ProCredit HOLDING

2014 Annual Report

Key Figures of the Group

Consolidated Statement of Financial Position (in EUR '000)	Dec 2014	Dec 2013	% Change
Total Assets	5,968,363	5,841,734	2.2%
Loans and Advances to Customers	4,332,241	4,185,071	3.5%
Business Loan Portfolio	3,347,337	3,267,053	2.5%
≤ 50,000 EUR/USD	1,533,892	1,598,577	-4.0%
> 50,000 – 250,000 EUR/USD	1,127,155	1,044,244	7.9%
> 250,000 EUR/USD	686,289	624,232	9.9%
Agricultural Loan Portfolio	672,475	617,268	8.9%
Housing Improvement Loan Portfolio	222,493	202,411	9.9%
Other Loan Portfolio	89,937	98,340	-8.5%
Allowance for Losses on Loans and Advances to Customers	-188,471	-188,475	0.0%
Net Loan Portfolio	4,143,770	3,996,596	3.7%
Liabilities to Customers	3,992,163	3,801,895	5.0%
Liabilities to International Financial Institutions	544,140	673,076	-19.2%
Debt Securities	244,839	250,048	-2.1%
Total Equity	555,380	502,736	10.5%

Consolidated Statement of Profit or Loss (in EUR '000)			
Operating Income	387,872	407,603*	-9.9%
Operating Expenses	313,953	346,284*	-14.8%
Profit Before Tax	73,919	61,320*	19.4%
Profit for the Year	50,217	38,953	28.9%

Key Ratios			
Cost-Income Ratio	71.7%	74.6%*	-4.4%
Return on Average Equity	9.4%	7.7%	22.3%
Capital Ratio**	12.7%	12.2%	3.9%

Operational Statistics			
Number of Financial Institutions	19	22	-13.6%
Number of Staff	7,794	11,514	-32.3%
Number of Outlets	503	645	-22.0%

* *Previous years' figures are presented exclusive discontinued operations.*

** *The figures as of 31 December 2013 were calculated according to the German Banking Act and the German Solvency. Since January 2014, the Basel III requirements, implemented in Europe through Capital Requirements Directive IV and CRR, have been binding for the group.*

Contents

Combined Management Report for ProCredit Holding AG & Co. KGaA, Frankfurt am Main for the 2014 Financial Year

The Combined Management Report presents the course of business and the present situation of the ProCredit group and ProCredit Holding AG & Co. KGaA. It was prepared in accordance with sections 289 and 315 of the German Commercial Code (*Handelsgesetzbuch – HGB*) and German Accounting Standard 20 (*Deutscher Rechnungslegungsstandard 20 – DRS 20*). The Risk Report also contains the notes pursuant to IFRS 7.

This Management Report is divided into the following sections:

- **Fundamental Information about the Group** describes the key aspects of the business model and the objectives of the group.
- **Human Resources Report** describes the approach to recruitment, training and remuneration.
- **Report on the Economic Position of the Group** provides an overview of the business and financial results and covers the following subjects:
  - Macroeconomic and sector-specific environment
  - Course of business operations
  - Financial performance describing the development of the financial position of the group and the results of operations

Photo: ProCredit Bank Serbia

- **Significant Post-Balance Sheet Events** describes events that occurred after the balance sheet date but are relevant to the financial year under review.
- **Risk Report** provides an overview of the group's risk profile and describes measures taken in response to the current economic environment during the period under review.
- **Report on Expected Developments p**resents the business opportunities and discusses the potential risks for the group in 2015 and beyond.

Fundamental Information about the Group

The ProCredit group comprises 17 banks and one financial institution operating in Eastern Europe, South Eastern Europe, Central America, South America and Africa, as well as a bank in Germany, and thus has a presence in 19 countries. The superordinated company of the group is ProCredit Holding AG & Co. KGaA, based in Frankfurt am Main, hereinafter referred to as ProCredit Holding, which guides the group's operations. At a consolidated level the ProCredit group is supervised by the German financial supervisory authorities (BaFin and Bundesbank).

ProCredit banks are specialised banks for small and medium enterprises, to which we offer a comprehensive range of high quality banking services related to financing, payments and deposits that are flexibly and individually tailored to the needs of our clients. We see ourselves as the "house bank" of our clients, and attach importance to building long-term relationships with them. Our clients value a bank that works with them as an equal partner to achieve their corporate goals and which understands the specific issues facing small businesses. Our business clients are generally characterised by their formal or increasingly formalised structures, and their need for banking services goes beyond mere credit. We particularly focus on agriculture and on promoting local manufacturing firms.

The ProCredit banks view themselves as dependable and professional providers of financial services that give long-term support to sound SMEs, and in this way contribute to creating jobs, enhancing capacity for innovation, raising ecological awareness and assuming greater social responsibility. The ProCredit strategy is based on two core objectives: On the one hand, we aim to make an active contribution to the economic, social and ecological development of the "ProCredit countries", and on the other, we aim to do so in a profitable manner. Our banks are therefore normal commercial banks which aim to promote development while adhering to ethical standards. This includes in particular our commitment not to cause our clients to become overindebted.

In addition to business clients, we also address private individuals that are associated with our business clients, as well as other private clients. We offer transparent and responsible banking services with a special focus on deposits and savings. We have set ourselves the goal of promoting a culture of savings, and thus helping to bring greater stability and security to private households. This is particularly true of countries where, if one's financial situation deteriorates, one cannot rely on state support. For this reason, we design accessible savings services and we train the Client Advisers who work in our service points to explain the benefits of saving to our clients in a transparent way and to offer them savings products in a form that matches their needs. Only to a very limited extent do we issue loans to private clients, and when we do, it is essentially with a view to enabling them to accumulate assets, e.g. by financing home improvement.

The business model of the ProCredit group is straightforward. Our assets consist predominantly of loans to our clients, and our liabilities consist mainly of customer deposits. The ProCredit group does not engage in speculative lines of business and has no trading book. Thanks to the resilience of our clients, our conservative approach to risk management and our focus on building long-term relationships with our clients, the group has been able to achieve steady performance in terms of our return on equity[1], the development and quality of our loan portfolio[2] and our cost-efficiency[3] , despite the economic volatility of the markets in which we operate.

Specialised in serving small and medium-sized businesses

Our orientation towards small and medium enterprises permeates our entire organisational structure. We divide our business clients into three categories: very small, small and medium, depending on the volume of their turnover and their loans. The units that make up our branch network, as well as our Business Client Advisers (BCAs), are each specialised in serving one of these client groups in order to ensure the high quality, efficiency and effectiveness of our services.

Our so-called "very small" business clients receive a credit volume of at least EUR 10,000. The category of "small" business clients starts from a credit volume of EUR 50,000, and we define clients with credit volumes exceeding EUR 250,000 as "medium" enterprises.

Business clients in all three categories are served on an individual basis by BCAs specifically trained for that particular category. Each business client is assigned to a BCA whom they can contact directly, who is familiar with the company and who can therefore offer appropriate advice.

Very small businesses are served at our "service centres", while small and medium enterprises are served at our "branches". The main point of contact for both our business and our private clients are our "service points", which for the most part are equipped with technologically advanced 24/7 self-service areas. The service point is where various financial services related to payment transactions are carried out, and where our business clients' accounts are managed; at the same time, it provides the full range of services available to private clients. These service points are the public face of our banks, supporting our positioning as a modern and competent bank that offers friendly service.

The range of services is tailored to our target groups. In our credit operations, we offer individual solutions to finance fixed assets and working capital, as well as to cover our clients' short-term liquidity needs. For example, we are experts in financing agricultural businesses. In addition, we have developed a line of energy efficiency loans and "Green Finance". Our payment and account-based services range from modern e-banking, cards and automated payments, to documentary business (letters of credit and guarantees) and trade finance, to salary accounts for employees, and also include various deposit and savings products.

[1] Our return on equity is defined as follows: Net income for the year attributable to the shareholders of the parent company, divided by the average equity held by the shareholders of the parent company.

[2] Measured in terms of the indicator "PAR 30": Loans and advances to customers on which individual instalments are more than 30 days past due as a percentage of the total volume of loans and advances to customers.

[3] Measured in terms of the indicator "cost-income ratio": Operating expense as a percentage of the operating income before provisioning expenses.

Our responsibility

The ProCredit group is committed to certain principles and values which guide our business operations and our decisions. They can be summed up in the following five key principles:

- Transparency
- Open communication
- Social responsibility and tolerance
- High professional standards
- Personal integrity and commitment

These principles are also reflected in our Code of Conduct; they are regularly discussed and are actively applied in our daily operations both with clients and with staff.

Another important principle underlying our development policy vision is the ecological and social sustainability of the economic development we support. The ProCredit group has developed a comprehensive environmental management system based on three pillars: The first pillar comprises internal measures aimed at reducing the negative environmental impact of the banks themselves, by lowering their consumption of energy and materials, and minimising their waste production. The second pillar aims to reduce the external impact of our lending operations through a detailed assessment of the environmental impact of clients' activities. The third pillar refers to the development of a "green loan" portfolio through the financing of client investments in energy efficiency, renewable energy and environmentally sound projects.

Furthermore, the ProCredit group places strong emphasis on ensuring that our institutions are not used as a vehicle for money laundering, terrorist financing and other illegal activities. All ProCredit banks likewise work emphatically to combat the risks of fraud. In addition to our uniform policy framework, which applies to all our banks and is fully compliant with German, European and local regulations, the greatest safeguards against risks of this kind are the efforts made by our staff to know our clients well, combined with our staff's strong business ethics and our frequent open communication.

The organisation of the ProCredit group

The group divides its business operations into regional segments. ProCredit institutions operate in the following six regions:

- **South Eastern Europe**, with seven banks located in Balkan countries, accounting for 45.0% of the group's total assets: Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, Macedonia, Romania and Serbia
- **Eastern Europe**, with four banks located in countries currently or formerly belonging to the Commonwealth of Independent States (CIS), accounting for 13.5% of the group's total assets: Armenia, Georgia, Moldova and Ukraine
- **South America**, with three banks accounting for 15.5% of the group's total assets: Bolivia, Colombia and Ecuador
- **Central America**, with three banks accounting for 5.1% of the group's total assets: El Salvador, Mexico and Nicaragua
- **Africa**, with one bank (D.R. Congo) accounting for 2.4% of the group's total assets
- **Germany**, with ProCredit Bank Germany, ProCredit Holding, Quipu and the ProCredit Academy in Fürth, accounting for 18.4% of the group's total assets

ProCredit Holding is the "superordinated company" of the group. It is responsible for maintaining an adequate level of capital for the group and ensuring that all reporting, risk management and compliance obligations required under German banking regulations, specifically as defined in section 25a of the German Banking Act (*Kreditwesengesetz – KWG*), are met throughout the group. ProCredit Holding also provides equity and debt funding to its subsidiaries. ProCredit Holding has 149 staff members, including 46 employees who have been seconded to ProCredit banks or who work at the regional academy in Colombia, an operational unit of ProCredit Holding.

The management and staff of ProCredit Holding are strongly involved in guiding the operations of group banks, especially with regard to HR and professional development. ProCredit Holding sets the overall policy guidelines and standards regarding the key areas of banking operations and ensures that appropriate organisational structures and procedures are in place in the ProCredit banks.

Via membership of local supervisory boards, ProCredit Holding is also involved in the appointment of the banks' management board members. ProCredit Holding takes the lead in the development and delivery of curricula in the central ProCredit Academy in Fürth, Germany and the group's regional academies, a training programme that all managers of ProCredit banks are required to complete. It also facilitates the exchange and dissemination of best practices by holding regular seminars, workshops and trainings on specific topics.

Quipu GmbH is the dedicated software provider for the ProCredit group. It is a 100% subsidiary of ProCredit Holding and had 169 staff as of end-2014. Good IT infrastructure and banking software systems are central to the group's business and risk management strategy. The systems used in connection with client operations, treasury functions, reporting and accounting are developed and maintained by Quipu in close collaboration with the banks in order to address their needs adequately and efficiently. The IT and software development priorities are set in the Group IT Strategy and approved by the Management of ProCredit Holding.

ProCredit Bank Germany started its operations in 2013. The bank aims to support the ProCredit group by making low-cost funding and international payment options available to the ProCredit banks. It also plays a central role in the group treasury function. ProCredit Bank Germany also brings its international expertise to the German market, with a particular focus on financing investments in renewable energy. It offers internet-based savings services in Germany as well as co-financing for medium business clients of the ProCredit banks, initially in Bulgaria, Romania and Serbia. ProCredit Bank Germany has 55 staff members.

Our shareholders

The shareholders of ProCredit Holding, a small group of private and public sector institutions which have been guiding the activities of the group since its foundation, make a very important contribution to the success of the ProCredit group. These owners are equally interested in the banks' developmental impact and in their commercial success. The largest and most important single shareholder is IPC GmbH, which holds 18.4% of the shares. IPC GmbH, a Frankfurt-based consulting firm that has been active in development finance for 35 years, was a key initiator behind the founding of the ProCredit group and continues to have a lasting influence on its development. IPC Invest GmbH & Co. KG, consisting of three affiliated legal entities, holds 5.5% of the shares. IPC Invest was founded by a group of (former) IPC staff members and is currently owned by approximately 950 employees of the ProCredit group. The Dutch DOEN Foundation holds 13.3% of the shares. The DOEN Foundation is financed by the Dutch Postcode, BankGiro and Friends lotteries, which aim to promote a green, socially integrative and creative society.

Five of the shareholders are internationally operating development finance institutions: KfW (13.6%), acting on behalf of the German Federal Government and other entities, finances investments and accompanying advisory services in developing countries and emerging economies with the aim of creating sustainable, integrative financial systems. IFC, the International Finance Corporation (10.3%) is a member of the World Bank Group and is the world's largest development institution focused exclusively on the private sector. Shares in ProCredit Holding are also held by the Belgian BIO (5.7%), the Dutch development finance institution FMO (5.3%) and the French development bank Proparco (2.9%).

TIAA CREF (10%) is a leading US provider of pension fund services with assets totalling USD 500 billion under its management. The Omidyar-Tufts Microfinance Fund (5.2%), which is part of the US Tufts University Foundation, invests in the financial services sectors of emerging economies and developing countries. ResponsAbility (four funds together holding 5.2% of the shares), headquartered in Switzerland, is one of the world's leading independent asset managers that invest in developmentally relevant sectors of emerging economies. The Salvadoran foundation FUNDASAL holds 1.9% and is a non-governmental organisation which supports municipal projects. MicroVest (1.6%), a private consulting firm based in the US, is registered with the US Securities and Exchange Commission (SEC) and manages a number of specialist funds. GAWA Microfinance Fund (0.5%), based in Luxembourg, is a fund for investments in sustainable development projects.

ProCredit Holding has the legal form of a partnership limited by shares. The general partner of ProCredit Holding AG & Co. KGaA is ProCredit General Partner AG, a small independent company owned by the core shareholders (IPC GmbH, IPC Invest GmbH & Co. KG, DOEN, KfW and IFC). The legal form "KGaA" allows ProCredit Holding to increase its capital without diluting the influence of its core shareholders. This ensures that the group will continue to pursue its twin objectives, "development impact and commercial success".

Human Resources Report

The key to the ProCredit group's success is our employees, who put our "house bank for small and medium businesses" approach and our business philosophy into practice in the 19 countries in which we operate. Responsible financial intermediation requires staff who are willing and able to establish long-term relationships with our customers and to provide them with efficient and effective service in a competent and friendly manner. A well-developed approach to staff recruitment, training and remuneration is therefore a central component of the ProCredit group's business model. In order to ensure a transparent, fair and long-term approach to staff-related issues, we have developed group-wide standards for HR management.

Staff recruitment and the Young Bankers Programme

Our disciplined approach to recruitment illustrates our commitment to a certain way of doing business. We seek individuals who are honest, down-to-earth and willing to learn. They should enjoy working with clients and colleagues, take an interest in the world around them and have a good instinct for business. Our staff and managers also need sound analytical abilities, a professional approach and the capacity to develop good judgment skills. We also value candidates from various educational and professional backgrounds, as we believe in the advantages provided by diversity in our teams.

The ProCredit recruitment process is unusually rigorous compared to the norm in the countries in which we work, where often “who you know” counts more than what your potential is. On average only two out of 100 applicants are offered an employment contract with a ProCredit bank. After passing through the steps of a standard selection procedure, such as a written application, mathematics and logic tests and interviews, successful candidates are invited to attend a two-week “Focus Session”. Here they not only have the chance to demonstrate that they possess the required social, communication and analytical skills but also get an insight into ProCredit as an institution and as an employer.

Selected candidates then attend a six-month training programme (“Young Bankers Programme”), which covers all aspects of our responsible banking approach and challenges participants to take responsibility for making their own contribution to ProCredit and to building a fair financial sector. The ProCredit group’s Young Bankers Programme helps young people to make the right choices about their career and helps ProCredit identify people who have the potential to contribute over the long-term to the development of “their” ProCredit Bank.

Training and the academies

After joining ProCredit, a career-long professional development path is available to each employee. We have a particular focus on developing the broad-based client advisory skills of our Business Client Advisers (BCAs), in terms of correctly evaluating the needs of our clients for banking services, assessing credit risk and building long-term customer relationships. Training for our Client Advisers (CAs) focuses on processing transactions and in particular on advising clients about our account and savings services.

At the same time, the training of our middle managers is an essential part of our approach, in particular the training provided to our Service Centre Heads and Branch Managers who manage our relationships with business clients. In order to ensure that the quality of training is consistently high group-wide, the group operates academies in Macedonia, Colombia and Germany, and has developed its own curricula for them. Alongside training on the principles of banking and courses on communication and leadership skills, there are units dedicated to philosophy, anthropology and history. So far, more than 650 of our current employees have graduated from or are currently attending the academies.

The regional academies in Macedonia and Colombia provide intensive training for middle managers, typically over six two-week periods per year.

At the ProCredit Academy in Germany we provide a three-year, part-time course for our future high-level managers. The course covers all key areas of banking, financial analysis and business development. It also includes ethics, development economics, history, anthropology and political theory, as well as a wide range of management and communication skills.

Remuneration

Rather than paying short-term, erratic bonuses we apply a transparent salary structure that focuses on fair fixed salaries combined with long-term development prospects which are based on regular dialogue with each member of staff about performance and expectations. Offering short-term bonuses is not how we ensure that our staff perform well. The manner in which senior managers communicate with their employees on a day-to-day basis is the principal staff management tool within the ProCredit group.

In order to ensure that the principles on which staff compensation is based are uniform throughout the ProCredit group, a group-wide salary system has been introduced, which defines the relationships between the salaries for various positions and the training courses which are required for each specific position. Our employees appreciate the transparency of our remuneration structure as well as the long-term and transparent career development prospects which are available to them.

Remuneration and promotion are primarily linked to performance appraisals. Managers give regular feedback to their employees throughout the year. Combined with an annual staff conversation with a representative of the senior management, this allows each employee to establish a professional development plan together with the institution.

Essentially, the core of ProCredit's approach and also the key to our competitive edge is the way our staff interact with one another and with clients. We make considerable demands on our employees, but we also have plenty to offer in return: a challenging and friendly working atmosphere, a lean organisational structure and long-term career development prospects. The strong commitment and integrity of our employees, the constant sharing of experience, and the clear vision of our identity and objectives represent a very strong foundation for sound and sustainable development in the future.

Report on the Economic Position of the Group

Macroeconomic and sector-specific environment

The performance of ProCredit banks in the different regions is significantly influenced by the overall macroeconomic environment prevailing in our countries of operation, since this impacts both the real economy and the investment appetite of our business clients, as well as the growth and behaviour of competitor financial institutions. The brief analysis provided below of the economic and recent competitor trends in the different regions is based on data from the IMF (World Economic Outlook database of October 2014) and the World Bank (Global Economic Prospects Report, published in January 2015), unless otherwise stated.

South Eastern Europe

The bulk of the ProCredit group's assets are in the ProCredit banks in South Eastern Europe or the Balkans. As in 2013, the macroeconomic environment in 2014 was subdued. Somewhat more buoyant conditions were expected for the year, but in the end poor performance in the Eurozone, slow growth in the Russian Federation, the uncertainty created by the Ukraine conflict and political stagnation in individual countries negatively impacted development in this region.

Most of the Balkan countries of South Eastern Europe experienced little GDP growth (typically below 2%) and stagnation in the banking sector. The performance of the group is strongly impacted by the performance of its three largest institutions, the ProCredit banks in Serbia (estimated GDP contraction of 2% in 2014, compared to growth of at least 2% in 2013), Kosovo (estimated GDP growth of 2.6% in 2014, compared to 3.4% in 2013) and Bulgaria (estimated GDP growth of about 0.5% in 2014, in line with 2013), which together account for 29.7% of the group's total assets.

Romania and Macedonia showed somewhat more positive trends, with GDP growth of 2.6% and 3.3%, respectively. Particularly in Romania, domestic demand is picking up along with a noticeable improvement in consumer confidence and the prospect of EU investments. Albania and Bosnia remain economically and politically stagnant.

There is little growth in the loan portfolios of Balkan banks. Deposit volumes in some countries are growing a little (by less than 5%), which is exerting greater downward pressure on asset-side interest rates. Asset quality in the region has likewise failed to improve: NPL ratios still exceed 15% in most countries. Kosovo is a notable exception here, due to the fact that ProCredit Bank plays the leading role in the banking sector. Asset quality continued to decline in the Bulgarian and Serbian banking sectors. In Bulgaria, the sector was further impacted by the collapse of the Corporate Commercial Bank Group.

Despite low asset growth and high NPLs, competition and pressure on interest rates in the South East European markets remained strong in 2014, particularly for loans to small and medium enterprises. Interest rate pressure was reinforced in many markets by high-profile subsidised lending programmes. Competition in Balkan countries comes above all from relatively strong Western banking groups such as Raiffeisen, Intesa and UniCredit, who sustained their focus on retaining good SME clients in 2014. Nevertheless, ProCredit's positioning as a highly specialised bank for SME finance has proven rather successful.

