnostenská banka did not execute any other legal actions in the interest of interconnected persons other than common legal actions normally undertaken within the scope of ordinary trade relations or common legal actions within the scope of exercising the rights of UCI as the majority shareholder of Živnostenská banka.

4. Other measures adopted or taken by Živnostenská banka in the interest or at the initiative of interconnected persons, their advantages and disadvantages:

The Board of Directors of Živnostenská banka declares that within the accounting period 1.1.2006 – 30.9.2006 Živnostenská banka did not adopt or take any measures in the interest or at the initiative of interconnected persons going beyond the scope of ordinary trade relations or the standard exercise of the rights of UCI as the majority shareholder of Živnostenská banka.

5. Detriment caused to Živnostenská banka in connection with contracts and adopted measures:

The Board of Directors of Živnostenská banka declares that Živnostenská banka suffered no detriment in connection with contracts and adopted measures.

Prague, December 13, 2006

On behalf of the Board of Directors of Živnostenská banka



Jiří Kunert
Chairman of the Board of Directors



Aleš Barabas
Deputy Chairman of the Board of Directors

SUPPLEMENTARY DATA IN COMPLIANCE WITH THE MEASURE OF THE MINISTRY OF FINANCE OF THE CZECH REPUBLIC, REF 282/73391/2001, FROM 7 DECEMBER 2001

1. Data relating to the members of the Supervisory Board and the Board of Directors

1.1. The Supervisory Board as at 30 September 2006

Name	Post	Commencement of post	Qualification	Membership of the bodies of other companies
Carmine Ferraro	Chairman	29 July 2003	university and many years of practical experience in banking	<u>Vice Chairman of the SupB:</u> UniBanka, a.s. <u>Member of the BoDir:</u> Comital Cofresco, SpA
Alberto Devoto	Deputy Chairman	27 April 2006	university and many years of practical experience in banking	<u>Member of the SupB:</u> UniBanka, a.s.
Marie Bartošová	Member	15 June 2006	university and many years of practical experience in banking	none
Ivana Burešová	Member	24 June 2004	university and many years of practical experience in banking	none
Elena Goitini	Member	27 April 2006	university and many years of practical experience in banking	<u>Member of the SupB:</u> UniBanka, a.s. <u>Member of the BoDir:</u> UniCredit Romania, UniCredit Assicura
Marco Iannaccone	Member	11 May 2005	university and many years of practical experience in banking	<u>Member of the SupB:</u> UniBanka, a.s., Bulbank (Bulgaria) <u>Director:</u> KOC Bank, Yapi Kredit Bank
Carlo Marini	Member	27 April 2006	university and many years of practical experience in banking	<u>Member of the SupB:</u> UniBanka, a.s. <u>Member of the BoDir:</u> UniCredit Leasing Romania
Carmelo Mazza	Member	27 April 2006	university and many years of practical experience in banking	none
Eva Mikulková	Member	10 June 2003	secondary school and many years of practical experience in banking	none

During the accounting period from 1 January 2006 to 30 September 2006 there were the following personnel changes: Massimiliano Moi, Uwe Kruschinski and Giuseppe Vovk resigned, while Carlo Marini, Elena Goitini and Marie Bartošová were newly elected.

1.2. The Board of Directors as at 30 September 2006

Name	Post	Commencement of post	Qualification	Membership of the bodies of other companies
Jiří Kunert	Chairman	12 May 2003	university and many years of practical experience in banking	<u>Chairman of the SupB:</u> UniBanka, a.s.
Aleš Barabas	Deputy Chairman	17 October 2005	university and many years of practical experience in banking	<u>Executive Director:</u> Zivnostenska Finance B.V.
Massimiliano Fossati	Member	17 October 2005	university and many years of practical experience in banking	none

There were no personnel changes during the accounting period from 1 January 2006 to 30 September 2006.

2. Selected quantitative ratios

- Capital adequacy*):	9,95 %
- Tier 1*):	CZK 3,336,134,000
- Tier 2*):	CZK 1,000,089,000
- Tier 3*):	CZK 0
- Total capital:	CZK 4,336,223,000
- Individual capital requirements pursuant to special regulations*):	A: CZK 3,297,089,000
	B: CZK 188,582,000
- Return on average assets (ROAA):	0.47%
- Return on average equity (ROAE):	7.11%
- Assets per employee:	CZK 69,417,000
- Administration costs per employee:	CZK 1,448,000
- Net profit per employee:	CZK 303,000

*) non-audited

ADDITIONAL INFORMATION

Anticipated future developments in the activities of Živnostenská banka, a.s.