Given low GDP growth, still tight government budgets and limited consumer confidence, the investment appetite of business clients and their demand generally for banking services continued to be muted across most of our South Eastern European countries in 2014. Demand on the credit side was above all for working capital loans, despite incentives provided for investment loans. In the agricultural sector, however, demand continued to be steady. Given the still difficult overall environment, the ProCredit group focused above all on acquiring promising clients in a targeted way and on deepening business relationships with such clients.

Overall, the performance of the ProCredit banks in South Eastern Europe was stronger than most competitor banks. In Serbia, Bulgaria and Kosovo, the ProCredit banks were among the two or three most profitable banks, with higher asset quality than the competitors. In most countries, management concludes that loan portfolio growth in the ProCredit banks outpaced average market growth rates for our core client categories.

Eastern Europe

Our countries of operation to the East of the Balkans are strongly impacted by developments in Russia and Ukraine. The whole of Ukraine has been severely affected by the conflict in the eastern regions and economic output has declined sharply, with an estimated drop in GDP of 8% in 2014. The economic situation in Armenia and Moldova is strongly influenced by developments in Russia, as exports to and remittances from the Russian Federation are important economic factors. As a result, GDP growth in 2014 was markedly below 2013 levels (in Armenia 2.6%, compared to 3.5% in 2013; in Moldova 2%, compared to 8.9% in 2013). The Ukrainian hryvna, Armenian dram and Moldovan lei all experienced significant devaluation in the course of 2014, both reflecting and exacerbating macroeconomic uncertainty. For the countries most strongly linked to Russia (Armenia and Moldova), the outlook remains difficult. In this region, only Georgia witnessed improving market conditions, with GDP growth of 5% in 2014, up from 3.5% in 2013.

Competitors in our Eastern European countries of operation are more broadly distributed, often local and regional market players, and are generally weaker and less developed than in South Eastern Europe. As a result, there are significant opportunities for the ProCredit banks even in depressed markets, where competitors are also tentative. Therefore, in Ukraine, Armenia or Moldova, where ProCredit banks are relatively small in the market, above-average loan portfolio growth rates are achievable in our core client categories. Competition for deposits tends to be strong in these less developed markets. This is particularly the case where the local currency is under pressure, which pushes up the cost of funds.

South America

The South American countries in which the group operates experienced stronger growth in 2014 than South Eastern and Eastern Europe, albeit slower than the previous year. In Bolivia GDP growth in 2014 is estimated to be about 5%, compared to more than 6% in 2013. In Ecuador GDP growth of 4% (4.5% in 2013) was recorded, although falling oil prices are expected to impact Ecuador in the future. In Colombia GDP growth was steady at about 4.7%, consistent with the previous year, although the Colombian peso depreciated significantly against the US dollar in 2014.

The banking sectors in all three countries recorded growth in 2014, although at a somewhat lower rate than in 2013. Interventions in the banking sectors by the regulatory and fiscal authorities of Bolivia and Ecuador are very substantial but also predictable. In Bolivia, where our largest bank in South America is located, lending to the private sector has increased by an average of 20% in each of the last three years. The new financial services law and banking code, which is supposed to regulate access to financial services, sets lending quotas and caps lending rates for different sectors. President Evo Morales was re-elected for a third presidential term, contributing to political stability in the country and indicating a continuation of current policies concerning the banking sector. Although these circumstances make the operating environment challenging, they have had only limited direct impact on Banco Pyme Los Andes ProCredit Bolivia. In Ecuador banking sector growth was more subdued, and here too a new banking law was passed. Nevertheless, as in Bolivia the direct impact on the ProCredit bank is likely to be limited.

Competition in Latin American markets comes from well-established local banks. The ProCredit banks have a strong position as a provider of high quality and efficient banking services for SMEs. Market lending rates are slightly higher in Latin America than in South Eastern Europe. The average interest income on loans from ProCredit banks in South America is 14.7%, compared to 10.6% in Eastern Europe. This reflects the somewhat lower competitive pressure in these markets, although competition in the SME sector is also strong in Latin America. Economic formalisation is not advancing in Latin America as noticeably as in Eastern Europe, and very small businesses continue to employ the bulk of the population. Growth potential among our very small and small business client categories is good. In 2014 the three South American banks grew by 8.1% in the USD 10,000–500,000 segment, though this was partly influenced by exchange rate fluctuations. In the past, very small loans (exposures below EUR 10,000) accounted for a relatively large share of the portfolio in South America, which is why there was a significant decline of around EUR 102.1 million in this category in 2014.

Central America

Our Central American countries of operation (Nicaragua, El Salvador and Mexico) remain difficult, with severe security problems and still limited stimulus from the US despite gradual recovery in the American economy. GDP growth in 2014 was estimated to be 1.9% for El Salvador, 2.1% for Mexico and 4.2% for Nicaragua. The somewhat more positive developments in Nicaragua were supported by stronger coffee and beef prices. ProCredit exited Honduras at the end of 2014 largely in response to the security situation and limited market growth potential in the SME sector.

Generally, banking sector development is flat in Central America. The Central American countries in which ProCredit operates have underdeveloped SME sectors that limit the potential for strong growth and sustainable economies of scale.

Africa

In 2014, ProCredit Holding sold its shares in the ProCredit institutions in Mozambique and Ghana. This leaves ProCredit Bank Congo as the only group institution operating on the African continent. The macroeconomic and political environment was relatively stable in the Democratic Republic of Congo in 2014, with GDP growth of around 8%. The banking sector continues to show strong expansion, although growth rates have slowed.

Germany

Still a small start-up institution, ProCredit Bank Germany is not strongly influenced by the external environment. Overall the economic environment in Germany is stable. The low interest rates prevailing in the country have slowed the bank's progress towards becoming profitable.

Course of business operations

In 2014, the group was able to further pursue the development initiated in previous periods while also achieving growth in terms of both volume and profitability. In particular, we were successful in expanding our business with our core target groups and achieved higher growth rates than our competitors.

Our strategy centres around competent Business Client Advisers (BCAs) responsible for serving one of our client segments – very small, small or medium enterprises – and who in their lending operations focus on clients requiring loan amounts exceeding EUR 10,000. In addition to bearing responsibility for acquiring clients and maintaining business relationships, BCAs also perform analyses of the financial and business position of our clients, particularly our very small and small business clients. Our BCAs are thus in a position to provide useful advice that is based on the client's real needs instead of merely acting as sellers of banking products. In this way, we are able to meet our goal of getting to know our clients very well, thus laying the foundation for a long-term business relationship based on trust. Our aim is to further strengthen our position as a specialised partner for these businesses. Therefore, in addition to our lending activities we are placing greater emphasis on deposit-taking and transactions with business clients.

Another major focus in 2014 was on further optimising the structure of our outlet network. Building upon the previous year's efforts to clearly orient our outlets towards the various client groups, we further refined our approach to achieve greater efficiency in 2014. The total number of outlets decreased from 645 to 503 (partly due to the sale of the banks in Mozambique, Ghana and Honduras, which reduced the number of outlets by 48).

Despite this reduction in the number of physical locations, we have expanded our presence in the areas where our target client groups are mainly based, and strengthened our teams. Furthermore, we have begun to expand our modern service points, including 24-hour zones in attractive locations, and this effort will continue in 2015.

Lending

At the end of the year the loan portfolio stood at EUR 4.3 billion (compared with EUR 4.2 billion at end-2013). This meant that growth of EUR 147.2 million (3.5%) was achieved.

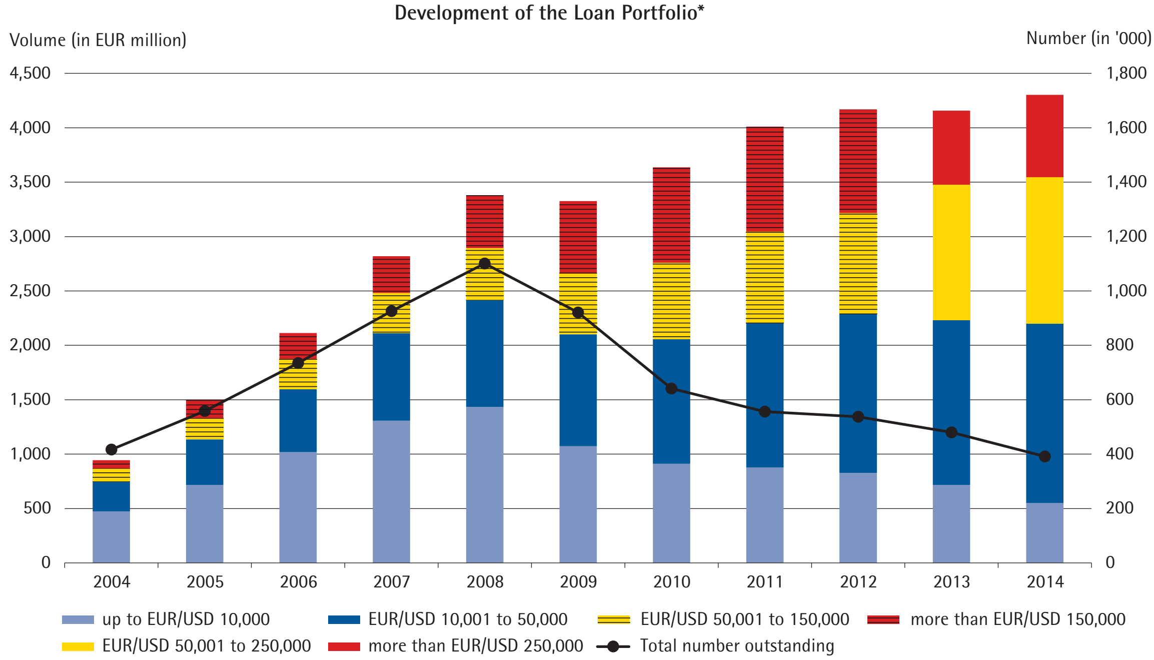
Growth in lending to our strategic target clients, at 9% on average, was significantly stronger. Here we grew the loan portfolio by EUR 312 million in 2014. This more than made up for the strategic withdrawal from operations involving loan amounts under EUR 10,000 per client, which reduced the loan portfolio by roughly EUR 160 million. It also offset the one-off effects of selling the banks in Ghana, Mozambique and Honduras, which shrank the loan portfolio by EUR 100.6 million.

Loans with an initial amount below EUR 10,000 comprised 12.8% of the total loan portfolio at the end of 2014 (2013: 17.2%). Loans between EUR 10,000 and EUR 50,000 (typically to "very small" business clients) accounted for 38.3% of the total portfolio. Loans in excess of EUR 50,000 up to EUR 250,000 (generally taken by "small" business clients) made up 31.3% of the group's credit volume. The remaining 17.6% were loans for amounts exceeding EUR 250,000 ("medium" business clients), more than three-quarters of which were for amounts below EUR 1 million.

Altogether, reducing the number of individual loans disbursed and increasing the average loan amount had the desired positive effect on efficiency.

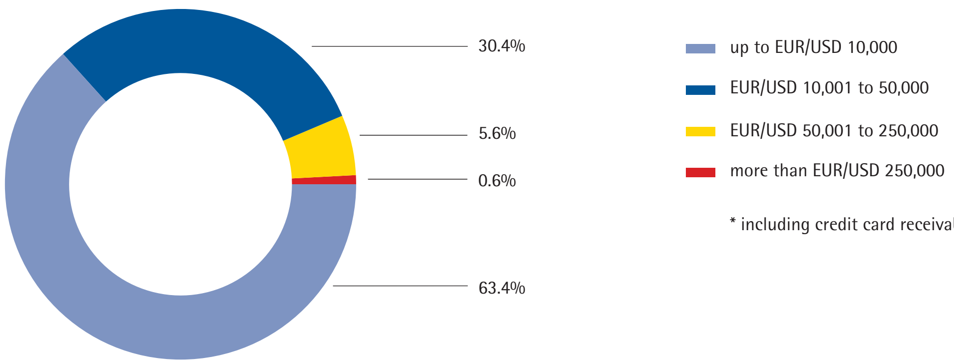
Unlike the previous period, in 2014 each of the geographical regions where we operate showed loan portfolio growth (except Africa, solely due to the sale of the institutions in Mozambique and Ghana). The strongest growth was recorded in South America and Eastern Europe. In terms of lending volume, 17.0% of the group's total portfolio is in Eastern Europe, with 19.6% in South America.

Development of the Loan Portfolio*



(*) Starting from 2013, new volume splits applied

Breakdown of the Number of Outstanding Loans by Loan Size*



* including credit card receivables

In 2014 we were again able to achieve growth in lending to agricultural businesses. We recorded a total increase of 8.9% in this category. Agricultural loans now account for 15.5% of the total loan portfolio, slightly higher than in the previous period. The decision to discontinue the granting of loans below EUR 5,000 (and in some countries EUR 10,000) had a particularly striking impact on agricultural lending. Nevertheless, the portfolio of loans above the EUR 10,000 threshold grew by an encouraging 18.7% in 2014. Those ProCredit banks that focused on agricultural lending were able to reinforce their positioning and further expand their market share.

Housing improvement and energy efficiency loans for private households represented 5.1% of our total loan portfolio. As ProCredit banks do not actively promote consumer loans, these exposures make up only 1.5% of the total loan portfolio.

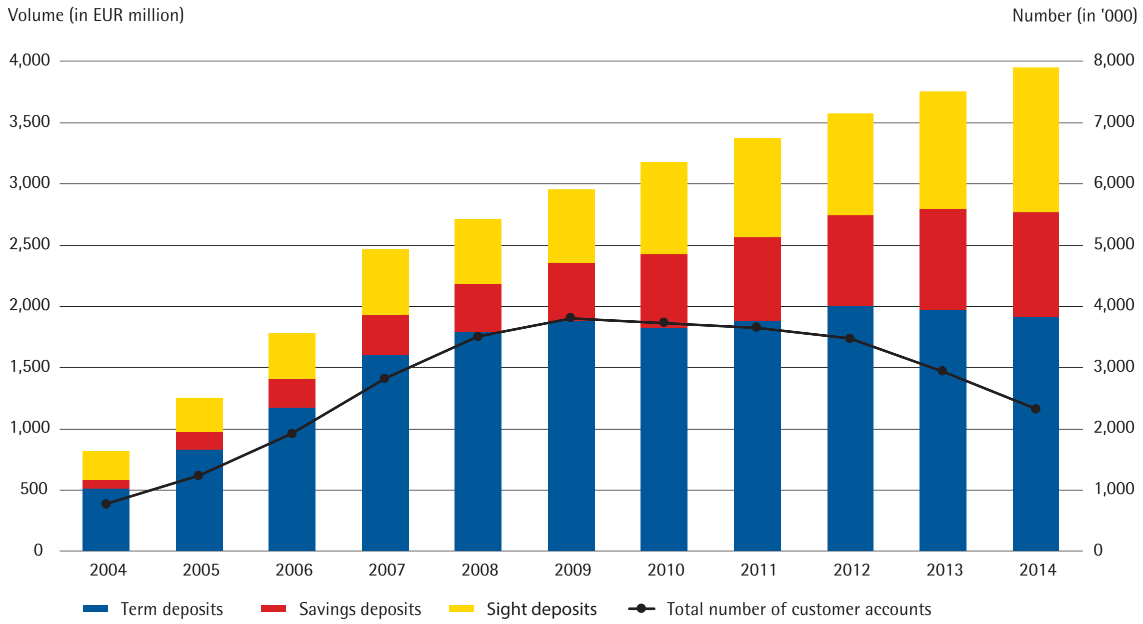
Loan portfolio quality at the ProCredit banks is typically much better than the average in their markets, reflecting our commitment to knowing our clients very well and providing them with products and services which are tailored to their individual needs. At the end of 2014, our key indicator of portfolio quality, PAR 30, stood at 4.6% (2013: 4.7%); at the same time, PAR 90 was 3.8% (2013: 3.7%). This high loan portfolio quality was achieved despite the difficult situation in Ukraine and the flooding that hit Serbia and Bosnia and Herzegovina.

Deposits and other banking services

The volume of customer deposits totalled EUR 4.0 billion as of end-2014, which is 5% higher than 2013. The ratio of deposits to loans stood at 92.2%. Following planned reductions in surplus liquidity in the first quarter of 2014, deposit volume resumed its upward trend in Q2 and Q3 in line with the uptake in lending.

The structure of deposits has improved: sight deposits and savings grew while term deposits decreased.

Development of Customer Deposits*



(*) excluding accrued interest

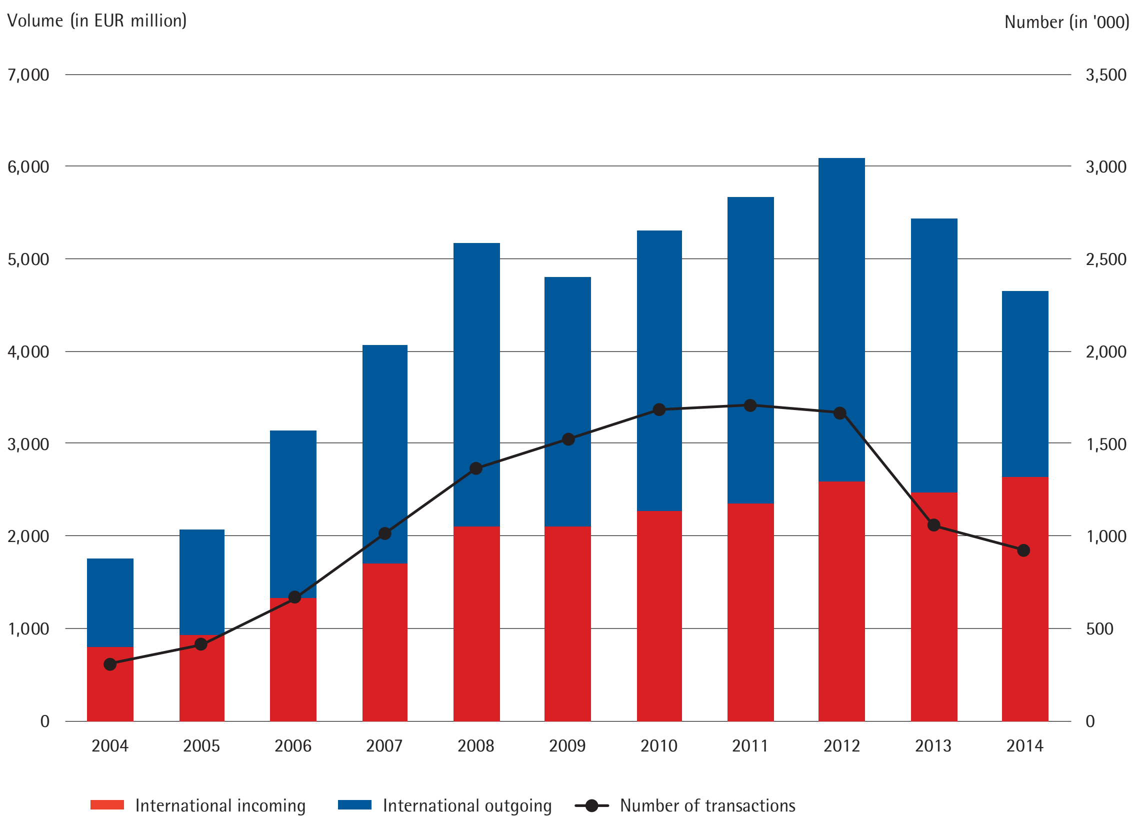
Photo: ProCredit Bank Romania

In 2014 31.7% of the deposit base was held by business clients and 68.3% by private clients.

As a partner for our small and medium business clients, in 2015 we aim to further strengthen our business relationships with this target group by placing greater emphasis on mobilising deposits from business clients and expanding payment transactions in our target client segment.

In 2014 we were able to divert a growing proportion of transactions to our e-banking platform (65% of eligible transactions were actually performed online) by offering a range of modern, user-friendly and competitive electronic banking services. In addition, the use of our self-service areas has increased further. These special zones, which allow private and business clients to access a wide range of services and perform transactions around the clock, have been and will continue to be expanded, thereby underscoring our commitment to being a progressive, modern bank with services that are easy to use and are based on the needs of our clients.

Development of International Money Transfers



Ratings

In 2014, most institutions in the group again received an international rating (ProCredit Holding and the banks in Eastern and South Eastern Europe) or a national rating (Latin America) from FitchRatings. Typically our banks are rated at the country ceiling. The downgrading of the ProCredit banks in Albania and Ukraine was due to the downgrading of the respective country ceiling. ProCredit Holding's investment grade rating of BBB- was raised to BBB in 2014.

Institution	2014 Rating	2013 Rating	
ProCredit Holding	BBB	BBB-	(international rating)
ProCredit Bank, Albania	B	B+	(international rating)
ProCredit Bank, Bosnia	B	B	(international rating)
ProCredit Bank, Bulgaria	BBB-	BB+	(international rating)
ProCredit Bank, Georgia	BB	BB	(international rating)
ProCredit Bank, Kosovo	B+	B	(international rating)
ProCredit Bank, Macedonia	BBB-	BB+	(international rating)
ProCredit Bank, Romania	BBB-	BB+	(international rating)
ProCredit Bank, Serbia	B+	B+	(international rating)
ProCredit Bank, Ukraine	CCC	B-	(international rating)
Banco Los Andes PYME ProCredit, Bolivia	AAA	AAA	(national rating)
Banco ProCredit, Colombia	AA+	AA+	(national rating)
Banco ProCredit, Ecuador*	AAA-	AAA-	(national rating)
Banco ProCredit, El Salvador	AAA	AA+	(national rating)
Banco ProCredit, Nicaragua	AA+	AA+	(national rating)

** by Bankwatch Ratings S.A.*

Financial performance

Overview

The financial development in 2014 was satisfactory. Despite difficult macroeconomic conditions, the ProCredit group was able to hold its position and remain competitive, even expanding in a number of markets. The profit situation of the group improved significantly, in spite of the internal restructuring processes and the prevailing economic conditions. The ProCredit group recorded an after-tax profit of EUR 50.2 million in 2014, an increase of EUR 11.3 million over the previous year. The return on average equity rose from 7.7% at the end of 2013 to 9.4% in 2014.