The logical result of the European merger of HVB Group and UniCredit Group at the local level will be the merger of Živnostenská banka, a.s. and HVB Bank Czech Republic, a.s. which will be completed during the second half of 2007. Before this, UniCredit Group will reorganize its activities in Central and Eastern Europe, in particular, Bank Austria Creditanstalt AG will become a new and single shareholder of Živnostenská banka, a.s. The aim of these steps is to create new possibilities for the clients of the merged bank, giving them access to a wider range and better quality of services.

Business activities of Živnostenská banka, a.s. as per the Articles of Association

Activities resulting from the banking license:

- the activities specified in the Act on Banks in Section 1, letter
 - a) Acceptance of deposits from the public,
 - b) Provision of credits

- t the activities specified in the Act on Banks in Section 1 (3), letter
 - a) Investments in securities on own account,
 - b) Financial leases,
 - c) Money transmission services and settlement of payments,
 - d) Issuance and administration of means of payment,
 - e) Provision of guarantees,
 - f) Opening of letters of credit,
 - g) Arrangement of payment collection,
 - h) Provision of investment services including
 - the principal investment service under Section 8(2)(a) of Act No. 591/1992 Coll; on Securities, as amended (the "Securities Act"), reception and transmission of orders relating to investment instruments on the client's account, that being in respect of the investment instruments under Section 8a(1)(a) - (g) of the Securities Act,
 - the principal investment service under Section 8(2)(b) of the Securities Act, execution of orders relating to investment instruments on a foreign account, that being in respect of the investment instruments under Section 8a(1)(a) - (g) of the Securities Act,
 - the principal investment service under Section 8(2)(c) of the Securities Act, trading in investment instruments on own account, that being in respect of the investment instruments under Section 8a(1)(a) - (g) of the Securities Act,
 - the principal investment service under Section 8(2)(e) of the Securities Act, subscription in respect of issues of investment instruments or placement of such issues, that being in respect of the investment instruments under Section 8a(1)(a) - (g) of the Securities Act,

- supplementary investment services under Section 8(3)(a) of the Securities Act, safekeeping and administration of one or several investment instruments, that being in respect of the investment instruments under Section 8a(1)(a) - (c) of the Securities Act,
- supplementary investment services under Section 8(3)(d) of the Securities Act, advisory activities regarding capital structure, industrial strategy and related matters, as well as the provision of advice and services regarding mergers and acquisitions of businesses,
- supplementary investment services under Section 8(3)(e) of the Securities Act, services relating to the subscription of securities pursuant to Section 8(2)(e) of the Securities Act, that being in respect of the investment instruments under Section 8a(1)(a) - (g) of the Securities Act,
- supplementary investment services under Section 8(3)(f) of the Securities Act, advisory activities regarding investments into investment instruments, that being in respect of the investment instruments under Section 8a(1)(a) - (g) of the Securities Act,
- supplementary investment services under Section 8(3)(g) of the Securities Act, execution of foreign exchange transactions related to the provision of investment services,

- i) Issuance of mortgage bonds,
- j) Financial brokerage,
- k) Acting as a depositary,
- l) Currency exchange services (purchases of foreign exchange),
- m) Provision of banking information,
- n) Trading on own account or on the account of clients in foreign exchange and gold,
- o) Lease of safe deposit boxes,
- p) Activities directly associated with the activities specified in the banking license of the Bank.

Information about judicial proceedings

Živnostenská banka, a.s. is party to several legal disputes. As at 30 September 2006, the Bank had created a provision of CZK 22 million (31 December 2005: CZK 21 million) based on an estimate by the Bank as to the outcome of these legal disputes. The Bank's management expects that the judicial proceedings for which the provisions has been created will be completed within twelve months of the balance sheet date. Given this estimated period, the provision has not been discounted.

Živnostenská banka, a.s. is also party to several active legal disputes where the outcome is uncertain. Even if the Bank wins these disputes, in the overwhelming majority of cases the recoverability of the court-awarded amounts is by no means guaranteed. Therefore, as a precaution the Bank does not record the potential yields from these disputes in its accounts.

Information about main investments

In 2006, Živnostenská banka, a.s., invested CZK 25 million into intangible assets and CZK 62 million into tangible assets.

Risk Management

Risk management processes constitute an integral part of the Bank's activities and are a cornerstone of its sound operations. They must be further deepened and improved because the Bank is exposed ever more frequently to various risks during transactions with its clients, particularly to credit, market and liquidity risks but also to operating risk. Živnostenská banka has been paying close attention to its risk management processes. Through early identification, monitoring and measuring of risks and by applying a sophisticated structure of internal limits for individual types of risks and products, the Bank can reduce individual risks to an acceptable level. This is supported by the relatively low volume of classified loans and the Bank's overall business results.

Organization of Risk Management

Risk management processes are independent of all commercial trading activities of banks. In Živnostenská banka this process is managed by the following divisions:

- the Risk Management Division responsible particularly for market and operating risks
- the Credit Division responsible for credit risks.

Both divisions are responsible to the Chief Financial Officer. The Bank's Board of Directors covers the whole risk management process and regularly reports to the Supervisory Board.

Decision-making authority in the area of risk management rests with the respective committees, i.e. the Assets and Liabilities Committee and the Credit Committee, whose regular members also include the Bank's Directors.

In 2006, the Bank made intensive preparations for the change in the regulatory environment, reflecting the requirements of the Basel Committee on Banking Supervision and it will continue these preparations in the forthcoming years. The Bank's officials representing the individual areas of risk management are participating on a joint project with representatives from the CNB, the Czech Banking Association, the Chamber of Auditors and other banks, and they are also improving their qualification in specialized seminars.

The Bank has been trading on the OTC market and uses financial derivatives for risk management as follows:

- Interest swaps (segmented into hedging swaps and swaps to be traded);
- Currency swaps;
- Currency forwards; and
- Forward rate agreements.

Operating Risks

Risks to which the Bank is exposed and which cannot be classified as market, credit, liquidity, strategic or reputation risks, are considered operating risks. Since 2003, the Bank has been monitoring the operating risk in the individual organizational divisions. In the same year a project was launched aimed at introducing active management of operating risks on a central basis including the implementation of instruments to monitor and measure them. The project has been guaranteed by the parent bank UniCredito Italiano (UCI) and will continue in the forthcoming years. The UCI Group plans a gradual transfer to the advanced measurement approach ("AMA") in the area of operating risk management.

At the beginning of 2004, a centralized database of individual operating risk events was created in compliance with the new rules of the Basel Committee on Banking Supervision concerning the requirements for capital adequacy management. This database forms one of background components for drawing up procedures to reduce the risk of individual events and mitigating their impact and it is also used as a control of reliability of the implemented system of measures reducing the operating risk. Data is entered into the database on a quarterly basis with the help of the individual divisions of the Bank. All significant events are reported and solved without delay.

In 2005, the Bank approved several intervention plans, the fulfilment of which was regularly monitored. In the second half of 2005, some of the activities of the individual divisions were assessed from a risk viewpoint, i.e. a so-called "risk assessment" was made. A new risk assessment will be made together with an assessment of the risk level development at the end of 2006 or at the beginning of 2007. In the forthcoming period, the Bank plans to analyse different scenarios and to determine risk indicators and limits.

Market Risks

Owing to the unfavourable development of interest rates, exchange rates, and changes in volatility, the Bank is exposed to the risk of potential losses arising from its balance-sheet and off-balance sheet positions. These three factors are considered a source of market risks. The Bank can apply a set of instruments, such as Value at Risk, gap analyses by maturity or re-valuation, stress testing, and sensitivity analyses to measure the market risk. In co-operation with the parent bank UCI, it has produced a strategic document called "Investment Policy" describing in detail the sources of market risk and the processes for recognizing individual market risks by applying the following principles:

- all market risk limits are checked on a daily or weekly basis;
- risk control is independent of the Financial Markets Division;
- all new activities and products on financial markets must be analysed in detail from the viewpoint of their impact on risk management prior to their introduction to the market or inclusion into the Bank's respective portfolio;
- the parent bank's risk management and Živnostenská banka's top management must always be informed about significant changes in the Bank's risk profile, exceeded limits, new products to be introduced on the financial markets, and all significant decisions concerning market risks.

The Risk Management Division re-evaluates all market risk limits at least once a year. New limits must be approved by the Bank's Board of Directors.

The main target met in the area of market risk management in 2003 was the implementation of the Value-at-Risk (VaR) methodology. This is still being developed onwards and back-tested. The VaR methodology is used to quantify the interest risk of the Trading Book, the portfolio available for sale and newly for the Bank's overall position risk and to quantify the foreign exchange risk of the total open position in foreign currencies.