In the 2014 financial year we further accelerated the pace of withdrawal from the segment of very low-volume business loans. Focusing on our core client groups and adjusting the structure of our branch networks accordingly has enabled us to achieve loan portfolio growth in precisely the client categories we aim to serve. The consistent drive to shed our portfolio of loans under EUR 10,000 was not considered in the Business Plan; nor was the sale of institutions. As a consequence, the growth of the loan portfolio in 2014 fell short of the originally projected figure.

Deposits from our clients represent the most important form of funding for our assets. The ratio of customer deposits to the loan portfolio remained at a constantly high level throughout 2014 and ended the year at 92.2%, which is above the target of 86.3%. The share of current account deposits in total customer deposits likewise grew from 26.2% to 30.8% during the course of the year.

The net interest margin fell during 2014 from 7.4% to 6.5%, and thus below the planned level of 7.1%. This is partly due to the global trend towards low interest rates, but also to the deliberate withdrawal from high-interest microlending. Microloans generally have higher nominal interest rates – although they too are currently falling – but carry an above-average risk of default. Furthermore, this segment is associated with high operating expenses. As total portfolio growth was below plan and the net interest margin showed a stronger-than-expected decrease, the group's net interest income of EUR 386.5 million in 2014 fell short of the planned EUR 428.7 million.

The focus on small and medium-sized businesses led to reduction in the size of our branch network. In line with this development, the number of staff also declined further in 2014. This in turn led to a significant reduction of personnel expenses, despite the increase in per capita personnel expenses reflecting the higher demands placed on our staff. Operating costs stood at EUR 314.0 million in 2014, which is EUR 46.8 million lower than the EUR 360.8 million planned for the period, thus offsetting the reduction in net interest income.

The financial position and financial performance of the group are solid. The group as a whole and each individual institution in the group remained at all times in full compliance with all financial commitments.

Development of financial position

Assets

Due to our straightforward business model, the structure of the balance sheet is simple and comprises primarily customer loans and deposits. The breakdown of assets as of end-2014 was as follows: 69.4% net customer loan portfolio, 25.2% assets held for liquidity purposes, and 5.4% non-financial assets. This is nearly identical to the breakdown as of end-2013 (68.4% net customer loan portfolio; 25.7% liquid assets; 5.9% non-financial assets).

The customer loan portfolio amounted to EUR 4,332.2 million at the end of 2014, a net increase of EUR 147.2 million over the previous period, but EUR 343.5 million below the planned amount of EUR 4,675.7 million. Portfolio growth was impacted by the planned reduction in the portfolio of loans with initial amounts below EUR 10,000 (2013-2014 decrease of 23.4% or EUR 167.4 million) and by the sale of institutions (total portfolio volume of EUR 100.6 million). Although a number of local currencies in Eastern Europe depreciated during the year, the appreciation of the US dollar against the euro had a positive effect on the portfolio held in USD or USD-linked local currencies. Overall, exchange rate developments had a positive effect on customer loan portfolio volume.

In 2014, liquid assets increased by EUR 2.9 million and stayed above the planned volume. At 25.2%, the share of liquid assets in total assets remained stable compared to the previous period. The high level of liquidity was due to low growth of the customer loan portfolio, the sale of institutions and the still conservative regulatory requirements. A large share (EUR 370.2 million) of liquid assets was held in order to be able to comply with local minimum reserve requirements. Of the remaining liquidity reserves, 51.5% was placed in OECD banks or held in highly rated OECD bonds. Liquidity reserves in non-OECD countries mainly comprised central bank balances and sovereign bonds.

Non-financial assets decreased by EUR 23.5 million to EUR 320.9 million by the end of the year. The largest share (EUR 227.2 million) of non-financial assets is made up of the ProCredit group's fixed assets, which mainly comprises property and buildings. The strongest decrease within non-financial assets was in fixed assets affected by the downsizing of our branch network.

Liabilities

The most important and the largest item on the liabilities side is customer deposits. At year-end 2014, they made up 73.8% of total liabilities, up from 71.2% in 2013 and above the planned level of 71.5%. The ratio of customer deposits to the customer loan portfolio, at 92.2%, was above the 2013 level and above the target of 86.3%. The second-largest position was liabilities to international financial institutions, accounting for 10.1% (end-2013: 12.6%). Liabilities to banks made up 6.5% of total liabilities at the end of 2014, with the remainder consisting of bonds (4.5%) and subordinated debt (4.1%).

Customer deposits grew by EUR 190.3 million in 2014, thus outpacing loan portfolio growth. The share of demand deposits in total deposits increased from 26.2% as of end-2013 to 30.8%, above the 26.1% planned for the period. Growing demand deposits are not only a good source of funding, they are also an indication that an increasing number of business clients view ProCredit as their "house bank" and perform their transaction business with our banks. Savings deposits developed according to plan, representing 22.2% of the total deposit portfolio at year-end 2014. The share of term deposits fell to 47.0%. Despite their contractually agreed maturity periods, term deposits do not automatically constitute a stable source of funding. Only 26.0% of the term deposits in the group had a maturity over 12 months; moreover, in most of our Eastern European countries of operation, depositors are entitled to withdraw term deposits prior to the maturity date with only limited financial penalties.

The increase in customer deposits led to a drop of EUR 128.9 million in liabilities to international financial institutions (excluding subordinated debt) compared to the previous period. Nevertheless, liabilities to international financial institutions (IFIs) amounted to EUR 544.1 million and represented the second-largest item on the liabilities side with 10.1% of total liabilities, thereby making an important contribution to the maturity structure of the group. Liabilities to banks as well as bonds remained similar to previous periods in terms of their share in total liabilities.

At EUR 498.6 million (end-2013: EUR 532.5 million), the volume of off-balance sheet items is limited, which reflects the focus of our business model on small and medium business clients. Of this amount, 68.0% consisted of credit commitments with immediate right of cancellation, while the share of irrevocable credit commitments declined to 2.6% of the total. The other contingent liabilities consist mainly of documentary and commercial letters of credit and performance bonds. The potential liquidity risk associated with these commitments is very low.

The share of the consolidated balance sheet that is funded with equity, hybrid capital and subordinated debt increased from 12.6% as of end-2013 to 13.0% in 2014. Equity amounted to EUR 555.4 million in 2014, thereby exceeding the 2013 volume by EUR 52.6 million. The increase in equity was due to retained earnings minus dividend payments of EUR 0.20 per share in 2014, and to a reduction of EUR 18.5 million in the currency translation reserve. No capital increases were carried out in 2014. The volume of hybrid capital and subordinated debt declined slightly from EUR 230.6 million to EUR 223.2 million in 2014.

The group is supervised by the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*). The regulatory minimum capital ratios stipulated in the Capital Requirement Regulation (CRR) are set to 4.5% for the Common Equity Tier 1 ratio, 6% for the Tier 1 ratio and 8% for the total capital ratio. The ProCredit group has set stricter internal benchmarks of >9% for the Tier 1 capital ratio and >12% for the total capital ratio. With a Common Equity Tier 1 capital ratio of 10.1%, a Tier 1 capital ratio of 10.6% and a total capital ratio of 12.8% as of 31 December 2014, the ProCredit group's ratios exceed both the current regulatory requirements and the internal benchmarks.

in '000 EUR	31.12.2014	31.12.2013
Common equity Tier 1 capital ratio	10.1%	9.0%
Tier 1 capital ratio	10.6%	10.2%
Total capital ratio	**12.8%**	**12.2%**

Earnings

Group overview

The ProCredit group ended the 2014 financial year with a profit of EUR 50.2 million, which is EUR 11.3 million higher than the previous year. Profit for the year was EUR 2.4 million below the planned amount, due largely to lower-than-expected portfolio growth and the low net interest margin. In line with the improved profit situation compared to the previous year, the return on equity climbed from 7.7% in 2013 to 9.4% in 2014.

Net interest income totalled EUR 386.5 million in 2014, which is EUR 42.1 million below the amount planned for the period. In addition to the lower portfolio growth, the lower net interest margin impacted the development of net interest income. Due to interest rate developments the net interest margin fell further than anticipated, from 7.4% to 6.5%, and thus below the planned level of 7.1%.

As a consequence of lower volumes and also falling interest rates, both interest income and interest expenses were below plan. Average lending interest rates fell more sharply than expected. The average monthly rate dropped from 14.2% in January to 12.7% in May, with the year-end figure at 11.9%. The average interest rate for the year as a whole was 12.4%, which is 0.9 pp below the planned level of 13.3%. Combined with the general market interest rate developments, the reduction in the portfolio of loans with initial amounts below EUR 10,000 in particular had an impact on the average interest rate for loans, especially as that portfolio bore relatively high interest rates.

Lower funding costs compensated in part for the effect of falling lending rates. At 2.9%, the cost of funding was below the previous year's figure of 3.6% and also below the planned level of 3.3%. Average expenses for other funding fell from 4.7% in 2013 to 4.5% in 2014, which is still above the 4.3% planned for the period. The decrease in funding costs is due to customer deposits, which at year-end comprised 73.8% of the group's liabilities. The average interest on customer deposits fell from 3.1% in 2013 to 2.3% in 2014, which is 0.6 pp below the planned level for the period. The share of sight deposits and savings in total customer deposits increased as expected, rising to 53.0% as of year-end. Sight deposits made up 30.8% of total deposits, which is 4.7 pp above the level planned for the period. In combination with the overall market developments, the growing proportion of customer deposits in total liabilities and the greater share of sight deposits had a positive impact on the development of funding costs.

Loan loss provisioning expenses in 2014 amounted to EUR 55.1 million, which is equivalent to 1.3% of the loan portfolio. These provisions totalled EUR 188.5 million, roughly the same level as in the previous year. These still high provisioning levels reflect the difficult business environments in which the ProCredit banks operate. Provisioning expenses were already increased in 2013, particularly in Mexico and Colombia, and it was decided that the group would exit from regions where economic conditions and security were difficult. In 2014, political tensions in Eastern Ukraine and the flood disaster in Serbia and Bosnia and Herzegovina led to higher provisioning expenses in those countries. Allowances for lump-sum specific impairment came to EUR 39.5 million in 2014, representing a share in total allowances similar to the allowances for specific impairment, which amounted to EUR 37.4 million. Portfolio-based provisioning was low due to the limited growth of the loan portfolio.

Recoveries of written-off loans developed as expected, and the total for the year stood at EUR 18.2 million.

At 14.5%, the share of net non-interest income in total operating income was higher than in 2013, but the volume of net non-interest income remained largely constant at the previous year's level. The percentage increased because, as described above, net interest income had dropped. Net non-interest income came mainly from commission and brokerage services. In 2014 this income amounted to EUR 56.2 million, which is EUR 7.1 million above the planned amount. On the basis of the ProCredit banks' positioning as the "house bank" for SMEs, the number of clients has been significantly reduced, with a corresponding drop in income from account maintenance and transaction fees. In line with the growing use of electronic processing compared to the previous year, the number of cash transactions in 2014 was reduced by 31.7% and fee income from e-banking increased.

The focus on small and medium-sized businesses led to an optimisation of the size of our branch network and a reduction in personnel and administrative expenses. At year-end 2014, these amounted to EUR 314.0 million, which is EUR 46.8 million below the amount planned for the period and is thus more than sufficient to compensate for net interest income being EUR 42.1 million below plan.

The downsizing of the branch network, measures to enhance efficiency and the sale of institutions, the number of staff fell by 32.3% to 7,794 at the end of 2014. In contrast, personnel expenses only decreased by 12.0%. This asymmetry is due partly to severance payments to departing staff but more significantly to an increase in average staff salaries. Higher salaries are commensurate with the greater complexity of acquiring, advising and serving SME clients that match the desired profile. Total personnel expenses in 2014 stood at EUR 152.2 million in 2014, down EUR 20.7 million from the previous year and EUR 15.2 million below the level planned for the period.

In 2014, administrative expenses (including write-offs) decreased by EUR 11.7 million to EUR 161.7 million, which is EUR 31.7 million below the level planned for the period. The expenses for rent, transport, communication and marketing were EUR 8.4 million less than the planned amount. Expenses for write-offs were also lower, ending the year EUR 2.9 million below plan.

The profit for the year was only slightly negative, which was a consequence of extraordinary items totalling EUR 1.6 million. These included losses resulting from the sale of institutions. While the sale above book value had a positive impact on profits, the release of the currency translation reserves set aside for these institutions had a negative impact on the profit for the year, though without influencing the equity. Furthermore, ProCredit Holding concluded purchase agreements to acquire the minority interests held by the European Bank for Reconstruction and Development (EBRD) in the ProCredit banks in Armenia, Macedonia and Ukraine, as well as the minority interest held by Kreditanstalt für Wiederaufbau (KfW) in ProCredit Bank Armenia. The liabilities associated with these agreements were recognised at the agreed purchase prices, which had a positive impact on the profit for the year.

Segment overview

South Eastern Europe – The South Eastern Europe region is the group's largest segment. As of end-2014, it accounted for 45.0% of the group's total assets prior to consolidation. Despite the difficult operating environment and the floods in Serbia and in Bosnia and Herzegovina, the total assets for the region proved stable, and at the end of 2014 were slightly higher than a year earlier at EUR 3,260.1 million. The South East European ProCredit banks reported a sound financial position and solid results.

The loan portfolio for the region, at EUR 2,325.5 million, remained comparable to the previous year's level, in line with the development of total assets. This was attributable to a contraction of the loan portfolio in the region's largest ProCredit banks: in Bulgaria, Kosovo and Serbia (incl. SPV). The reduction of the loan portfolio as a consequence of the intentional withdrawal from the portfolio segment of loans under EUR 10,000 and the deliberate downsizing of the loan portfolio in Kosovo was offset by growth at the other ProCredit banks in the region and growth in the portfolio of loans exceeding EUR 10,000. Loans in the range EUR 10,000 – 500,000 as a share of the region's total portfolio increased from 72.5% to 75.4%. The share of loans above EUR 500,000 remained largely constant.

Customer deposits as a share of total liabilities and equity remained stable at a high level, making up 80.0% for the region as a whole as of year-end. Thanks to the high proportion of liquid funds, it proved possible to further reduce liabilities to international financial institutions and similar liabilities. At the end of 2014, the ratio of customer deposits to loan portfolio stood at 98.3%.

The relatively high level of liquid funds coupled with falling loan interest rates put pressure on the region's net interest margin. In 2014, the net interest margin declined from 6.3% to 5.8%. The average interest rate on loans decreased at all of the ProCredit banks in the region; it dropped from 11.9% to 10.6% over the course of the year. Interest income from other interest-earning assets, mainly consisting of short-term bank deposits and sovereign bonds from OECD countries, remained limited; its share of total interest income for the region fell slightly from 2.6% to 2.4% in 2014. The average income from liquid funds also declined slightly from 0.9% to 0.7% as of end-2014.

The region's banks succeeded in bringing down the average cost of funds from 3.0% to 2.3%. This reduction was due to the downward movement of interest rates for customer deposits and other borrowed funds, and the disproportionately large increase in demand deposits. In 2014, average interest expense for customer deposits dropped from 2.6% to 1.8%. Aside from the general market interest rate trends, the increased share of demand deposits in customer deposits from 29.7% to 35.6%, as well as the reduction of the share of term deposits from 50.5% to 42.8% contributed to this development. At the same time, interest rates for other borrowings fell from 4.4% to 4.2%. The growth of the customer loan portfolio was not enough to compensate for the impact of the falling net interest margin, and the fall in interest income was only partially offset by the reduced cost of funds; consequently, net interest income as of year-end was EUR 13.1 million below the previous year's figure.

Owing to the moderate growth of the region's loan portfolio coupled with the lower risk of default (measured in terms of PAR 30, which dropped from 5.4% to 5.0%), loan loss provisioning expenses decreased by EUR 6.6 million to a total of EUR 25.3 million in 2014.

Net non-interest income in 2014 came to EUR 32.3 million, and was thus very little changed in comparison to the previous year (2013: EUR 34.1 million). Within this total, net income from foreign currency transactions and from commission and brokerage services was slightly down on the previous year's result by EUR 0.8 million due to the reduced number of clients and transactions.

The focus on small and medium businesses and the change in branch network infrastructure had a positive impact in reducing operating costs, which was for the most part enough to compensate for the decline in operating profit. For the region as a whole, operating expenses decreased by EUR 10.7 million in 2014.

Personnel expenses were down EUR 6.2 million or 9.0% compared to the previous year. The number of staff in the region dropped by 23.0% to 3,421. Higher salaries to reflect the more demanding nature of the work, combined with severance payments for staff members leaving the banks, caused average personnel expenses per employee to rise by 17.1%.

Administrative expenses including depreciation costs fell by 5.8% to EUR 73.6 million. Within this figure, the fall in expenses for rent, transport, communication and marketing was EUR 4.5 million (-16.4%). While IT expenses increased by EUR 2.1 million, depreciation costs in 2014, at EUR 14.4 million, were EUR 0.8 million below the previous year's figure.

The EUR 10.7 million reduction in operating expenses in 2014 (-7.3% compared to 2013) was not sufficient to fully offset the EUR 14.9 million decline in operating profit before provisions (-6.3% compared to 2013). However, the difference was made up by the reduction in provisioning expenses. Thanks to the relatively larger drop in operating expenses, the cost-income ratio improved from 62.2% to 61.5%. In 2014, profit after taxes for the region, at EUR 51.0 million, was at a level comparable to the previous year's profit. The region thus reported a return on equity of 12.8%, as against 13.4% in 2013.

Eastern Europe – As of end-2014, the Eastern European ProCredit banks accounted for 13.5% of the group's total assets prior to consolidation. The region's total assets increased from EUR 911.2 million to EUR 978.6 million. Despite the challenging business environment and the political tensions in Ukraine, all four ProCredit banks in the region were profitable in 2014.

In 2014 the region's loan portfolio grew by 10% from EUR 669.0 million to EUR 735.7 million. The largest contribution to this growth came from the two largest ProCredit banks in the region, Georgia and Ukraine, which grew by a combined total of EUR 53.6 million. The loan portfolio in the size category up to EUR 10,000, which accounts for a smaller share of the total than in the other regions, declined by EUR 14.2 million in 2014. This drop was more than offset by growth in the EUR 10,000 – 500,000 range. This size category made up 82.8% of the region's loan portfolio in 2014. At the same time, the share of loans exceeding EUR 500,000 increased from 6.1% to 8.0%.

Customer deposits accounted for a very high 68.7% share of total liabilities as of end-2014, yet in comparison to the 73.8% reported at group level, their share is relatively low here. Liabilities to international financial institutions and similar liabilities dropped by 7.9% in 2014 compared with the previous year. At the end of 2014, the ratio of customer deposits to loan portfolio stood at 80.0%.

The net interest margin for the region, starting the year at 7.7%– higher than the group average and higher than in the South East European region – also dropped during 2014, ending the year at 7.3%. This lower net interest margin was primarily due to a reduction in the average interest rate on loans from 17.3% to 15.4%. Similarly, the average interest income from liquid funds also declined from 1.3% to 0.8% as of end-2014.

Photo: ProCredit Bank Macedonia

The average interest expense for customer deposits in the region came down from 5.9% to 4.7% in 2014, while interest rates on other funds fell from 6.6% to 6.3%. With customer deposits making up a share of total liabilities comparable to that of the previous year, the average cost of funds decreased from 5.9% to 5.1%. Contrary to the group-wide trend, the decline in average interest expense for customer deposits was not boosted by a rise in sight deposits. Their share of the region's total customer deposits shrank from 25.5% to 24.3%, while the share of term deposits rose from 40.7% to 43.1%. The growth of the loan portfolio and the reduction in the average cost of funds were not sufficient to fully offset the decline in interest income caused by the drop in average lending interest rates. Consequently, net interest income for the region decreased by EUR 2.5 million compared to the previous year.

Loan impairment expenses increased by EUR 9.6 million to EUR 15.0 million due to the growing loan portfolio and rising level of default risk (with PAR 30 up from 3.6% to 4.2%). Within the region, the largest increase in impairment expenses in absolute terms took place in Ukraine, due to a higher level of default risk (up from 2.6% to 4.4%) accompanied by strong 11.1% growth of the customer loan portfolio.

Net non-interest income, at EUR 18.3 million, was slightly above the previous year's figure of EUR 16.6 million. However, net income from foreign currency transactions and from commission and brokerage services was down on the previous year's result by EUR 1.0 million due to the reduced number of clients and transactions.

The review of the branch network and the desired client profile produced noticeable effects in the region in terms of reduced costs and higher efficiency. Operating expenses for the region decreased by EUR 10.5 million compared to the previous year, comparable to the drop achieved in South Eastern Europe. This more than made up for the decline in net interest income.

The reduction in operating expenses was predominantly due to an EUR 8.2 million or 25.4% drop in personnel expenses compared to the previous year's figure.

Administrative expenses including depreciation costs fell by 7.1% to EUR 29.7 million. While IT expenses increased by EUR 1.2 million, costs for rent, transport, communications and marketing decreased by a total of EUR 2.6 million (21.0%) compared with 2013. Depreciation expenses in 2014, at EUR 5.4 million, were comparable to the previous year's figure.

The decline in operating profit before provisions by EUR 0.9 million (-1.0% compared to 2013) and in operating expenses by EUR 10.5 million (-16.3% compared to 2013) led to a significant improvement of the cost-income ratio from 73.0% to 61.7%. Profit after taxes for the region, at EUR 15.0 million, was 6.9% up on the previous year's profit. The region thus reported a return on equity of 12.2%, as against 11.4% in 2013.

South America – As of end-2014, the South American region accounted for 15.5% of the group's total assets prior to consolidation. All of the banks in the region invested substantially in institution-building measures in the context of staff training, definition of the client profile and reduction of the branch network. This was a challenging task, given that the share of clients with exposures under EUR 10,000 and thus not belonging to the envisaged target group is relatively large. Despite the significant reduction in the portfolio of loans under EUR 10,000, the region largely succeeded in meeting its growth targets.