Credit Risks

With regard to its banking activities, the Bank, as a provider of loans and other credit facilities to institutional, commercial and personal customers, is exposed to credit risks connected with the ability of the counterparties to meet their obligations. In terms of the share of credit transactions in the total volume of the Bank's business activities, the credit risk constitute a substantial part of the Bank's total risk profile.

In order to assess and manage its credit risk, the Bank has drawn up internal procedures and limits to reduce and spread the risk.

Based on the joint principles of the UCI Group the Bank has prepared, and updates every year, a strategic document entitled "Credit Policy" summarizing the main principles of its credit risk management:

- control and management of risks is independent of the Bank's trade divisions;
- the distribution of credit exposures in the Bank's portfolio is judged with regard to economic activity segments, concentration (volume) of individual transactions and types of credit transactions;
- decision-making powers are classified with regard to the volume and character of credit transactions, the top management is informed and approves all transactions exceeding the limit determined in advance;
- UCI's credit risk management must be informed about all extensive transactions of the Bank exceeding the determined limit.

The main instruments for judging and managing credit risk include: credit analyses, rating systems, credit transactions collateral, and credit transactions portfolio management.

In 2005, internal rating systems for corporate clients and personal banking were put into operation in co-operation with the parent bank UCI. Such systems assess information on credit transactions and analyse the possible risk of non-payment by means of statistical methods. The rating models are graduated and re-tested to reflect the development of the volume and composition of the Bank's credit portfolio.

The Bank is preparing for the introduction of stress testing procedures and Credit Value-at-Risk.

OTHER TOP MANAGERS OF ŽIVNOSTENSKÁ BANKA, A.S.

Managing Directors

Mr Pasquale Barbaro - Retail Banking (until 31 August 2006)
Mr Petr Bartel - Risk Management Division
Mr Jan Boček – Marketing Division
Ms Vladimíra Josefiová, MBA – Human Resources Division (until 30 April 2006)
Mr Martin Macko – Financial Markets (until 31 March 2006)
Mr Petr Merežko – Private Banking Division (since 1 April 2006)
Mr Josef Pitra – Logistics
Mr Michal Provazník – Information Technology (until 31 May 2006)
Ms Jana Riebová – Human Resources Division (since 1 May 2006)
Mr Michal Vančík – Private Banking Division (until 31 March 2006)
Mr Josef Vanžura – Organization Division
Mr Pavel Vinter – Financial Markets (since 1 April 2006)

Directors

Mr Miloš Bádál – Retail Credit Division
Ms Ivana Burešová - Legal Division
Mr Petr Beránek – Structured Finance and Product management Division
(since 1 April 2006)
Mr George Briford – Retail Strategy and Controlling Division (until 31 January 2006)
Mr Jakub Dusílek – Support Sales Division
Mr Jiří Eigel – Retail Sales and Distribution Management Division
Ms Monika Halířová – Regional Branch Liberec, retail Banking
Mr Petr Hladký – Corporate Credit Division
Mrs Olga Hudcová – Regional Branch Brno, Corporate Banking
Mr Vladimír Chudárek - Regional Branch Zlín, Retail Banking
Mr František Klufa – Regional Branch České Budějovice, Retail Banking
Mr Radim Kolek – Regional Branch Ostrava, Retail Banking
Mr Aleš Krátký – regional Branch Brno, retail Banking
Mr Martin Macků – Regional Branch České Budějovice, Retail Banking
Ms Lýdie Matajová – Regional Branch Pardubice, Retail Banking
Mr Miroslav Matoušek – Operations Division (until 31 May 2006)
Mr Petr Merežko - Structured Finance and Product Management Division
(until 31 March 2006)
Mr Aleš Novák – Regional Branch Praha, Corporate Banking
Ms Veronika Panáčková – Financial Division
Ms Jaroslava Pelechová - Internal Audit Division
Mr Pavel Rauscher – Regional Branch Karlovy Vary, Retail Banking
Mr Ladislav Řehák – Regional Branch Pardubice, Corporate Banking
Mrs Helena Suchánková – Retail Segment and Product Development Division
Mr Vladimír Štefánik – Regional Branch Zlín, Corporate Banking
Mr Jiří Štěgl – Regional Branch Praha, Retail Banking
Mr Luboš Váňa – Regional Branch Liberec, Corporate Banking

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