The region's loan portfolio grew by 9.0% in 2014. This portfolio growth is mainly attributable to developments at the bank in Bolivia, whose loan portfolio increased by EUR 92.4 million (22.8%), supported by the appreciation of the local currency. The exit from credit exposures under EUR 10,000 in 2014 had a particularly noticeable impact in South America. The loan portfolio for the region in the size category up to EUR 10,000 declined by EUR 60.1 million in 2014. This drop was more than offset by portfolio growth in the EUR 10,000 – 500,000 range. In the region the increase in this segment was more than twice as large as the decrease in the segment below EUR 10,000.

Customer deposits rose by 7.0% to EUR 680.8 million as of end-2014 and thus did not match the growth rates achieved in the loan portfolio. Consequently, the ratio of customer deposits to loan portfolio dropped from 81.5% to 80.0%. As intended, the share of demand deposits in total customer deposits increased by 6.0% to 13.0%. Whereas liabilities to international financial institutions and similar liabilities were reduced by EUR 5.8 million in 2014, liabilities to banks increased.

The region's net interest margin narrowed from 9.6% to 8.5% as of year-end 2014, with the sharpest reduction occurring in the first quarter. The decreased net interest margin at all of the institutions in the region was due to the lowering of lending interest rates while the cost of funds remained unchanged. Average earnings on loans, influenced partly by the reduced size of the portfolio of loans under EUR 10,000, dropped from 15.6% to 14.4% in 2014. The growth of the loan portfolio was not sufficient to compensate for the decline in average interest income, which is why interest income, at EUR 120.3 million, was EUR 2.1 million down on the previous year's figure.

The average cost of funds for the region in 2014 remained at a level comparable to that of the previous year. There was a slight reduction in average interest expenses for customer deposits compared with the previous year, by 0.1 pp to 2.5%. At the same time, average interest expenses for other borrowings rose slightly by 5.5% to 5.8% due to higher interest rates on bonds. Interest expenses increased mainly because of the growth in customer deposits. At end-2014, net interest income totalled EUR 91.6 million, down EUR 4.4 million from the previous year.

In 2014 loan impairment expenses went up from EUR 8.2 million to EUR 10.0 million. This increase in loan loss provisioning expenses was due partly to the small increase in loan default risk, which remained at a low level, but mainly to the growth of the loan portfolio and to the raising of the rate for lump-sum specific provisions.

As a consequence of legal restrictions, net non-interest income is of only minor importance in the Latin American region.

Operating expenses in the region, following the restructuring of the loan portfolio to conform to the desired client profile and the accompanying improvements to the efficiency of the branch network structure, were EUR 4.9 million lower than in the previous year. The lower operating expenses compensated for the drop in net interest income.

Personnel expenses declined by 10.2% to EUR 28.5 million. By comparison, the number of employees in the region fell by 29.5% to 1,401. Accordingly, the average expenses per staff member increased by 21.3%, which was also due to compensation paid to exiting staff members.

Administrative expenses including depreciation costs also fell from EUR 42.3 million to EUR 40.6 million. While depreciation expenses, at EUR 7.2 million, remained at a level comparable to that of the previous year, costs for transport, communications and marketing as well as for consulting, legal advice and auditing decreased by a total of 17.9% compared with 2013. IT expenses, in contrast, rose from EUR 2.4 million to EUR 3.7 million.

In 2014 the decline in operating profit before provisions by EUR 5.0 million (-5.0% compared to 2013) and in operating expenses by EUR 4.9 million (-6.6% compared to 2013) led to a slight improvement of the cost-income ratio from 74.4% to 73.2%. Profit after tax for the region, at EUR 11 million, remained stable compared to the previous year. The larger institutions, i.e. the ProCredit banks in Bolivia and Ecuador, demonstrated solid profitability with a net profit of EUR 8.5 million and EUR 4.8 million, respectively. The region as a whole thus reported a return on equity of 8.4%.

Central America – With the economy still sluggish and the security situation worsening, the operating environment in Central America deteriorated. Under the circumstances, the region's performance remained stable, but found it particularly difficult to adapt to the desired client profile. In response to the low market potential and the difficult security situation, the ProCredit group sold its shares in the institution in Honduras in December 2014. As of end-2014, the region accounted for 5.1% of the group's total assets prior to consolidation.

The growth of the region's loan portfolio was adversely affected by the sale of the bank in Honduras. The loss of the portfolio in Honduras, totalling EUR 58.0 million, brought the region's total credit volume down by EUR 17.0 million to EUR 287.1 million, whereas if Honduras had been disregarded, the region's loan portfolio would have grown by 13.2%. It should be noted that the banks benefited from the appreciation of the US dollar against the euro. The strongest growth in the region in absolute terms – EUR 24.8 million – was reported by the bank in El Salvador, whereas the bank in Nicaragua posted the largest growth in relative terms, at 26.1%. In 2014, disregarding the loan portfolio of the bank in Honduras, the region's portfolio of loans up to EUR 10,000 shrank by EUR 2.4 million, while the portfolio in the size range EUR 10,000 –500,000 grew by EUR 39.0 million. The portfolio of loans above EUR 500,000 decreased slightly by EUR 2.6 million.

The sale of the bank in Honduras meant a EUR 41.0 million reduction in customer deposits for the region. The other institutions in Central America were able to grow their customer deposits by a total of 8.8% (EUR 16.5 million) compared with the previous year's figure. The ratio of customer deposits to loan portfolio rose from 69.8% to 71.1%. Demand deposits and term deposits as a share of the region's total customer deposits remained nearly unchanged.

In 2014 the average lending interest rate decreased by 0.7 pp to 13.4%. At the same time, the region's net interest margin declined from 7.9% to 7.6%. In combination with the contraction of the region's loan portfolio due to the sale of Honduras, this resulted in a decrease of net interest income by EUR 4.2 million to EUR 39.8 million by year-end.

The slight increase in average interest expense for customer deposits from 2.4% to 2.5% pushed the average cost of funds for the region up slightly by 0.1 pp to 3.2%. Due to the increase in the share of customer funds in total liabilities, however, this led overall to a EUR 1.1 million reduction in interest expense. Net interest income as of end-2014 was 11.4% down on the previous year, standing at EUR 29.1 million.

Loan impairment expenses were EUR 6.3 million lower in 2014, ending the year at EUR 3.0 million. This drop in loan loss provisioning expenses is primarily attributable to the high level of expenses incurred in Mexico in 2013. The impairment expenses of the other two institutions were comparable to those of the previous year.

Net non-interest income plays a relatively insignificant role for the Central American institutions. This is primarily due to the legal restrictions on charging fees for banking services.

Without taking the institution in Honduras into account, operating expenses in the region fell by EUR 6.8 million compared with the previous year, a drop which more than offset the decline in net interest income in the region.

Personnel expenses at the region's remaining institutions came to EUR 10.0 million, a 24.7% reduction compared with the previous year, while the number of employees dropped by 39.1%.

Administrative expenses including depreciation costs fell by 16.4% to EUR 18.1 million in 2014, disregarding the institution in Honduras. While IT expenses increased by 5.9% to EUR 1.1 million, costs for transport, communications and marketing as well as for consulting, legal advice and auditing decreased by a total of 18.0% compared with 2013. Depreciation expenses in 2014 totalled EUR 3.9 million in 2014, 9.1% less than the previous year.

The sale of the ProCredit bank in Honduras, leading to the release of the currency translation reserve, made a positive contribution of EUR 1.8 million to the group's profit.

Africa – At the start of the year the Africa region comprised three institutions, but by the end of the year, after the sale of the ProCredit bank in Mozambique in April 2014 and the institution in Ghana in October 2014, it consisted solely of the ProCredit bank in Congo. The sale of the institutions in Mozambique and Ghana together reduced the region's total assets by EUR 68.7 million. As of December 2014, the region accounted for 2.4% of the group's total assets prior to consolidation. While the sale of the institutions in Mozambique and Ghana above book value had a positive impact on the group's profit for the year, the release of the currency translation reserve set aside for these institutions had a negative impact on the profit for the year, though without influencing total equity.

The following account of the development of the region relates solely to the development of the one remaining bank in the region, in Congo. Accordingly, the figures for 2013 cited for the purpose of comparison also relate only to this institution.

The loan portfolio in Congo grew by 43.5% (EUR 24.0 million) to EUR 79.1 million during 2014. At the same time, the portfolio of loans up to EUR 10,000 was reduced by 15.4%. Aside from a small EUR 1.1 million increase in the portfolio of loans exceeding EUR 500,000, the bulk of the portfolio growth (60.1% or EUR 24.6 million) took place in the EUR 10,000 – 500,000 size range.

ProCredit Bank Congo finances itself predominantly with local customer deposits. These accounted for 93.7% of total liabilities at end-2014, or 182.2% of the loan portfolio (2013: 214.5%). The total volume of customer deposits increased from EUR 118.2 million to EUR 144.1 million at the end of 2014.

In 2014, the net interest margin declined from 11.1% to 9.5%. This decrease in net interest margin was due not only to the small share of the loan portfolio in total assets but also to the reduction in average earnings on the portfolio from 32.1% to 24.3%. The strong growth of the loan portfolio compensated for the drop in net interest income. Interest income in 2014 saw minor growth of EUR 0.3 million to EUR 16.4 million by year-end.

Interest expenses for customer deposits decreased slightly from 0.7% to 0.6%. Average expenses for other borrowings also fell from 3.6% to 3.5%. This brought down the average cost of funds, which at 0.6% as of end-2014 were almost at the previous year's level of 0.7%. Due to the growth of customer deposits while average interest expenses remained constant, total interest expenses increased from EUR 0.8 million to EUR 1.0 million. Thus, net interest income came to EUR 15.4 million, which is comparable to the 2013 figure.

Provisioning expenses remained at a similar level to 2013, despite the growth of the loan portfolio in 2014. This reversed the significant increase in provisions relative to the loan portfolio that took place in 2013.

Personnel and administrative expenses, at EUR 5.9 million and EUR 9.5 million, respectively, remained broadly stable. Higher IT expenses were offset by reductions in communication costs and expenses for consulting, legal and auditing services.

Thanks to higher operating income and lower operating expenses, the bank in Congo succeeded in raising its profit after tax from EUR 1.4 million to EUR 2.0 million. The cost-income ratio improved from 76.9% auf 74.2% and the return on equity rose from 8.4% to 10.3%.

Germany – The development of the Germany segment essentially consists of the operations of ProCredit Holding and ProCredit Bank Germany. In 2014 the region's total assets grew by 2.0% to EUR 1,335.2 million. ProCredit Bank Germany, which as of end-2014 increased its share of the total assets for the region from 16.0% to 17.1%, made a significant contribution to this growth.

The growth of total assets in the Germany region was partly attributable to the EUR 51.8 million increase in the volume of credit exposures to the group banks, but above all to the increase in ProCredit Bank Germany's customer business. In 2014 it grew from EUR 19.1 million to EUR 54.2 million.

Total liabilities in the Germany segment increased to EUR 596.9 million (2013: EUR 580.9 million), a total increase of EUR 16.0 million. This was mainly due to the growth of customer deposits in ProCredit Bank Germany, with most of the incoming funds held in highly liquid assets.

The region's net interest income was negative at EUR -7.6 million, up EUR 1.2 million compared to the previous year's figure of EUR -8.8 million. The negative figure is explained by the fact that ProCredit Holding's equity investments in the subsidiaries are partly financed by debt instruments.

Other operating income positions were dominated by gains from dividends received from subsidiary banks totalling EUR 66.3 million. These payments accounted for 85.3% of total operating income before provisions in 2014. Further income came from commission and brokerage services as well as from IT services provided by Quipu GmbH and from the management services agreements with the ProCredit banks.

Operating expenses in the region increased by EUR 1.3 million to EUR 48.5 million. At the same time, personnel expenses increased slightly by EUR 0.3 million and administrative expenses by EUR 1.0 million. The profit earned in the region came to EUR 25.1 million in 2014.

Management Report of ProCredit Holding AG & Co KGaA

The activities and associated operational and financial results of ProCredit Holding AG & Co KGaA (ProCredit Holding) are deeply intertwined with the development of the group and its entities. Therefore, it has been decided to integrate the Management Report for ProCredit Holding into the Management Report of the group. With regard to ProCredit Holding's report on significant post-balance sheet events, the risk report and the report on expected developments, we refer to the corresponding sections of the Group Management Report. Please note that, in contrast to the consolidated financial statements for the group, the financial statements for ProCredit Holding have been prepared according to the provisions of the German Commercial Code (*Handelsgesetzbuch – HGB*) and the German Stock Corporation Act (*Aktiengesetz – AktG*).

Business activities of ProCredit Holding AG & Co. KGaA

ProCredit Holding is located in Frankfurt am Main, Germany. The holding company exclusively conducts activities that are associated with the group. The main activities of ProCredit Holding are as follows:

- strategic management of the group and its subsidiaries
- supporting the subsidiaries in implementing the Group Business Strategy and Group Risk Strategy
- monitoring and supervising the subsidiaries, especially in the areas of risk management and internal audit, for which purpose ProCredit Holding has developed group policies, in particular for risk management
- providing equity for the subsidiaries and ensuring sufficient capital adequacy at group level
- providing medium- and long-term financing to the subsidiaries
- supporting the subsidiaries in liquidity management, e.g. by providing short-term financing
- other support services and providing management staff
- developing training programmes for staff of the ProCredit banks
- reporting to shareholders and third parties, including supervisory reporting (in particular to BaFin and the Bundesbank)

Since 2012, ProCredit Holding has been the "superordinated company" of the ProCredit group for financial supervision purposes. Alongside ensuring appropriate capital endowment of the group, its key responsibilities thus include the group-wide implementation of the requirements specified under section 25a of the German Banking Act (*Kreditwesengesetz – KWG*) and under the German Federal Financial Supervisory Authority's policy document "Minimum Requirements for Risk Management", commonly referred to as "MaRisk", as well as ensuring the group's compliance with the German Money Laundering Act (*Geldwäschegesetz – GWG*).

As of year-end 2014, ProCredit Holding had 149 staff members. Of this total, 46 employees were based abroad in the companies belonging to the group, some occupying management positions. This includes the entire local staff base of 29 employees of the Regional Academy in Colombia, a branch of ProCredit Holding set up as a training facility for staff of the ProCredit banks in Latin America.

A substantial proportion of staff based in Germany at the end of 2014 (46.5%) were engaged in risk management and finance, with responsibility for bookkeeping, accounting, controlling, and for management and supervisory reporting. The anti-money laundering and fraud prevention unit and the group audit unit together employed eight staff members.

Development of financial position

ProCredit Holding's close involvement in the activities of the group is reflected in the structure of both the balance sheet and the income statement. Receivables from and shareholdings in the subsidiaries make up over 90% of its assets. Payments from the subsidiaries to ProCredit Holding in the form of dividends, interest and management service fees account for the largest part of ProCredit Holding's earnings. Accordingly, the financial position of the holding company is strongly dependent on the operational and financial development of its subsidiaries.

ProCredit Holding continued to be the most important, and in many cases the only provider of equity to its subsidiaries. In addition, ProCredit Holding provides medium- to long-term funding, including subordinated debt facilities, to the ProCredit banks. The holding company also keeps a central liquidity reserve in the form of committed stand-by lines and highly liquid assets to cover the short-term liquidity needs of its subsidiaries, particularly in times of crisis. Aside from shareholders' equity, ProCredit Holding financed its assets mainly through accessing medium- to long-term facilities from banks and IFIs or the issuance of bonds by way of private placements.

Placements with banks decreased during the year by EUR 18.7 million to EUR 14.5 million, which is EUR 9.3 million below the planned amount. As expected, the volume of loans to group banks grew in 2014; the EUR 35.3 million increase in 2014 brings the total to EUR 235.1 million, which still falls short of the EUR 249.4 million target. Whereas the exposure to ProCredit Bank Bulgaria decreased by EUR 25.0 million, most banks recorded an increase, with the ProCredit banks in Romania, Georgia and Kosovo accounting for a combined EUR 30.9 million.

ProCredit Holding's total equity investment in its subsidiaries remained stable at EUR 646.5 million (2013: EUR 650.3 million), despite the sale of some institutions. Without taking these effects into account, the total volume would have reached the planned level of EUR 664.1 million. The share of capital increases from re-invested dividend proceeds amounted to EUR 13.7 million, or 39.1% of the total volume of all increases. Write-downs of participations totalled EUR 17.6 million in 2014, down EUR 3.1 million from the previous year.

In 2014, no capital increases were performed at the level of ProCredit Holding. The increase in the equity position from EUR 405.6 million to EUR 420.5 million reflected an increase in accumulated earnings, net of a dividend payment of EUR 10.2 million (EUR 0.20 per share) in May 2014. The deviation from planned equity volume was due to lower-than-planned profit.

ProCredit Holding's liabilities decreased by EUR 6.7 million to EUR 500.1 million at the end of 2014, which is EUR 47.3 million below the planned amount. The higher volume of bonds was more than compensated by the drop in other types of liabilities. The moderate changes in the structure of liabilities did not lead to changes in the maturity or currency structure. As of end-2014, 49.4% of liabilities had a remaining maturity of more than 5 years.

ProCredit Holding has signed stand-by agreements with the majority of its subsidiary banks (totalling EUR 107.1 million). At the same time it has built up liquidity reserves in order to be able to provide the required funds quickly in case of need. Aside from the liquid assets held at banks, ProCredit Holding had access to a committed, undrawn stand-by facility of EUR 18.0 million.

Result of operations

The financial results of the holding company are closely linked to the developments in the subsidiary banks. In the absence of third party business, the main income sources of the holding company remain, in order of importance, dividends from equity investments, interest income from funding provided to the subsidiary banks and income from the management services agreements concluded with the subsidiaries.

Dividend income came to EUR 66.2 million, which is EUR 10 million above the planned amount for 2014 and EUR 6.5 million lower than the previous year. The higher-than-planned dividend income was mainly due to ProCredit Bank Kosovo, whose dividend payments were EUR 10.0 million higher than projected and EUR 5.0 million below the previous year's figure.

Despite the increased volume of funding provided to the ProCredit banks abroad, the interest income earned by ProCredit Holding remained almost constant, at EUR 14.2 million as against EUR 14.7 million in 2013, mainly due to changes in the country mix of the portfolio and changes in average interest rates. At the same time, interest expenses remained virtually unchanged at EUR 25.2 million (2013: EUR 25.0 million). Neither the volume of liabilities of ProCredit Holding nor the average funding costs changed significantly in 2014. Net interest income came to EUR -11 million, down EUR 0.7 million from the previous year and EUR 0.5 million below the planned level.

Compared to the previous year, income from management services agreements in 2014 (recognised in other operating income) fell by EUR 3.3 million to EUR 9.3 million. This was attributable to a reduction in the number of ProCredit Holding employees working abroad, a proportional decrease in income from the companies leaving the group, and lower operating costs at ProCredit Holding. ProCredit Holding covers approximately 50% of its administrative expenses with income from the management services agreements.

Compared with 2013, the holding company's operating expenses decreased by EUR 2.1 million to EUR 27.6 million in 2014. Personnel expenses decreased by EUR 2.1 million to EUR 8.3 million due to the decrease in the number of staff (from 168 in 2013 to 149). Administrative expenses including depreciation costs, at EUR 19.3 million remained comparable to the previous year's figure. IT-related expenses (mainly payments for the services of Quipu GmbH) were down EUR 0.7 million, and the losses of ProCredit Bank Germany, which due to the profit and loss transfer agreement are borne by ProCredit Holding, shrank by EUR 0.9 million.

ProCredit Holding closed the year with a profit of EUR 25.1 million. The shortfall compared with the planned profit of EUR 28.5 million is a consequence of unplanned write-downs on subsidiaries, which were only partly offset by higher dividend income.

Report on Post-Balance Sheet Events

Acquisition of shares in subsidiaries

In January 2015 ProCredit Holding acquired the minority shares, accounting for 20.5% of the total equity, in ProCredit Bank Armenia, and thus now holds 100% of the ordinary share capital. In carrying out this transaction, ProCredit Holding exercised a purchase option on the shares in question.

Risk Report

In accordance with our simple, transparent and sustainable business strategy, our risk strategy is a conservative one. The aim is to achieve steady results, despite volatile external conditions, by following a consistent group-wide approach to managing risks.

The principles of our business activity, as listed below, provide the foundation for our risk management. The consistent application of these principles significantly reduces the risks to which the group is exposed.

- **Focus on core business**

The ProCredit institutions focus on the provision of financial services to small and medium-sized businesses as well as to private clients. Accordingly, income is generated primarily in the form of interest income on customer loans and fee income from account operations and payments. All of the banks' other operations are performed mainly in support of the core business. ProCredit institutions assume mainly customer credit risk and operational risk in the course of their day-to-day operations. At the same time, ProCredit avoids or strictly limits all other risks involved in banking operations even at the expense of forgone income opportunities.

- **High degree of transparency, simplicity and diversification**

ProCredit's focus on small and medium-sized businesses entails a very high degree of diversification in both customer loans and customer deposits. Geographically, this diversification is across regions, countries and across urban and rural areas within countries. In terms of client groups, this diversification is across economic sectors, client groups (small and medium enterprises divided into the very small, small and medium business client categories, as well as private clients and institutions) and income groups. The diversification of the loan portfolio is an integral part of the group's credit risk management policy. A further characteristic of our approach is that we seek to provide our clients with simple, easily understandable products. This leads to a high degree of transparency not only for the respective client, but also from a risk management point of view. Both the high degree of diversification and our simple, transparent products and processes result in a significant reduction of the group's risk profile.

- **Careful staff selection and intensive training**

Responsible banking is characterised by long-term relationships not only with clients, but also with staff. This is why we select our staff very carefully and have invested heavily in staff training over many years. Key elements of ProCredit's approach to staff management are a very thorough staff selection process, comprising a six-month intensive training programme for all new applicants (the "Young Bankers Programme"), regular training for all existing staff, intensive training for management staff in the ProCredit academies, and the application of a uniform salary system for all staff across the group based on fixed salaries and the avoidance of bonus payments to the greatest extent possible. Besides high levels of technical professionalism, the result of our intensive training efforts is an open and transparent communication culture. From a risk perspective, well-trained employees who are accustomed to voicing their opinions openly are an important factor for managing and reducing risk, specifically operational risk and fraud risk.

Other elements of our risk management approach include mechanisms designed to hedge and mitigate risks, and processes for monitoring the continuing effectiveness of these hedging and mitigating mechanisms. Specifically:

- All ProCredit institutions apply a single common risk management framework, which defines group-wide minimum standards for risk management. The risk management policies and standards are approved by the Management of ProCredit Holding and are updated at least annually. These policies and standards are based on the "Minimum Requirements for Risk Management" (MaRisk), and on our knowledge of the markets acquired over many years.
- All risks incurred by the group are managed by ensuring at all times an adequate level of capital and risk-bearing capacity of the group and all ProCredit institutions.
- Early warning indicators (reporting triggers) and limits are set and monitored for all material risks at the group level and at the level of each individual bank.
- Regular stress tests are performed for all material risks at the group level and at the level of each individual bank; stress tests are carried out for each individual risk category as well as across all risk categories.
- Regular and ad hoc reporting on the risk profile, including detailed descriptions and commentaries, is carried out at group level and at the level of each individual bank.
- Monitoring and control of risks and possible risk concentrations is carried out using comprehensive analysis tools for all material risks.
- The effectiveness of the chosen measures, limits and methods is continuously monitored and controlled. This also includes backtesting of the models used.
- All new or significantly changed business processes, products or instruments undergo a "New Risk Approval" (NRA) process before being used for the first time. This ensures that new risks are assessed and all necessary preparations and tests are completed prior to implementation.

The group's risk strategy and business strategy are updated annually and, after having been thoroughly discussed with the Supervisory Board, are approved by the Management of ProCredit Holding. While the business strategy lists the objectives of the group for all material business activities and regions of operation and presents measures to be taken to achieve them, the group risk strategy addresses the material risks arising from the implementation of business strategy and defines the objectives and measures of risk management. The risk strategy is broken down into strategies for all material risks and business activities in the group. The annually conducted risk inventory ensures that all material and non-material risks are identified and, if necessary, considered in the strategies.

Organisation of the risk management function

At the group level, overall responsibility for risk management is assumed by the Management of ProCredit Holding, supported by the Group Risk Management Committee and the Group Assets and Liabilities Committee (Group ALCO). The Group Risk Management Committee develops the group-wide framework for risk management, monitors the risk profile of the group and takes decisions on risk mitigation measures if necessary. The Group ALCO monitors particularly the liquidity reserve and liquidity management of the group and co-ordinates measures aimed at securing funding for the ProCredit banks and ProCredit Holding. In both committees the members of the Management of ProCredit Holding and the Management Board of ProCredit Bank Germany as well as the Finance & Controlling, HR and Internal Audit Managers of ProCredit Holding are represented. As a general rule, the committees meet monthly.

Risk management on the group level is supported by the specialised organisational units Group and PCH Risk Control, Group Credit Risk Management, Group Financial Risk Management, Group and PCH Operational Risk Management, Group AML and Fraud Prevention, and Supervision and Capital Planning. The responsibilities of

Photo: ProCredit Bank Bosnia and Herzegovina these units include proposing the framework for risk management in the group as well as limits for risk positions to the Group Risk Management Committee, monitoring risk positions and compliance with limits, performing the group's capital planning and monitoring risk-bearing capacity at both bank level and group level. The risk controlling function required by MaRisk is headed by a member of the Management of ProCredit Holding. Furthermore, the Management of ProCredit Holding is advised and supported by the compliance function, ensuring the implementation of legal regulations and requirements and avoiding the risks associated with non-compliance.

The local management bears responsibility for risk management at the level of the individual banks. All ProCredit banks have risk management departments, a risk management committee and an ALCO that generally meet monthly, as well as specialised committees that address individual risks. These committees regularly monitor and manage the risk profile of their respective institution. In addition, the risk departments of all banks report regularly to the different risk functions at ProCredit Holding, and the local supervisory board is informed on at least a quarterly basis on all risk-relevant developments.

At the individual bank level, risk positions are analysed regularly, discussed intensively and documented in standardised reports. On the basis of these risk reports, ProCredit Holding prepares an aggregate risk report for the Group Risk Management Committee and the Supervisory Board. Monitoring of both the individual banks' risk situation and the group's overall risk profile is carried out through a review of these reports and of additional information generated locally and on a group level. If necessary, additional topic-specific ad hoc reporting occurs. The aim is to achieve transparency on the material risks and to be aware at an early stage if potential problems might be arising.

In all ProCredit banks, adequate processes and procedures for an effective internal control system are in place. The system is built around the principles of segregation of duties, dual control and for all risk-relevant operations the separation of front and back office up to the management level.

Group Audit is managed as an independent functional area within ProCredit Holding. It provides support in determining what constitutes appropriate risk management and an appropriate internal control system within the group. Additionally, each ProCredit bank has an internal audit department which carries out the auditing procedures established by Group Audit. Once per year, internal audit departments at ProCredit banks carry out risk assessments of all of their bank's activities in order to arrive at a risk-based annual audit plan. Each internal audit department reports to an audit committee, which generally meets on a quarterly basis. In addition to providing technical guidance, the Group Audit team monitors the quality of the audits conducted in each ProCredit bank.

Regular regional and group-wide meetings and training events support the exchange of best practices and the development and enhancement of the risk management functions throughout the group.

Management of individual risks

Credit risk

The ProCredit group defines credit risk as the risk that the party to a transaction fails to meet its contractual obligations, or fails to meet them in full or on time. It comprises the risk arising from customer credit exposures as well as counterparty risk (including issuer risk) and country risk. As a consequence of the business model, credit exposures to customers dominate the balance sheet, both at the level of individual banks and at group level. Credit risk is thus the most significant risk facing the ProCredit group, and customer credit exposures account for the largest share of that risk.

Customer credit risk

in '000 EUR	31.12.2014	31.12.2013
Loans and advances to banks	**411,087**	**339,026**
Financial assets at fair value through profit or loss	**5,045**	**6,130**
Trading assets	750	2,157
Fixed interest rate securities	4,295	3,973
Available-for-sale financial assets	**232,439**	**323,178**
Fixed interest rate securities	174,692	312,041
Variable interest rate securities	56,156	9,283
Shares in companies situated in OECD countries	1,161	798
Shares in companies situated in non-OECD countries	430	1,057
Loans and advances to customers	**4,143,770**	**3,996,596**
Loans and advances to customers	4,332,241	4,185,071
Allowance for losses on loans and advances to customers	-188,471	-188,475
Contingent liabilities and commitments	**159,554**	**153,524**
Guarantees and stand-by letters of credit	99,710	94,863
Documentary and commercial letters of credit	2,700	2,611
Credit commitments (irrevocable loan commitments)	13,152	17,182
Performance bonds	43,064	36,531
Others	927	2,337

Some of the countries in which ProCredit banks work are characterised by a volatile macroeconomic environment and weak institutions, including weak legal systems. Thanks to the diversification of operations across four regions and 19 countries, and to the experience that the ProCredit institutions have gained in operating in these markets over the past 20 years, the group has extensive expertise with which to limit these risks effectively.

The banks serve a broad spectrum of clients, ranging from customers that have relatively low levels of financial literacy and not always reliable financial statements, to more experienced SME clients. The ProCredit group has developed procedures to effectively manage the credit risk posed by its clients. Our thorough knowledge of the risks associated with our countries of operation and our target clients has been the basis for drafting the policies that stipulate the requirements for risk management in the group. For our lending operations, we apply the following principles:

- intensively analysing the debt capacity of the banks' clients
- carefully documenting credit risk analyses and processes conducted during lending operations, ensuring that the analyses performed can be understood by knowledgeable third parties
- rigorously avoiding overindebtedness among the banks' customers
- building a personal and long-term relationship with the client, maintaining regular contact
- strictly monitoring credit exposure repayment
- closely customer-oriented, intensified loan management in the event of arrears
- collateral collection in the event of insolvency

The framework for managing customer credit risk is approved by the Management of ProCredit Holding and set forth in policies and standards. The policies define, among other things, the responsibilities for managing credit risk in the group and at the level of each individual bank, the principles for the organisation of lending business, the principles involved in lending operations, and the framework for the valuation of collateral for credit exposures. The standards define in more detail the group's lending operations with business clients and private clients and the range of credit products offered. They also set forth the rules governing restructuring, loan loss provisioning and write-offs. Thus, the policies and standards define risk-mitigating measures for the pre-disbursement phase (credit risk assessment) and the post-disbursement phase (regular monitoring of the financial situation and problem loan management). The credit risk profile of the group is assessed by the Group Risk Management Committee at least on a monthly basis, and more comprehensively on a quarterly basis.

The ProCredit group divides its credit exposures into four categories: very small, small and medium business credit exposures and credit exposures to private clients. Depending on the client category to which the respective credit exposure is assigned, different credit risk assessment processes are applied. These processes differ from one another in terms of the following attributes: degree of segregation of duties, type of information that provides the basis for the credit analysis, criteria for credit decisions, and collateral requirements. A strict division of front and back office functions up to the management level is applied for risk-relevant credit exposures.

The experience of the ProCredit group has shown that an appropriate credit risk assessment constitutes the most effective form of credit risk management. Credit decisions are based predominantly on an analysis of the financial situation of the client and an assessment of the creditworthiness of the client. All clients are regularly visited on-site to ensure an adequate consideration of their specific features and needs.

The ProCredit institutions' credit decisions are all taken by a credit committee. Its members have approval limits that reflect their expertise and experience. All decisions on medium credit exposures are taken by credit committees at the banks' head offices and, in exceptional cases, by the supervisory boards.

Setting appropriate credit limits, deciding which services correspond to the financial needs of clients and determining the proper structure of the credit exposure form an integral part of the decision-making process within the credit committee.

In this context, the following general principles apply: The lower the amount of the credit exposure, the stronger the documentation provided by the client, the shorter the term of the credit exposure, the longer the client's history with the bank and the higher the account turnover of the client with the bank, the lower will be the collateral requirements.

The group credit risk management policies limit the possibility of entering into uncollateralised credit exposures. Depending on the risk profile and the term of the exposure, loans may be issued without being fully collateralised. The threshold for unsecured credit exposures varies depending on the level of stability of the respective economic environment. Credit exposures with a higher risk profile are always covered with solid collateral, typically through mortgages.

The total amount of collateral held as security is EUR 3,311 million. Cash collateral is held by the banks only for an insignificant percentage of their credit exposures.

in '000 EUR	31.12.2014	31.12.2013
Mortgages	68.1%	60.9%
Inventories	3.0%	4.1%
Guarantees	3.7%	1.6%
Other	25.3%	33.5%

The early detection of increases in credit risk at the level of individual credit exposures is incorporated into all lending-related processes, resulting in a fast and efficient assessment of the degree of financial difficulty faced by clients.

The loan portfolios of the ProCredit institutions are predominantly composed of instalment loans with regular monthly payments of interest and principal. This is why payment delays are a reliable indicator of increased credit risk. Consequently, the key indicator employed by ProCredit to assess the level of credit risk in the group is the portfolio at risk (PAR 30 and PAR 90). This is defined as the outstanding volume of credit exposures with one or more payments of interest or principal overdue by more than 30 or 90 days, respectively. When calculating this indicator, the total outstanding exposure towards a client and its related parties is taken into consideration. Deductions for available collateral or *de minimis* limits are not applied. The indicator is expressed as a percentage of the total gross loan portfolio. The quality of the loan portfolio is monitored based on this key indicator on an ongoing basis.

At the end of 2014, PAR 30 stood at 4.6%, slightly lower than the level reported for the end of 2013 (4.7%); however, there were times during 2014 when it was above 5%. Thus, the level of PAR 30 and its evolution over the year do not differ strongly from the previous year's picture. The sale of the institutions in Ghana, Mozambique and Honduras during 2014 had no substantial impact on PAR 30. Rather, its development can be ascribed to the stagnating macroeconomic environment in some of the countries where the ProCredit banks operate, among other factors. Furthermore, there are credit exposures which have been non-performing for a number of years, but where the legal process has not yet been finalised due to the difficult legal environment. Some clients have still not recovered from the massive economic downturn that followed the financial crisis. In recent years the banks have increasingly initiated legal proceedings to recover these credit exposures. In most countries in which the ProCredit banks operate, however, the legal process is highly time consuming.

in '000 EUR **As at December 31, 2014**	**0 days**	**1 to 30 days**	**31 to 60 days**	**61 to 90 days**	**91 to 180 days**	**181 to 360 days**	**> 360 days**	**Total**
Loans and advances to customers								
Non-impaired								
Business	2,741,470	296,275	0	66	33	110	227	3,038,181
Agricultural	591,054	41,321	1	0	0	3	0	632,379
Housing improvement	199,887	15,539	0	0	0	0	0	215,426
Consumer	51,399	8,109	0	0	0	0	0	59,508
Finance leases	11,297	1,690	0	0	0	0	0	12,987
Other	19,243	1,348	0	0	0	0	0	20,591
Other advances to customers	4,011	0	0	0	0	0	0	4,011
Impaired								
Business	92,863	37,287	19,001	9,837	25,978	37,637	72,431	295,035
Agricultural	11,673	2,399	4,448	2,330	4,568	4,203	10,474	40,096
Housing improvement	1,528	553	992	500	1,009	1,344	1,139	7,067
Consumer	1,032	85	582	278	560	640	868	4,044
Finance leases	434	102	43	58	15	62	418	1,133
Other	584	25	58	32	77	101	907	1,783
Total	**3,726,477**	**404,733**	**25,125**	**13,101**	**32,239**	**44,101**	**86,464**	**4,332,241**

in '000 EUR **As at December 31, 2013**	**0 days**	**1 to 30 days**	**31 to 60 days**	**61 to 90 days**	**91 to 180 days**	**181 to 360 days**	**> 360 days**	**Total**
Loans and advances to customers								
Non-impaired								
Business	2,828,492	117,178	185	3	21	29	266	2,946,173
Agricultural	563,113	18,418	0	2	1	0	10	581,544
Housing improvement	191,734	4,929	0	0	1	3	0	196,667
Consumer	54,879	3,830	0	1	0	0	3	58,713
Finance leases	22,484	2,576	0	0	0	0	0	25,060
Other	29,093	406	1	1	0	1	1	29,504
Other advances to customers	4,650	0	0	0	0	0	0	4,650
Impaired								
Business	91,900	41,206	20,464	12,464	25,857	34,669	66,451	293,012
Agricultural	7,797	1,846	3,589	2,011	4,024	3,468	12,988	35,724
Housing improvement	1,184	441	871	408	837	610	1,391	5,743
Consumer	833	79	624	266	416	443	863	3,524
Finance leases	1,266	38	81	21	148	137	1,118	2,808
Other	495	47	63	41	143	123	1,037	1,950
Total	**3,797,918**	**190,994**	**25,880**	**15,218**	**31,449**	**39,483**	**84,128**	**4,185,071**

Credit exposures with overdue payments are reported daily to the responsible branch manager, the respective bank's head office and in aggregated form to ProCredit Holding. Follow-up measures are then taken in accordance with the policies and standards.

Once a higher risk of default is detected for a credit exposure, it is placed under intensified management. This centres around close communication with the client, identification of the source of higher credit default risk and close monitoring of the client's business activities. At the individual banks, decisions on the most effective measures to reduce the credit default risk for individual credit exposures are taken by the authorised decision-making bodies for the credit exposures in question. In addition, specialised recovery officers may be called in to support the intensified management of the credit exposure.

One arrears management measure is a proactive redefinition of the repayment plans to align them with the client's actual and expected future payment capacity. The necessity of such a measure is mostly due to a significant change in the client's economic environment which reduces payment capacity. Such restructurings follow a thorough, careful and individual analysis of the client's changed payment capacity in order to ensure that the client can comply with the renegotiated payment plan. The decision to restructure a credit exposure is always taken by a credit committee and aims at full recovery of the credit exposure.

During 2014, slightly more restructurings were undertaken at group level than in the previous year. As of year-end, the combined total volume of such credit exposures which had not already been classed as impaired came to EUR 53.2 million, as against EUR 52.9 million at end-2013. This is the result of an increase in restructurings in South Eastern Europe.

in '000 EUR As at December 31, 2014	Loan portfolio	Restructured loans	Restructured loans as % of loan portfolio
Germany	54,067	0	0.0%
South Eastern Europe	2,325,497	35,959	1.5%
Eastern Europe	735,655	11,660	1.6%
South America	850,845	4,117	0.5%
Central America	287,123	999	0.3%
Africa	79,053	488	0.6%
Total	**4,332,241**	**53,222**	**1.2%**

in '000 EUR As at December 31, 2013	Loan portfolio	Restructured loans	Restructured loans as % of loan portfolio
Germany	19,086	0	0.0%
South Eastern Europe	2,312,859	29,585	1.3%
Eastern Europe	668,991	12,665	1.9%
South America	780,384	6,463	0.8%
Central America	304,104	2,975	1.0%
Africa	99,646	1,207	1.2%
Total	**4,185,071**	**52,895**	**1.3%**

When a credit exposure reaches problem credit exposure status, recovery officers take over full responsibility for dealings with this client. The handover is based on factors such as insolvency and occurs after the loan has been arrears for 90 days at the latest. Generally speaking, problem credit exposures are characterised as such if the bank has significant doubts about the ability of the client to comply with the contractual terms and conditions. If necessary, recovery officers are supported by litigation officers (legal department) and/or specialists in the sale of assets or collateral. Collateral is always liquidated through sales to third parties. Repossessed property is sold at the highest possible price, typically via public auction. In volume terms, the bulk of the collateral sold consists of tangible assets such as land or buildings.

in '000 EUR	31.12.2014	31.12.2013
Real estate	34,401	36,153
Inventory	349	177
Others	387	477
Repossessed property	**35,137**	**36,807**

As a principle, the ProCredit banks do not write off their receivables from clients until they no longer expect to receive any further payments. As a rule, the more days that the client's payments are past due and the more doubtful the recoverability of the collateral, the lower the probability of further payments is. Additionally, the direct and indirect costs of managing credit exposures that have not been written off must be in proportion to the size of the outstanding exposure. Bearing these points in mind, the banks write off insignificant credit exposures earlier than significant ones, as a rule. In 2014, net write-offs stood at 0.9% of the gross loan portfolio (2013: 0.8%). Thus, net write-offs in 2014 did not differ substantially from the previous year.

The ProCredit group views the adequate provisioning of credit risk as a key strategic objective, which is achieved by making allowance for losses and impairment. In this context, a distinction is drawn between individually significant and individually insignificant credit exposures; the threshold is EUR/USD 30,000.

For all credit exposures that currently show no signs of impairment, portfolio-based allowances for impairment are made based on historical loss experience. This applies to both individually significant and individually insignificant credit exposures.

The ProCredit banks calculate lump-sum specific provisions for individually insignificant credit exposures in arrears more than 30 days. Respective provisioning rates are based on historic default rates. The amount of such provisions is determined on the basis of the number of days that the client's payments have been overdue.

in '000 EUR **As at December 31, 2014**	**Loan portfolio**	**Allowance for impairment**	**PAR (> 30 days)**	**PAR as % of loan portfolio**	**Coverage ratio**	**Net write-offs**	**Net write-offs as % of loan portfolio**
Germany	54,067	-647	0	-	-	0	0.0%
South Eastern Europe	2,325,497	-114,935	116,172	5.0%	98.9%	23,791	1.0%
Eastern Europe	735,655	-30,465	30,725	4.2%	99.2%	4,183	0.6%
South America	850,845	-24,901	23,101	2.7%	107.8%	5,520	0.6%
Central America	287,123	-13,792	26,232	9.1%	52.6%	5,307	1.8%
Africa	79,053	-3,732	4,801	6.1%	77.7%	973	1.2%
Total	**4,332,241**	**-188,471**	**201,031**	**4.6%**	**93.8%**	**39,774**	**0.9%**

in '000 EUR **As at December 31, 2013**	**Loan portfolio**	**Allowance for impairment**	**PAR (> 30 days)**	**PAR as % of loan portfolio**	**Coverage ratio**	**Net write-offs**	**Net write-offs as % of loan portfolio**
Germany	19,086	-233	0	0.0%	0.0%	0	0.0%
South Eastern Europe	2,312,859	-119,871	124,445	5.4%	96.3%	21,841	0.9%
Eastern Europe	668,991	-24,083	24,052	3.6%	100.1%	1,814	0.3%
South America	780,384	-18,665	13,740	1.8%	135.8%	3,211	0.4%
Central America	304,104	-18,609	25,478	8.4%	73.0%	3,089	1.0%
Africa	99,646	-7,015	7,640	7.7%	91.8%	2,485	2.5%
Total	**4,185,071**	**-188,475**	**195,356**	**4.7%**	**96.5%**	**32,441**	**0.8%**

Individually significant credit exposures are individually monitored by the risk management committee of the respective bank. For such credit exposures, the bank performs an impairment test (specific provisions) once objective evidence exists that their quality has deteriorated. The main indicator of this is that the receivable is more than 30 days past due (PAR 30). However, credit exposures can show other signs of impairment as well. Typical examples are:

- breach of covenants or conditions, unless waived or modified by the bank
- initiation of legal proceedings by the bank
- initiation of bankruptcy proceedings
- any information on the customer's business or changes in the client's market environment that are having or will have a negative impact on the client's payment capacity

Based on signs of a deterioration in the quality of the credit exposure, an impairment test is performed, applying the discounted cash flow method. In this context, expected future cash flows from realised collateral items as well as other realisable cash flows are taken into account. The level of loan loss provisions is determined by the difference between the book value of the credit exposure and the net present value of the expected future cash flows.

The following table shows that the level of specific provisions for individually significant credit exposures in 2014 rose by EUR 2 million to roughly EUR 77 million, a slight increase compared with the previous year. As the total gross volume of receivables from this group is stagnating at the previous year's level, this rise is partly due to the banks' changed risk assessment of some exposures that were specifically provisioned.

in '000 EUR **As at December 31, 2014**	**Gross outstanding amount**	**Allowance for specific impairment**	**Net outstanding amount**
Business	227,208	-68,302	158,906
Agricultural	24,627	-7,689	16,939
Housing improvement	2,306	-434	1,873
Consumer	345	-162	183
Finance Lease	871	-328	543
Other	195	-36	159
Total	**255,551**	**-76,950**	**178,602**

in '000 EUR **As at December 31, 2013**	**Gross outstanding amount**	**Allowance for specific impairment**	**Net outstanding amount**
Business	229,227	-65,558	163,670
Agricultural	22,490	-8,562	13,928
Housing improvement	1,342	-245	1,096
Consumer	376	-57	319
Finance Lease	1,863	-533	1,330
Other	195	-46	149
Total	**255,493**	**-75,002**	**180,491**

When a certain group of clients is adversely affected by external factors and/or extraordinary events, those clients' credit exposures may also be tested for impairment.

in '000 EUR **As at December 31, 2014**	**Gross outstanding amount**	**Allowance for individually insignificant impaired loans & collectively assessed loans**	**Net outstanding amount**
Business	3,106,009	-82,834	3,023,175
Agricultural	647,847	-17,886	629,962
Housing improvement	220,187	-6,223	213,963
Consumer	63,207	-2,994	60,213
Finance Lease	13,249	-255	12,995
Other	22,179	-1,330	20,849
Other advances to customers	4,011	0	4,011
Total	**4,076,690**	**-111,522**	**3,965,168**

in '000 EUR **As at December 31, 2013**	**Gross outstanding amount**	**Allowance for individually insignificant impaired loans & collectively assessed loans**	**Net outstanding amount**
Business	3,009,958	-84,322	2,925,636
Agricultural	594,778	-17,246	577,532
Housing improvement	201,069	-5,650	195,419
Consumer	61,861	-3,135	58,726
Finance Lease	26,005	-1,366	24,639
Other	31,259	-1,754	29,505
Other advances to customers	4,650	0	4,650
Total	**3,929,578**	**-113,473**	**3,816,105**

At group and bank level, the loan portfolio is monitored continuously for possible risk-relevant developments with the aid of "reporting triggers". These include past due credit exposures (PAR 30 and PAR 90), restructured credit exposures, written-off credit exposures and allowances for impairment on the loan portfolio. These indicators are analysed in the ProCredit group's Risk Report and discussed by the ProCredit Group Risk Management Committee. In addition, exceptional events which could have an impact on large areas of the loan portfolio (common risk factors) are analysed at group and bank level. If appropriate, these discussions lead to the imposition of limits on risk exposures towards certain groups of clients, e.g. in specific sectors of the economy or geographical regions.

Concentration risk in the group is primarily minimised through the high degree of diversification stemming from lending to the core client groups (very small, small and medium businesses) in various economic sectors and the distribution of the loan portfolio across 19 banks. Generally, the high granularity of the loan portfolios of ProCredit banks is an extremely effective credit risk-mitigating factor.

in '000 EUR **As at December 31, 2014**	**EUR/USD < 50,000**	**EUR/USD 50,000 – 250,000**	**EUR/USD > 250,000**	**Total**
Germany	11	966	53,090	54,067
South Eastern Europe	1,073,566	747,821	504,111	2,325,497
Eastern Europe	318,129	298,362	119,165	735,655
South America	635,519	183,068	32,257	850,845
Central America	155,574	93,034	38,515	287,123
Africa	35,332	30,926	12,795	79,053
Total	**2,218,130**	**1,354,178**	**759,933**	**4,332,241**

in '000 EUR **As at December 31, 2013**	**EUR/USD < 50,000**	**EUR/USD 50,000 – 250,000**	**EUR/USD > 250,000**	**Total**
Germany	26	136	18,925	19,086
South Eastern Europe	1,121,096	711,127	480,636	2,312,859
Eastern Europe	**319,700**	**255,950**	**93,341**	**668,991**
South America	**595,574**	**153,167**	**31,643**	**780,384**
Central America	180,599	83,998	39,507	304,104
Africa	54,855	31,032	13,759	99,646
Total	**2,271,850**	**1,235,411**	**677,811**	**4,185,071**

In addition, the ProCredit banks limit the concentration risk of their portfolios by means of the following policies: Large credit exposures (those exceeding 10% of the regulatory capital of the respective ProCredit bank) require the approval of the Group Risk Management Committee; no large credit exposure may exceed 25% of the regulatory capital of a bank; and the sum of all large credit exposures of a bank may not exceed 150% of its regulatory capital.

in '000 EUR **As at December 31, 2014**	**Business**	**Agricultural**	**Housing improvement**	**Consumer**	**Finance leases**	**Other**	**Other advances to customers**
< 50,000 EUR/USD	1,526,285	403,690	197,845	60,960	7,608	17,732	4,011
50,000 to 250,000 EUR/USD	1,122,919	195,876	23,916	2,589	4,236	4,641	0
> 250,000 EUR/USD	684,013	72,909	732	3	2,276	0	0
Total	**3,333,217**	**672,475**	**222,493**	**63,552**	**14,120**	**22,373**	**4,011**

in '000 EUR **As at December 31, 2013**	**Business**	**Agricultural**	**Housing improvement**	**Consumer**	**Finance leases**	**Other**	**Other advances to customers**
< 50,000 EUR/USD	1,585,130	401,822	183,429	58,755	13,448	24,617	4,650
50,000 to 250,000 EUR/USD	1,031,352	162,636	18,357	3,337	12,892	6,837	0
> 250,000 EUR/USD	622,703	52,809	624	145	1,529	0	0
Total	**3,239,185**	**617,268**	**202,411**	**62,237**	**27,868**	**31,454**	**4,650**

The quality of credit operations in all client categories is monitored by credit controlling units at the individual bank level. They assess the quality of the credit analysis, verify compliance with internal procedures and identify signs of fraudulent activity. The departments employ experienced credit staff who not only conduct on-site visits to customers in order to monitor the lending process but also systematically screen the portfolio.

Continuous training of the staff ensures that credit risk is properly evaluated whenever a loan is issued, and that credit exposures are closely observed throughout their lifetime and appropriate measures are taken in a timely manner. That is why the quality of the ProCredit banks' loan portfolios is significantly higher than the sector average in most countries, even in times when recovering outstanding loan repayments is more difficult.

The group's client credit risk is regularly quantified in the risk-bearing capacity calculation using a credit risk model. Relevant stress scenarios are also used to determine the economic capital needed by the group to cover client credit risk in extremely negative circumstances. The results of these calculations are regularly discussed at Group Risk Management Committee meetings and documented in Risk Reports.

The procedure applied at group level to quantify and manage client credit risk is based on the CreditRisk+ model. This approach determines the probability of various degrees of portfolio losses by applying information on the riskiness of individual clients. The probability distribution of the loss amounts is calculated using a Monte Carlo simulation. The client-specific probabilities of default used for this purpose as well as estimates of the proportion that could be recovered if a loss event materialised are determined empirically by applying statistical procedures to individual loss histories. To model the client-specific probabilities of default, the materialised loss events are matched up to individual client characteristics; the recovery percentages are estimated – also based on individual loss and repayment histories – separately for different size categories. The probabilities of default vary considerably from country to country and between different client groups. For non-restructured loans they were between 2.43% and 9.43% in 2014. The average probability of default for all client segments across all countries came to 5.2% in 2014.

Counterparty risk (including issuer risk)

The ProCredit group defines counterparty risk, including issuer risk, as the risk that a counterparty/issuer is unwilling or unable to fulfil its obligations on time or in full. Counterparty risk in the ProCredit group mainly arises from keeping highly liquid assets for the purpose of mitigating liquidity risk. There are also structural exposures towards local central banks in the form of mandatory minimum reserves.

The framework for managing the group's counterparty risk is approved by the Management of ProCredit Holding and is specified in the respective group policies and standards. These define counterparty risk, specify the responsibilities at bank and group level, and establish minimum requirements for managing, monitoring and reporting. Both the Group ALCO and the Group Risk Management Committee are involved in decisions made with regard to counterparty risk. The counterparty risk profile of the group is assessed regularly by the Group Risk Management Committee. This organisational structure is also replicated in each of the ProCredit banks.

The overarching counterparty risk management strategy is to invest our liquid assets safely and in a diversified manner. While the group tries to generate some income from these assets, the overriding objective is to ensure secure placement and timely availability; risk considerations predominate. For this reason, we only work with carefully selected reliable banks with high credit quality, typically place our money for short terms (up to three months, but typically shorter) and use only a very limited number of simple financial instruments.

Issuer risk is likewise managed according to these principles. The ProCredit banks are prohibited from engaging in speculative trading or proprietary trading. As a matter of principle, only highly liquid papers are bought, typically with a maximum maturity of three years (for fixed-interest securities). Local currency liquidity is predominantly invested in central bank papers or sovereign bonds in the respective country. EUR or USD, on the other hand, are generally invested in OECD sovereigns or securities issued by multilaterals internationally rated at least AA-. The impact of market price changes on the group is limited. The reasons are that the volume of securities is rather low, their maturities are short and issuers are carefully selected based on conservative risk criteria.

Photo: Banco PyME Los Andes ProCredit Bolivia

Typically, our counterparties are central banks, central governments and commercial banks. The main types of exposure are account balances, short-maturity term deposits, highly liquid securities, and, on a very limited scale, simple derivative instruments for liquidity management and hedging purposes (particularly foreign currency forwards and swaps).

Because of our low-risk investment strategy, counterparty risk and issuer risk are low for the ProCredit banks and the group. Due to mandatory minimum reserves, a certain concentration exists at group level with regard to exposures towards central banks. Since 2010 the group has insured more than half of this amount with guarantees from the Multilateral Investment Guarantee Agency (MIGA).

The group's exposure to counterparty and issuer risk has remained relatively stable compared to end-2013. However, our securities portfolio contracted due to a lack of re-investment options. Instead, we placed this liquidity with selected OECD banks. The risk-adjusted exposure of the group did not change significantly during the year, remaining low.

in '000 EUR	31.12.2014	in %	31.12.2013	in %
Banking groups	411,087	38.5	339,026	31.2
OECD banks	*319,899*	*29.9*	*233,952*	*21.5*
Non-OECD banks	*91,188*	*8.5*	*105,074*	*9.7*
Central banks	342,639	32.0	311,363	28.6
Mandatory reserve	*370,195*	*14.2*	*373,266*	*15.8*
of which covered by insurance	*-218,846*		*-201,310*	
Other exposures	*191,290*	*17.9*	*139,408*	*12.8*
Securities	315,359	29.5	436,740	40.2
Total	**1,069,085**	**100.0**	**1,087,130**	**100.0**

The exposure to banking groups contains repurchase agreements in the amount of EUR 17 million. For these, collateral items with an approximately equal fair value were obtained. None of them was repledged or sold.

For counterparty risk, the same definitions for "in arrears" and "impaired" apply in principle as for customer credit risk. Due to the careful selection of the counterparties, none of positions shown was in arrears nor showed any signs of impairment as of 31 December 2014. Accordingly, no allowance for impairment was set aside for them in 2014.

As with customer credit risk, the exposure towards counterparties/issuers is managed by a limit system. ProCredit banks conclude transactions only with counterparties that have previously been carefully analysed and for which a limit has been approved. The total limit towards a non-OECD bank or banking group may not exceed 10% of the ProCredit bank's capital (unless this amount is below EUR 1 million) without prior additional approval from Group ALCO or the Group Risk Management Committee. For an OECD bank, the threshold is 25%. The typical maximum maturity of our term deposits is three months; longer maturities must be approved by Group ALCO or the Group Risk Management Committee. Approval is likewise required before any investments in securities, except for central bank papers in the local currency of the respective country with a remaining maturity of up to three months.

In order to avoid risk concentrations on group level, an additional maximum limit towards each banking group and each state group (total exposure towards central bank, government and state-owned entities) exists.

The group's counterparty risk is quantified and analysed regularly as part of the risk-bearing capacity calculation. When calculating the risk- and term-adjusted exposure, all exposures towards counterparties are taken into account. A portion of the mandatory minimum reserves is insured against the risk of default and expropriation. This reduces the level of economic capital necessary to cover counterparty risk in the risk-bearing capacity calculation. Moreover, sensitivity to deteriorating counterparty risk (e.g. rating downgrades) is measured using stress tests.

Country risk

The ProCredit group defines country risk as the risk that the group is not able to enforce rights over certain assets in a country or that a counterparty in that country is unable to perform an obligation due to country-specific peculiarities. Country risk arises from cross-border transactions and comprises a range of aspects. Many of the elements that make up country risk are already included in other risk management areas, notably credit risk, foreign currency risk, interest rate risk and operational risk. The ProCredit group's country risk management therefore focuses on those aspects which are not otherwise covered. This includes the risk of convertibility, transferability and expropriation as well as regulatory risks, the risk of macroeconomic shocks and security risks.

The framework for managing the group's country risk is approved by the Management of ProCredit Holding and is specified in the respective group policies and standards. These define country risk, specify the responsibilities at bank and group level, and establish minimum requirements for managing, monitoring and reporting. The Group Risk Management Committee is responsible for all key decisions regarding country risk management and regularly monitors the country risk profile of the group.

Country risk is material and significant only for ProCredit Holding and ProCredit Bank Germany because only these institutions conduct cross-border transactions with other group banks. Other ProCredit banks are only permitted to enter into cross-border transactions within the group in exceptional cases and with prior approval from the Group Risk Management Committee.

Country risk is limited by setting risk limits derived from internal country ratings. These ratings combine various aspects of country risk and are based on country risk ratings published by acknowledged rating agencies as well as internal information. Furthermore, all ProCredit banks monitor country-specific developments and report on them, both regularly and ad hoc, to ProCredit Holding.

Country risk is covered by the risk-bearing capacity calculation at the level of ProCredit Holding and ProCredit Bank Germany. When quantifying country risk, all exposures to the ProCredit banks are taken into account. Country risk is classified as a material risk at group level; however, it is assessed to be insignificant. Therefore, country risk is not allotted a share of the risk-taking potential in the group's risk-bearing capacity calculation.

Market risks

Relevant market risks for the ProCredit group are currency and interest rate risk.

In accordance with the group risk strategy, foreign currency risk and interest rate risk may not be incurred for the purposes of speculative or proprietary trading. Therefore, ProCredit banks are strictly non-trading book credit institutions within the terms of the German Banking Act. The banks close currency positions to the extent possible. Interest rate risk positions are always only taken within established limits. Foreign currency and interest rate derivatives are used exclusively for hedging or liquidity purposes. We do not apply hedge accounting as defined by IAS 39.

Foreign currency risk

Since the ProCredit group is a non-trading book group and has no commodity positions, foreign currency risk is the only risk of those classified as market price risks according to section 2 (3) sentence 2 of the German Solvency Regulation (Solvabilitätsverordnung – SolvV) that is relevant for regulatory capital requirements.

We define foreign currency risk as the risk that an institution incurs losses or is negatively affected by exchange rate fluctuations. Foreign currency risk at bank level has two aspects: the P&L effect and the capital adequacy ratio effect. At group level, foreign currency risk arises from the equity investments made by ProCredit Holding.

The framework for managing the group's foreign currency risk is approved by the Management of ProCredit Holding and is specified in the respective group policies and standards. These define foreign currency risk, specify the responsibilities at bank and group level, and establish minimum requirements for managing, monitoring and reporting. Both the Group ALCO and the Group Risk Management Committee are involved in decisions made with regard to currency risk. The currency risk profiles of the banks and the group are assessed regularly by the Group Risk Management Committee. This organisational structure is also replicated in each of the ProCredit banks.

The P&L effect of foreign currency risk occurs when the volumes of its assets and liabilities denominated in foreign currencies do not match and the exchange rates move unfavourably. The key risk indicator that captures the balance sheet discrepancy for each currency is the open currency position (OCP). The total OCP is calculated as the sum of the absolute values of the individual currency positions and is limited to 10% of the bank's capital, unless deviation from this limit has been approved by the Group ALCO or Group Risk Management Committee. A threshold of 7.5% of a ProCredit bank's capital has been defined as an early warning indicator for the total OCP, and ±5% for each individual currency OCP. The P&L effect arising from OCPs is also measured regularly when calculating the risk-bearing capacity of each individual ProCredit bank. The calculation is based on a Value at Risk (VaR)-type analysis of the OCPs considering historically extreme exchange rate volatilities during the past seven years. In addition, regular stress tests are conducted for the risk arising from OCPs.

The capital adequacy ratio effect occurs in cases where the capital of a bank is held in a different currency than many of the assets it supports. In that case, local currency depreciation can result in a significant deterioration of the capital adequacy because the foreign currency assets appreciate (from a local perspective) and the bank therefore has higher risk-weighted assets but the capital remains unchanged. To mitigate this risk, the group aims at increasing the share of local currency assets in the banks' balance sheets. At least once a year, extensive currency risk stress tests are performed that depict the effects of unfavourable exchange rate developments on the banks' capital adequacy ratios.

Foreign currency risk at group level arises primarily as a result of the equity that ProCredit Holding holds in its foreign subordinated companies. Most banks keep their equity in the respective local currency or in USD. Thus, from a consolidated group perspective, OCPs in the respective local currencies and USD exist and are roughly equal to the amount of the respective equity base. The group's regulatory capital and risk-taking potential are thus exposed to fluctuations due to changes in the exchange rates of local currencies and the USD against the EUR. These fluctuations are partially accompanied by simultaneous changes in the credit risk reported in EUR. The translation reserve in the equity position of the group decreased from EUR -67.2 million at the end of 2013 to EUR -48.7 million as of December 2014. This was driven to a large extent by the USD appreciation against the EUR.

The following table shows the consolidated EUR and USD OCPs of the banks. The "other currencies" mainly include the local currencies. Since most banks keep their equity in the respective local currency, they have significantly more assets than liabilities in this local currency and thereby expose the group to foreign currency risk from equity participations.

in '000 EUR **As at December 31, 2014**	**EUR**	**USD**	**Other currencies**
Assets			
Cash and cash equivalents	317,338	200,488	337,300
Loans and advances to banks	233,230	111,413	66,444
Financial assets at fair value through profit or loss	748	4,238	59
Available-for-sale financial assets	142,641	47,726	41,899
Loans and advances to customers	1,517,156	1,069,709	1,576,782
of which: indexed to EUR / USD	*481,255*	*24,251*	*0*
Tax assets	16	0	2,142
Other assets	9,664	12,632	31,749
Total assets	**2,220,794**	**1,446,206**	**2,056,378**
Open forward position (assets)	**182,320**	**10,298**	**1,649**
Liabilities			
Liabilities to banks	187,600	72,668	91,846
Financial liabilities at fair value through profit or loss	2,342	0	232
Liabilities to customers	1,520,809	879,898	1,591,654
of which: indexed to EUR / USD	*8,430*	*6,739*	*0*
Liabilities to international financial institutions	306,502	198,436	40,567
Debt securities	167,658	79,223	1,096
Tax liabilities	371	859	2,904
Provisions	3,837	4,525	6,956
Other liabilities	4,947	6,734	9,835
Subordinated debt	103,542	53,323	698
Hybrid capital	67,082	0	0
Total liabilities	**2,364,689**	**1,295,667**	**1,745,788**
Open forward position (liabilities)	**4,372**	**116,932**	**74,361**
Net position	**34,053**	**43,905**	**237,877**

in '000 EUR **As at December 31, 2013**	**EUR**	**USD**	**Other currencies**
Assets			
Cash and cash equivalents	255,738	181,174	395,527
Loans and advances to banks	155,154	134,831	49,041
Financial assets at fair value through profit or loss	2,156	3,872	102
Available-for-sale financial assets	215,640	47,361	60,004
Loans and advances to customers	*1,581,784*	*984,116*	*1,454,803*
of which: indexed to EUR / USD	499,121	27,948	0
Tax assets	1,679	0	3,405
Other assets	12,005	9,769	32,543
Total assets	**2,224,156**	**1,361,124**	**1,995,424**
Open forward position (assets)	**63,183**	**6,029**	**3,209**
Liabilities			
Liabilities to banks	210,938	69,288	49,120
Financial liabilities at fair value through profit or loss	28	0	8
Liabilities to customers	1,409,095	818,800	1,574,344
of which: indexed to EUR / USD	*7,800*	*6,567*	*0*
Liabilities to international financial institutions	374,507	233,116	67,467
Debt securities	167,666	80,675	5,350
Tax liabilities	540	312	5,710
Provisions	2,240	2,797	7,040
Other liabilities	4,276	7,384	12,006
Subordinated debt	102,551	55,599	5,608
Hybrid capital	67,095	0	0
Total liabilities	**2,338,936**	**1,267,971**	**1,726,653**
Open forward position (liabilities)	**7,995**	**61,996**	**41,854**
Net position	**-59,592**	**37,187**	**230,125**

Since June 2014, the group foreign currency risk (foreign currency risk from equity participations) has been quantified and analysed regularly in the context of the risk-bearing capacity calculation with the support of a VaR model. Relevant stress scenarios are also used to determine the group's economic capital requirements to cover foreign currency risk in extremely negative circumstances in two regions which are highly relevant for the group. During the 2014 financial year, the foreign currency risk calculated for the group over a one-year horizon increased slightly due to some strong devaluations in Eastern Europe.

Interest rate risk in the banking book

Interest rate risk is the risk of incurring losses driven by changes in market interest rates and arises from structural differences between the repricing maturities of assets and liabilities. This risk is divided into three sub-categories: repricing risk, basis risk and option risk. The group's interest rate risk is primarily due to the fact that, in our countries of operation, most loans are offered at fixed interest rates, and are financed by short-to-medium-term customer deposits. Overall funding costs could increase over time if new deposits could only be attracted by paying a higher interest rate. As the income from fixed-rate loans remains unchanged over the longer term, our margins would contract.

The framework for managing the group's interest rate risk is approved by the Management of ProCredit Holding and is specified in the respective group policies and standards. These define interest rate risk, specify the responsibilities at bank and group level, and establish minimum requirements for managing, monitoring and reporting. The Group Risk Management Committee is responsible for all key decisions regarding group interest rate risk management, and this committee analyses, at least quarterly, the interest rate risk profile of the group. This organisational structure is replicated in the ProCredit banks. In addition, each bank's ALCO reviews any interest rate-sensitive transaction with a notional amount exceeding 5% of the bank's capital, and which has a maturity to the next repricing longer than six months. This is designed to avoid the conclusion of transactions that could have a negative impact on the interest rate risk of the institution.

In order to maintain an acceptable level of interest rate risk even when loans are disbursed with longer maturities, many ProCredit banks are increasingly offering their clients variable-rate loans, and are also issuing loans with shorter terms. In this way, the repricing maturities of assets can be matched to the repricing maturity of liabilities, even when liabilities have shorter maturities than loans. In order to grant variable-rate loans in a transparent manner, banks use a publicly available interest rate as a benchmark when adjusting the interest rates and communicate this clearly to the client at the time of disbursement. Financial instruments to mitigate interest rate risk (hedges) are not available in most local currencies.

The group-wide approach used to measure, monitor and limit interest rate risk is based on repricing gap analyses. The assets and liabilities are distributed across time buckets according to the terms of the underlying contracts. Sight deposits and savings accounts are included in the gap analyses according to their expected repricing maturities. These maturities are derived from a group-wide analysis of historical developments.

The economic value impact is a key indicator for managing interest rate risk, and measures the potential economic value change on all assets and liabilities determined by a sudden detrimental change in interest rates. For EUR or USD we assume a parallel shift of the interest rate curve by +/- 200 basis points in line with the BaFin Circular on interest rate risk management dated November 2011. For local currencies the magnitude of the shocks is derived using a VaR-type methodology taking into consideration interest rate volatilities over the past seven years.

The potential economic impact when simulating a simultaneous detrimental (upward or downward) interest rate shock across all currencies must not exceed 10% of its capital, unless approved by the Group Risk Management Committee; the early warning indicator for each currency is set at 5%.

A second key indicator measures the potential impact of interest rate shocks on the expected earnings of the individual banks (P&L effect) over a period of three months. This risk measure indicates how the income statement may be influenced by interest rate risk under a short-term perspective and is deemed significant if it exceeds 1% of the bank's capital. In addition, the P&L effect is monitored over 12 months.

In order to further analyse the bank's sensitivity to interest rate risk in extremely negative circumstances, the results of quarterly stress scenarios are calculated.

The group-wide exposure to interest rate risk is quantified and analysed quarterly in the context of the risk-bearing capacity calculation. The quantification is based on the P&L effect for the group, with the interest rate shocks for local currencies being determined under consideration of historical correlations. Regional stress scenarios are also used to determine the economic capital needed by the group to cover interest rate risk in extremely negative circumstances.

in '000 EUR **Currency**	**31.12.2014** **12-month interest earnings**	**31.12.2014** **Interest rate shock Basis points**	**31.12.2013** **12-month interest earnings**	**31.12.2013** **Interest rate shock Basis points**
EUR	5,430	-200	3,700	-200
USD	4,106	-200	3,908	-200
Other*	7,178	230	12,448	447
Total in amount	**16,714**		**20,056**	

** The interest rate shock for other currencies is the weighted average shock for the local currencies used in the group. It is the interest rate shock that would have the severest adverse impact on the group and is based on the historical development over the past seven years.*

The need for economic capital to cover interest rate risk in the group (P&L effect) remained limited in 2014, and was somewhat reduced at some banks by the measures implemented.

Liquidity and funding risk

Liquidity and funding risk addresses the ProCredit group's short- and long-term ability to meet its financial obligations in a complete and timely manner.

The framework for managing the group's liquidity and funding risk is approved by the Management of ProCredit Holding and is specified in the respective group policies and standards. These define liquidity risk, specify the responsibilities at bank and group level, and establish minimum requirements for managing, monitoring and reporting. The Group ALCO is responsible for all key operational decisions regarding group liquidity management. Selected liquidity risk indicators of the banks and ProCredit Holding are reported to the Group ALCO and are presented each month in detail to the Group Risk Management Committee. This organisational structure is replicated in each of the ProCredit banks. The respective local management is responsible for liquidity management in each ProCredit bank within the context of the group liquidity risk management framework.

Liquidity risk is limited by the fact that we primarily issue instalment loans which feature monthly repayments and are financed largely by local deposits. Our deposit-taking operations focus on our target group of business clients and savers, with whom we establish strong relationships. The financial crisis in 2008 and 2009 has shown that our customer deposits are a stable and reliable source of funding.

We measure our liquidity risk using, among other instruments, a liquidity gap analysis, and limit the risk based on the liquidity indicator defined by the German Liquidity Regulation (*Liquiditätsverordnung – LiqV*), which requires institutions to hold sufficient liquidity for the next 30 days. For deposits without contractual maturities we apply liability outflow assumptions that are more conservative than necessary according to LiqV, in order to reflect the more volatile environment in our countries of operation.

In addition, early warning indicators are defined and are monitored using reporting triggers. If the indicators go above or, as the case may be, fall below the reporting triggers, the reasons must be explained, and if appropriate, mitigating measures must be decided by the bank's ALCO and communicated to Group Financial Risk Management. A key indicator is the highly liquid assets indicator, which determines that the banks must always hold sufficient highly liquid assets to be able to pay out at least 20% of all customer deposits at all times.

In addition, as part of risk management, idiosyncratic, market-related and combined stress tests are conducted monthly and ad hoc to make sure that every ProCredit bank keeps sufficient liquid funds to meet its obligations, even in difficult times. Moreover, each bank has a contingency plan. If unexpected circumstances arise and an individual bank proves not to have sufficient liquid funds, the ProCredit group has a liquidity contingency plan and ProCredit Holding would step in as a "lender of last resort". ProCredit Holding keeps an adequate liquidity reserve available for this purpose.

The liquidity of the banks and of ProCredit Holding is managed on a daily basis by their respective treasury departments, based on the ALCO-approved cash flow projections which take account of planned business developments and liquidity indicators, and is monitored by risk management and ALCO.

The following table shows the undiscounted cash flows of the financial assets and financial liabilities of the group according to their remaining contractual maturities. The remaining contractual maturity is defined as the period between the balance sheet date and the contractually agreed due date of the asset or liability, or the due date of a partial payment under the contract for an asset or liability.

in '000 EUR **As at December 31, 2014**	**Up to 1 month**	**1–3 months**	**4–6 months**	**7–12 months**	**1–5 years**	**More than 5 years**	**Total**
Assets							
Financial instruments							
Cash and cash equivalents	844,660	10,598	0	0	0	0	855,257
Loans and advances to banks	349,531	40,958	20,146	520	0	0	411,154
Financial assets at fair value through profit or loss	29	589	22	4,820	-258	0	5,202
of which derivatives	*29*	*504*	*0*	*475*	*-258*	*0*	
Available-for-sale financial assets	31,632	50,086	29,998	58,497	65,494	831	236,539
Loans and advances to customers	261,244	351,685	514,591	951,633	2,476,966	599,433	5,155,553
Non-financial instruments							
Current tax assets	542	1,575	27	14	0	0	2,158
Other assets	21,243	5,315	1,076	9,477	16,731	207	54,049
Total assets	**1,508,881**	**460,805**	**565,860**	**1,024,962**	**2,558,933**	**600,470**	**6,719,911**
Liabilities							
Financial instruments							
Liabilities to banks	80,167	23,427	20,589	36,441	163,221	65,044	388,889
Financial liabilities at fair value through profit or loss	1,972	635	25	0	0	0	2,632
of which derivatives	*1,972*	*635*	*25*	*0*	*0*	*0*	*2,632*
Liabilities to customers	2,327,169	339,368	329,494	604,270	377,834	89,644	4,067,780
Liabilities to international financial institutions	28,120	31,331	51,961	76,622	317,868	88,831	594,733
Debt securities	24,159	1,779	5,923	45,834	131,148	83,947	292,789
Subordinated debt	2,625	2,038	3,773	12,888	115,854	79,188	216,366
Hybrid capital	0	0	0	2,082	0	65,000	67,082
Non-financial instruments							
Other liabilities	12,497	4,113	2,378	1,117	659	751	21,515
Provisions	2,672	2,480	669	2,878	2,250	33	10,983
Current Tax liabilities	391	2,061	1,080	601	0	0	4,134
Total liabilities	**2,479,773**	**407,233**	**415,893**	**782,735**	**1,108,834**	**472,438**	**5,666,906**
Contingent liabilities							
Financial guarantees	146,402	0	0	0	0	0	146,402
Credit commitments (irrevocable loan commitments)	13,152	0	0	0	0	0	13,152
Contractual Liquidity surplus	**-1,130,446**	**53,572**	**149,967**	**242,227**	**1,450,099**	**128,032**	

in '000 EUR **As at December 31, 2013**	**Up to 1 month**	**1–3 months**	**4–6 months**	**7–12 months**	**1–5 years**	**More than 5 years**	**Total**
Assets							
Financial instruments							
Cash and cash equivalents	806,561	26,107	0	0	0	0	832,667
Loans and advances to banks	316,142	27,394	119	602	41	12	344,309
Financial assets at fair value through profit or loss	827	331	564	572	4,468	0	6,762
of which derivatives	*827*	*276*	*540*	*392*	*135*	*0*	
Available-for-sale financial assets	50,119	45,355	24,969	152,953	53,256	805	327,457
Loans and advances to customers	268,492	363,318	523,366	975,831	2,303,134	550,491	4,984,631
Non-financial instruments							
Current tax assets	426	803	1,966	1,889	0	0	5,084
Other assets	15,610	1,652	320	14,543	21,923	269	54,317
Total assets	**1,458,176**	**464,961**	**551,305**	**1,146,390**	**2,382,820**	**551,576**	**6,555,228**
Liabilities							
Financial instruments							
Liabilities to banks	46,718	23,686	29,702	63,736	134,487	72,340	370,668
Financial liabilities at fair value through profit or loss	86	114	0	164	214	0	577
of which derivatives	*86*	*114*	*0*	*164*	*214*	*0*	*577*
Liabilities to customers	2,087,168	345,277	385,000	634,963	366,095	75,331	3,893,834
Liabilities to international financial institutions	29,358	44,644	65,337	86,812	395,323	120,382	741,857
Debt securities	3,565	1,776	5,121	14,012	192,659	87,009	304,142
Subordinated debt	1,945	3,236	4,689	8,770	135,046	184,101	337,787
Hybrid capital	0	0	0	2,095	0	65,000	67,095
Non-financial instruments							
Other liabilities	15,244	4,436	1,377	1,130	630	849	23,666
Provisions	1,416	1,042	627	1,241	3,386	4	7,716
Current Tax liabilities	37	5,521	134	870	0	0	6,562
Total liabilities	**2,185,537**	**429,732**	**491,987**	**813,793**	**1,227,841**	**605,015**	**5,753,904**
Contingent liabilities							
Financial guarantees	136,342	0	0	0	0	0	136,342
Credit commitments (irrevocable loan commitments)	17,182	0	0	0	0	0	17,182
Contractual Liquidity surplus	**-880,885**	**35,229**	**59,318**	**332,597**	**1,154,980**	**-53,439**	

The following table shows the distribution of liquidity-relevant positions across certain time buckets. Some positions, especially liabilities to customers (daily due), are distributed into the time buckets according to their historical behaviour in times of stress.

in '000 EUR **As at December 31, 2014**	**Up to 1 month**	**1–3 months**	**4–6 months**	**7–12 months**	**More than 1 year**	**Total**
Assets						
Cash	215,767	0	0	0	0	215,767
Mandatory reserves with central bank	370,195	0	0	0	0	370,195
Other central bank balances (excl. minimum reserve)	191,290	0	0	0	0	191,290
Credit commitments	48,027	0	0	0	0	48,027
Government bonds & marketable securities	230,039	23,885	17,537	15,135	22,622	309,219
Placements with external banks	349,634	41,014	20,063	0	0	410,711
Loans and advances to customers	145,006	291,367	423,456	797,488	2,458,442	4,115,759
Currency derivatives (asset side)	81,487	117,410	0	6,442	24,995	230,334
Total Assets	**1,631,446**	**473,675**	**461,056**	**819,066**	**2,506,059**	**5,891,302**
Liabilities						
Current liabilities to banks (due daily)	7,848	7,848	0	0	0	15,697
Current liabilities to customers (due daily)	412,535	82,507	123,761	247,521	1,196,352	2,062,676
Contingent liabilities from guarantees	6,921	0	0	0	0	6,921
Credit commitments	70,296	0	0	0	0	70,296
Liabilities to external banks	66,456	20,828	15,841	27,425	201,069	331,620
Liabilities to international financial institutions	7,712	28,722	48,622	78,333	365,753	529,141
Liabilities to customers (term deposits)	239,532	324,551	314,590	572,145	421,535	1,872,352
Debt securities / Bonds	17,907	0	2,268	34,220	187,064	241,458
Subordinated debt	0	232	348	7,413	146,678	154,670
Currency derivatives (liability side)	83,378	117,652	0	5,988	24,714	231,732
Total Liabilities	**912,585**	**582,340**	**505,428**	**973,044**	**2,543,165**	**5,516,562**
Excess from previous band	0	718,860	610,196	565,824	411,845	
Expected liquidity surplus	**718,860**	**610,196**	**565,824**	**411,845**	**374,739**	
Sufficient Liquidity Indicator	**1.8**					
Highly liquid assets	**34%**					

The expected liquidity surplus quantifies the potential liquidity needs within a certain time period if it has a negative value, and it shows a potential excess of liquidity if it has a positive value. This calculation includes excess liquidity from the previous time buckets. As of December 2014 the group sufficient liquidity indicator stood at 1.8 and the HLA ratio at 34%, both indicating a comfortable liquidity situation.

Funding risk is the danger that additional funding cannot be obtained, or can only be obtained at significantly higher costs. It therefore covers parts of the non-systemic effect of interest rate changes. This risk is mitigated by the fact that we finance our lending operations primarily through retail customer deposits, supplemented by long-term credit lines from international financial institutions. We make little use of interbank and financial markets. The funding of the ProCredit group has proven to be resilient even in times of stress. As of end-December 2014 the largest funding source was customer deposits with EUR 3,992.2 million (2013: EUR 3,801.9 million). IFIs are the second-largest source of funding, accounting for EUR 544.1 million (2013: EUR 673.1 million).

The ProCredit group manages, measures and limits funding risk through business planning, maturity gap analysis and several indicators. The funding needs of the banks, identified in the business planning process, are monitored and regularly reviewed on group level. Group ALCO (with support from ProCredit Holding's Group Funding

Department) monitors the progress of all significant individual transactions with external funding providers, especially international financial institutions (IFIs). ProCredit Holding and ProCredit Bank Germany also offer bridge financing in case a funding project is delayed. A key indicator for limiting funding risk is the deposit concentration indicator. This is defined as the share of the ten largest depositors relative to the bank's total deposit base, which should not exceed 20%. Two more indicators additionally restrict the level of funding from the interbank market to a low level.

Funding risk is included in the risk-bearing capacity calculation. Liquidity risk is not taken into account in the risk-bearing capacity calculation because capital cannot be used to mitigate this risk.

Throughout the reporting period, all group companies had enough liquidity available at all times to meet all financial obligations in a timely manner. At year-end all banks had a sufficient liquidity indicator of at least 1. The ProCredit group had adequate liquidity levels at all times during 2014. ProCredit Holding's liquidity reserve for unexpected outflows as of end-December 2014 stood at EUR 65 million and was thus in excess of the target figure of EUR 55 million.

Operational risk and fraud risk

In line with Basel II, we define operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems and/or external events. This definition includes legal risk as well as reputational risk. Dedicated policies on operational risk management, fraud prevention, information security and outsourcing have been implemented across all group entities; they have been approved by the Management of ProCredit Holding and are reviewed annually. The principles outlined in these documents have been designed to effectively manage the group's operational and fraud risk exposure and that of each bank, and they are in compliance with the Basel II requirements for the "standardised approach" for operational risk (as described in more detail in CRR).

The allocation of responsibilities and tasks within ProCredit's operational risk management framework comprises the following levels:

- At **group level** operational risk is overseen by the Management Board of ProCredit Holding, the Group Risk Management Committee and the Group Committee on Financial Crime Prevention. The Group Operational Risk Management Department in ProCredit Holding is responsible for the development of methodologies in the area of operational risk management and fraud prevention as well as for monitoring the group's operational risk situation and providing support to the banks in the management of operational risks and fraud risks. With regard to fraud prevention, Group Operational Risk Management and Group AML collaborate closely.
- At **single institution level** each bank has an assigned operational risk manager to ensure the effective implementation of the operational and fraud risk management framework within the institution. Operational risk managers work in close co-operation with process owners who are responsible for the day-to-day management of operational and fraud risks in their area of expertise. Analogous to the Group Risk Management Committee, each bank has an (Operational) Risk Management Committee which serves as the decision-making body for operational risk matters. Each bank's management bears overall responsibility for appropriate implementation of the framework in the institution.
- As an independent function, **Internal Audit** ensures adherence to the rules defined for the management of operational risk in each of the ProCredit institutions.

A centralised and decentralised reporting procedure ensures that the Management of ProCredit Holding and the management of each ProCredit bank, as well as other members of the (Operational) Risk Management Committee, receive regular comprehensive reports on operational risks to serve as a basis for their decisions.

The operational risk management process consists of the identification, evaluation/quantification, treatment, monitoring, communication and documentation, and follow-up of operational and fraud risks. The main tools utilised to manage these risks are the Risk Event Database, Annual Risk Assessments, Key Risk Indicators and New Risk Approvals.

The Risk Event Database (RED) is a tool developed to ensure that all operational risk events identified in the group are documented, analysed and communicated effectively. It guides all ProCredit institutions through the risk management process, ensuring that adequate attention is given to the implementation of necessary corrective or preventive measures for risk reduction or mitigation. As opposed to ex-post analysis of risk events from RED, the Annual Risk Assessments are a systematic way of identifying and evaluating material risks in order to confirm the adequacy of the control environment. Like RED, Annual Risk Assessments are used throughout the risk management process. These two tools complement each other and provide an overall picture of the operational risk profile of each institution and of the group as a whole.

Key Risk Indicators (KRI) are used as indicators of elevated fraud risk in specific areas of banking operations or specific branch locations that could be used by a potential fraudster. These indicators are analysed regularly and where needed preventive measures are agreed on. To complete the picture of operational risk, new products, processes and instruments need to be analysed to identify and manage potential risks before implementation. This is ensured by the New Risk Approval (NRA) process.

In addition to the above mentioned principles and methodologies which are applicable to operational risk and fraud risk, the group employs methods and processes designed to handle specific aspects of operational risk, such as information security and system risk, external risk, legal and compliance risk and outsourcing risk. These are described briefly below:

Information security and system risk: The IT software and hardware support for the ProCredit group is provided by Quipu GmbH which is part of the ProCredit group. The group has set standards with respect to IT infrastructure, business continuity and information security. Information security controls are part of existing processes and procedures, and security procedures have been developed to bridge the gaps in identified areas. The banks carry out a comprehensive classification of their information assets and conduct an annual risk assessment on their critical information assets to ensure that the right level of security is assigned based on criticality.

A robust business continuity framework developed in the group allows threats to be understood, critical processes to be identified, and resources for recovery to be allocated depending on the priorities of the processes.

External risks: ProCredit banks obtain local insurance policies against losses arising from natural disasters as a means of risk mitigation. External risks that might disrupt business are addressed in the business continuity plans of each bank. Our staff are trained how to behave in risky situations in order to protect their life and health, especially in countries with a precarious security situation.

Legal and compliance risks are effectively limited on the one hand by diligent staff in the different head office departments as well as the branches. On the other hand, ProCredit Holding and all of the banks have a specialised department responsible for the identification and implementation of all regulations that apply to the bank. As the regulations in most of the countries in which we operate change relatively often, all of the banks as well as ProCredit Holding must be capable of monitoring these changes and responding to them quickly.

Outsourcing risk: The ProCredit group outsources relatively few activities. Consequently, the outsourcing risk for the group is low. The Group Outsourcing Policy, which is in line with the provisions of the German Banking Act, ensures appropriate risk assessment and control measures.

The table below provides an overview of gross and net losses due to operational risk events incurred by all ProCredit institutions in 2014.[4]

Key Operational Risk Figures 2014	
Gross Loss, EUR	2,775,036
Current Net Loss, EUR	1,564,082
Number of Loss Events	1,046

Risks arising from money laundering, terrorist financing and other acts punishable by law

Ethical behaviour is an integral part of the values-oriented business model of all ProCredit banks. The prevention of money laundering, terrorist financing and fraud are a key component of our self-perception. ProCredit banks do not tolerate any fraudulent activity or any other questionable behaviour from either their clients or their own employees.

ProCredit banks are in full compliance with all regulatory requirements concerning the prevention of money laundering and terrorist financing. Moreover, the banks adhere to group-wide guidelines on the prevention of money laundering and terrorist financing, which in many regards are stricter than the prevailing legal requirements.

As the ProCredit group is supervised by the German Federal Financial Supervisory Authority (BaFin), we implement the requirements stipulated by the German Money Laundering Act across the group as minimum requirements in all ProCredit banks. As the superordinated company for the ProCredit group, ProCredit Holding is responsible for ensuring group-wide compliance with these requirements.

This responsibility is documented in the form of our Code of Conduct and Exclusion List, which constitute the core rules and regulations that all employees of ProCredit banks are obliged to observe. The group-wide guidelines on the prevention of money laundering, terrorist financing and fraudulent activities – the Group AML Policy and the Group Fraud Prevention Policy, together with their subordinate directives – specify how these basic rules are to be implemented in practice.

Besides identifying all contracting parties and clarifying the purpose of the business relationship, "knowing the customer" for ProCredit banks always also entails identifying the beneficial owner of all funds that are managed in customer accounts. Beneficial owners are natural persons who substantially profit from a business structure, even if they are not personally in evidence during our business relationship with a client. Without exception, all ProCredit banks identify and screen all persons who could prove to be beneficial owners.

[4] Status as of: 27 February 2015 (recording date)

By thoroughly knowing our clients, our banks aim to understand every payment. In addition, all ProCredit banks use specialised software to identify payments that give cause for suspicion of money laundering, terrorist financing or fraud.

Anti-money laundering officers in all ProCredit banks work closely with the responsible law enforcement authorities and report regularly to the Group AML Officer at ProCredit Holding, who in turn is the main contact for the law enforcement authorities in Germany and other countries.

Capital management

At no time may either a ProCredit bank or the group as a whole incur greater risks than it is able to bear. This principle is implemented using different indicators for which early warning indicators and limits have been established. The indicators for each individual ProCredit bank and the group as a whole include, in addition to local regulatory standards, a Basel II capital adequacy calculation, a Tier 1 leverage ratio and a risk-bearing capacity calculation.

The capital management of the group has the following objectives:

- compliance with external capital requirements
- compliance with the internally defined minimum capital adequacy requirements
- support for the group in implementing its plans for continued growth while following its business strategy as a "house bank for small and medium-sized businesses"

The capital management of the ProCredit banks and the group as a whole is governed by group policies, and monitored on a monthly basis by the Group Risk Management Committee.

Risk-bearing capacity

The risk-bearing capacity concept is a key element of ProCredit's group-wide risk management and internal capital adequacy assessment process. In the context of the risk-bearing capacity calculation the capital needs arising from our specific risk profile are compared with the available capital resources to assure that the ProCredit group's capitalisation is at all times sufficient to match our risk profile. It is an ongoing process that raises group-wide awareness of our capital requirements and our exposure to material risks.

The methods we use to calculate the amount of economic capital required to cover the different risks the group is exposed to are based on statistical models, provided that appropriate models are available. Extreme scenarios, some of them historically observed in individual countries of operation, are applied to the group in its entirety to test its ability to withstand such shocks, both in individual risk areas and in combination. The guiding principle for our risk-bearing capacity calculations is that the group is able to withstand shock scenarios without endangering depositors and other providers of funding. In our view, the crisis years 2009 and 2010 underscored, firstly, the necessity for a conservative approach towards capital management, and secondly, the developments during that time proved the strength of the group in dealing with a very difficult economic environment. Throughout this period, the group showed strong levels of capital, leaving ample headroom for additional loss absorption had the economic conditions further deteriorated.

The group currently applies both a going concern and a gone concern approach in managing and monitoring its risk-bearing capacity. Both approaches were subjected to a thorough review at group level in 2014 and will be further developed on an ongoing basis in 2015 in light of the changed regulatory requirements. We are committed to being able, in the event of unexpected losses in the gone concern approach both in normal and in stress scenarios, to meet our (non-capital) obligations at all times. The group applies the going concern approach to ensure that if risks materialise (unexpected losses are incurred) business operations can be continued. As a regulated financial holding group, we must satisfy the minimum capital requirements set by the supervisory authority at all times.

When calculating the economic capital required to cover risk positions we apply a one-year risk assessment horizon. The included material risks and the limits set for each risk reflect the specific risk profile of the group and are based on the annually conducted risk inventory.
These risks are:

- Client credit risk
- Counterparty and issuer risk
- Foreign currency risk
- Interest rate risk
- Operational risk
- Business risk
- Funding risk

The economic capital needed to cover the risks to which the ProCredit group is exposed is compared with the available capital.

The group's risk coverage potential in the gone concern approach, defined as the consolidated group's equity (net of intangibles, minority interests and deferred tax assets) plus ProCredit Holding's subordinated debt, amounted to EUR 662.9 million as of the end of December 2014. In 2014 the Resources Available to Cover Risk (RAtCR ~ *Risikodeckungsmasse*) were set at 70% of the risk-taking potential (less a fixed capital buffer), i.e. EUR 454.0 million. Only the RAtCR are used to define the limits in each risk category. This creates a buffer amounting to 30% of the risk coverage potential. The table below shows the distribution of RAtCR among the different risks and the limit utilisation as of end-December 2014. In the standard scenarios, which under the gone concern approach is calculated with a 99.9% confidence level, the ProCredit group needs only 33.7% of its RAtCR to cover its risk profile.

Risk Factor	**Limit** (in %)	**Limit** (in EUR m)	**Limit Used** (in EUR m)	**Limit Used** (in % of Limits)
Credit Risk (Clients)	25	162.2	55.5	34.2
Counterparty Risk	4	25.9	5.8	22.3
Interest Rate Risk	**10**	**64.9**	**16.7**	**25.8**
Foreign Currency Risk	**13**	**84.3**	**25.5**	**30.2**
Operational Risk	**10**	**64.9**	**30.5**	**47.0**
Business Risk	6	38.9	16.7	42.8
Funding Risk	2	13.0	2.2	17.0
Resources Available to Cover Risk		**454.0**	**152.8**	**33.7**

In the going concern approach, the RAtCR are defined as the surplus over regulatory minimum capital plus the expected pre-tax profit for the next twelve months (less the fixed capital buffer). As of end-December 2014, the RAtCR amounted to EUR 196.7 million. In the standard scenario, which under the going concern approach is quantified with a 99% confidence level, the ProCredit group needs 61.6% of its RAtCR to cover its risks.

Stress tests are also performed at least quarterly on the group level to test the group's risk-bearing capacity under severe conditions. In such scenarios we assume a significant deterioration of worldwide macroeconomic conditions. The stress scenario involves a massive economic downturn in South Eastern Europe and Central America. The results of the stress test show that the risks to which the group would be exposed in an extreme stress scenario would not exceed its risk-bearing capacity (47% utilisation of RAtCR in the gone concern approach). Our analysis of the ProCredit group's risk-bearing capacity thus confirms that the group would have an adequate level of capitalisation even under extremely adverse conditions.

The stress tests across all risk categories are supplemented by ad hoc stress tests for the individual risks and event-driven inverse stress tests performed at least once per year.

Regulatory capital adequacy

Whereas the external minimum capital requirements for the ProCredit group are imposed and monitored by the German Federal Financial Supervisory Authority and by the Supervisory College pursuant to section 8a of the German Banking Act, the individual ProCredit banks are subject to the requirements imposed by the local banking supervisory authorities.

Methods for the calculation of capital adequacy vary between countries, but an increasing number of jurisdictions where the ProCredit banks operate base their calculation methods on recommendations of the Basel Committee on Banking Supervision. Compliance with local supervisory requirements is monitored for each ProCredit institution on the basis of the respective local accounting rules, and all group banks have to ensure that they satisfy their respective regulatory requirements regarding capitalisation.

During the reporting period, all regulatory capital requirements were met at all times.

In the following the group's regulatory capital requirements and capital ratios are presented. The figures as of 31 December 2013 were calculated according to the German Banking Act and the German Solvency Regulation in the versions applicable as of 31 December 2013. Since 1 January 2014, the Basel III requirements, implemented in Europe through Capital Requirements Directive IV and CRR, have been binding for the group.

	31.12.2014		31.12.2013	
in '000 EUR	Risk weighted assets	Capital requirements	Risk weighted assets	Capital requirements
Credit risk	3,756,789	300,543	4,172,576	333,806
Market risk (currency risk)	540,015	43,201	512,070	40,966
Operational risk	**803,214**	**64,257**	**803,214**	**64,257**
CVA* risk	1,619	130		
Total	**5,101,636**	**408,131**	**5,487,860**	**439,029**

** Risk amount due to the credit valuation adjustment (CVA)*
Risk-weighted assets, by risk category and capital requirements

For assessing the exposure towards credit risk, the credit risk standardised approach (CRSA) is used for all exposure classes. Collateral is not included in the risk-weighted asset calculation. Guarantees from the Multilateral Investment Guarantee Agency (MIGA) for our mandatory minimum reserves held with local central banks are only recognised when determining the capital requirement for credit risk according to the standardised approach. Exposures towards central governments or central banks in non-EU countries, in countries whose supervisory system is not materially equivalent to that of EU countries, or in countries with a rating below the lower-medium grade (i.e. below BBB- in the case of Fitch Ratings) are given a risk-weighting of at least 100% regardless of the underlying currency, as stipulated in CRR. The mandatory minimum reserves are inevitable exposures driven by the group's business strategy, which is based on financing loans in transition economies and developing countries mainly through local customer deposits. The group has therefore chosen to insure part of this exposure against the risk of default and expropriation.

As the ProCredit group consists solely of non-trading book institutions, which moreover do not engage in transactions involving commodities, foreign currency risk is the only market risk to be considered. The determination of the capital requirement for foreign currency risk is based on the aggregation method. Foreign currency risk at group level arises primarily as a result of the equity holdings that ProCredit Holding maintains in foreign currency in its foreign subsidiaries. However, the effects of exchange rate fluctuations on the capital ratios are limited, as changes in equity are partially offset by corresponding changes in risk-weighted assets.

The ProCredit group applies the standardised approach to quantify operational risk. Compared to the regulatory capital requirements for operational risk, which amount to EUR 64.3 million, the average annual loss according to data recorded in the Risk Event Database in the last three years amounted to EUR 1.7 million.

Given the small volume of derivatives held by the group, the risk arising from credit valuation adjustment (CVA)[5] is insignificant. The ProCredit group uses the standardised approach to calculate the capital requirements to cover CVA risk.

The contraction of risk-weighted assets compared to the previous year was primarily due to the adjustment factor for risk exposures to small and medium enterprises (SMEs) introduced by the CRR.[6] During 2014 the development of risk-weighted assets largely mirrored the development of on-balance sheet assets.

in '000 EUR	**31.12.2014**	**31.12.2013**
Common equity Tier 1 capital	517,545	493,282
Additional Tier 1 capital	24,798	65,000
Tier 2 capital	108,380	113,714
Total capital	**650,722**	**671,996**
Risk weighted assets	**5,101,636**	**5,477,859**
Common equity Tier 1 capital ratio	10.1%	9.0%
Tier 1 capital ratio	10.6%	10.2%
Total capital ratio	**12.8%**	**12.2%**

Capital ratios of the ProCredit group

5 The CRR introduced a capital requirement to cover the CVA risk arising from over-the-counter (OTC) derivatives. In contrast to counterparty default risk, this risk refers to the danger that the positive replacement value is reduced because the credit risk premium for the counterparty increases, without a default occurring.

6 The CRR lowered the capital requirement for credit exposures to SMEs. It is calculated by multiplying the normal requirement by a factor of 0.7619. This is intended to offset the increase in the minimum capital requirement due to the introduction of the capital conservation buffer, i.e. institutions should have to maintain the same amount of capital in absolute terms after the introduction of the capital conservation buffer as they did under the formerly applicable regulatory capital requirements.

The Common Equity Tier 1 capital of the ProCredit group is mainly composed of subscribed capital and reserves. Deductions are made for intangible assets, deferred tax assets which are conditional on future profitability and do not result from temporary differences, and additional valuation adjustments for balance sheet items recognised at market value.

As of 31 December 2014, interim profits as of 30 September 2014, less foreseeable deductions and dividends, formed part of the Common Equity Tier 1 capital. The recognition of the interim profits was approved by the supervisory authority.

The additional Tier 1 capital consists of grandfathered hybrid capital in the form of Trust Preferred Securities, from which deductions were made in accordance with the transitional provisions of the CRR.

No new core capital instruments were issued in 2014.

The Tier 2 capital consists of long-term subordinated loans which in the event of insolvency or liquidation are not repaid until all non-subordinated creditors have been satisfied. This refers to capital instruments issued during the year under review (EUR 62.4 million) and the group's Tier 2 capital instruments which could be recognised under the transitional provisions of the CRR.

The CRR minimum capital ratios are set to 4.5% for the Common Equity Tier 1 ratio, 6% for the Tier 1 ratio and 8% for the total capital ratio. The ProCredit group has set stricter internal benchmarks of >9% for the Tier 1 capital ratio and >12% for the total capital ratio. With a Common Equity Tier 1 capital ratio of 10.1%, a Tier 1 capital ratio of 10.6% and a total capital ratio of 12.8% as of 31 December 2014, the ProCredit group's ratios exceed both the current regulatory requirements and the internal benchmarks.

The ProCredit group showed a comfortable leverage ratio. According to the German Banking Act the leverage ratio (modified balance sheet capital ratio) is defined as the ratio of balance sheet equity to the sum of total assets and off-balance sheet liabilities and the replacement cost for claims arising from off-balance sheet transactions.

in '000 EUR	**31.12.2014***	**31.12.2013**
Equity	554,609	502,736
Assets	5,967,606	5,841,734
Off-balance sheet liabilities (irrevocable)	159,554	153,524
Leverage ratio	**9.1%**	**8.4%**

** The figures presented here are in accordance with the regulatory scope of consolidation.*

Report on Expected Developments, including Business Opportunities and Risks

Macroeconomic environment and competitive situation

We expect the environment to remain challenging in 2015, but nonetheless anticipate that the economy will pick up slightly in the majority of our countries of operation compared with 2014. This assessment is based on the assumption that there will be a cautious easing of political tensions in Ukraine, and that the Eurozone and the US economies will experience modest growth. In the past year the expected slight economic recovery was impeded by the difficult situation in Ukraine, slower growth in Russia and the generally reduced flow of capital to the Eastern European countries.[7]

In the Balkan countries we anticipate GDP growth rates of around 2–3.5% in 2015. Bulgaria and Serbia, two very important markets for ProCredit, are an exception, however. In Serbia, economic output is expected to contract again (-0.5%), although less severely than in 2014, and in Bulgaria GDP growth is forecast to be around 1.1%, which is even lower than the 1.4% achieved in 2014.

It is difficult to make predictions for Ukraine at present, but here too we expect the recession to be less acute than in 2014. In 2014 Moldova and Armenia were hit hard by the situation in Russia and the reduced volume of transfer payments. We expect subdued economic growth of approximately 3% here. Georgia proved relatively robust, and we foresee growth of about 5% for 2015.

In the South American countries we expect the situation to remain similar to the previous year, with economic growth of between 3.8% and 4.5%.

Given our clear specialisation in small and medium-sized businesses and the highly individual service we provide to our clients, we see good development opportunities for the ProCredit group in our markets. Frequently, these clients do not receive very high quality service from banks, and their specific characteristics are not taken into account.

Nonetheless, we continue to face significant price competition and pressure on margins, especially in Eastern Europe. In South Eastern Europe our main competitors are international banking groups such as Raiffeisen, Intesa or UniCredit. In the Eastern European countries and also in South America, we are competing with a wide variety of local or regional banks and financial institutions.

A major challenge for the ProCredit group is the continued lowering of interest rates in the credit business, which can only partly be offset by reducing our funding costs. Our business planning is therefore based on the assumption that our interest margin will shrink.

[7] The following projections are based on the World Bank Global Economic Prospects Report, January 2015.

Expected development of the ProCredit group

We see good prospects for a specialised bank for small and medium enterprises to operate profitably and achieve stable growth. To accomplish this, we are relying on our core competence: providing high quality individual service to business clients, for whom we are their "house bank", based on long-term client relationships. Having a business model founded to a large extent on the quality of the staff, we will continue, as in the past, to invest heavily in staff development. This includes our careful, thorough selection programme for newly recruited staff, our regional academies and the management academy in Germany, as well as professional development courses offered at the banks.

In the future, our regional focus will be on Eastern and South Eastern Europe, and on South America; we will also promote the growth of our bank in Germany. We intend to further strengthen our position in these markets, attract new clients and broaden our existing client relationships. At present we do not regard Central America and Africa as our core markets, and are therefore exploring options for a strategic withdrawal from these regions.

In our core markets in Eastern and South Eastern Europe and in South America, we expect that growth in 2015 will more than compensate for the reduction of the very small scale lending business (mainly comprising loans of less than EUR 10,000), which is planned to continue in 2015. In the South Eastern European region in particular, we also see potential for intensification of international co-operation in serving business clients who also operate internationally. This enables us to establish a unique positioning in the region and present an attractive offer, not only in terms of credit but also, and in particular, in payment services, also in collaboration with ProCredit Bank Germany. The "co-financing" of medium business clients in Bulgaria, Serbia and Romania by ProCredit Bank Germany will also support this process.

We foresee loan portfolio growth in all client categories. In our work with "very small" business clients, however, the withdrawal from loan amounts under EUR 10,000 will continue to make itself felt in 2015. Therefore, the net growth of the loan portfolio at the South East European banks in 2015 will be mainly driven by our "small" business clients, while in the Eastern European banks we not only expect significant growth in the "small" business client category but also anticipate that "medium" business clients, which currently account for a relative small share of the overall portfolio, will become increasingly important. In South America the focus will be on growing our business with very small and small business clients.

Our medium-term plan is to grow the credit volume in our core markets by roughly 10% p.a.

In our deposit business, we will continue to focus on optimising the structure. In this context, we plan to enlarge our business clients' share of total deposits, and to increase the average balances of savings and sight deposits. In this manner, we will continue to pursue our strategy of funding our lending with customer deposits, and of optimising our funding costs. By extending the scope of our client relationships beyond credit alone, i.e. by conducting more transactions and taking more deposits, we are also creating the preconditions for integrating our clients into the formal financial sector, for providing better customer service, for building customer loyalty and, not least of all, for generating fee income. This will also be supported by the planned investments in modernising our branches. In particular the "service points" – small, efficient outlets in attractive locations – are equipped with modern devices that offer a comprehensive range of services on a 24/7 basis. The service points in busy locations also help to increase the visibility and accessibility of our banks. In the medium term we plan a moderate increase in the number of these service points. Complementary, convenient channels in the form of internet banking and mobile phone banking will also be further enhanced.

In general our business model is characterised by a personnel-intensive service and acquisition concept which we apply to business clients. In order to implement this model profitably, achieving further efficiency gains on the one hand, and maintaining the high quality of the loan portfolio on the other will again be the key factors in 2015.

We project that in the coming years the quality of our loan portfolio will be stable, with a tendency towards slight improvement. In 2015 we anticipate a PAR 30 figure of roughly 4.4%, which would be comparable to the 2014 level. Accordingly, we expect our provisioning costs to remain stable or slightly decline, provided that no highly adverse macroeconomic developments occur.

Stringent cost management supported by the shift of standardised transactions and services to e-banking and self-service areas in the branches will lay the foundation for efficient growth with our clients. Our branch network does not aim at maximum possible geographical coverage; rather, it is highly focused on locations where we see the greatest potential for our business model, and it is here that we will concentrate our resources. In addition, we will continue to exploit regional synergies, e.g. by promoting co-operation between our banks in recruitment and in the provision of staff training in regional centres. We anticipate further reductions in personnel expenses in 2015, in particular as a consequence of having lowered the number of staff in 2014. In 2015, the number of employees will again be reduced. The reduction in aggregate personnel expenses will be accompanied by an increase in average personnel costs, thus reflecting our increasing demands on the quality of staff. From 2016 we then expect to see moderate growth in personnel expenses.

We intend to continue steadily improving our cost-income ratio, from the present 71.6% to under 70% in 2015 and in the medium term to just over 60%.

For the medium term we plan to achieve a return on equity of 10–12%.The group has a sufficiently large capital base. The introduction of CRD IV/CRR in 2014 had relatively little impact on the group's capital planning.

In general, we currently assume that the additional capital required to cover the planned growth can be met with the expected return on equity.

Assessment of business opportunities and risks

At present, Management sees little or no opportunity to significantly increase the planned growth rates or profitability of the group in 2015 beyond what is outlined in the Report on Expected Developments section above. The expected growth rates and forecast profitability outlined above are already based on relatively optimistic assumptions.

The Risk Management section of this Management Report outlines the group's conservative approach to this topic. Management does not foresee any major deviations from expected developments that would undermine the capital base or sustainability of the business model. Were there to be major disruption in the Eurozone, a dramatic change in US monetary policy and significant foreign exchange fluctuations, an increase in arrears and reduced profitability would be a consequence. However, in comparison to competitor banks, ProCredit institutions are relatively resilient even to major disruption given the diversified base of assets and liabilities, close relationships with clients, limited exposure to capital markets and closed currency positions.

Key potential risks to the planned group financial results are lower-than-planned loan portfolio growth, and a deterioration in loan portfolio quality. These could result from disappointing developments in the global macroeconomic environment, unforeseen political or macroeconomic events in one or more of the countries where a large ProCredit bank is located, or as a result of stronger price pressure than assumed in our planning, particularly in our Eastern European markets. Given our experienced approach to credit risk management, a significant increase in loan loss provisioning costs in 2015 is not very likely.

The quality and motivation of our staff continue to be the key factor in achieving development impact and our target business results. We plan to continue to work closely with our staff on improving customer service quality and productivity. There is always the risk that staff recruitment and retention will become more difficult if competitors target our highly competent staff, but with our personal approach, along with our commitment to transparency, fair remuneration and strong group identity, we aim to maintain a corporate culture where people want to stay and contribute long-term.

Glossary

A

➜ Allowance for impairment losses on loans and advances to customers:
Loan loss provisions set aside in order to absorb current losses from non-repayment of loans. These are determined either collectively for a group of credit exposures or individually, depending on the size of the exposure. For collectively assessed credit exposures, the provisions set aside can be either portfolio-based impairment or lump-sum specific impairment. For individually assessed credit exposures specific allowance for impairment losses ("specific impairment") is set aside.

C

➜ Common Equity Tier 1 capital:
Common Equity Tier 1 capital (CET1) is mainly composed of subscribed capital, reserves and qualifying non-controlling interests in subsidiaries net of regulatory adjustments. The regulatory adjustments of the ProCredit group include goodwill, intangible assets and deferred tax assets that rely on future profitability.

➜ Cost/income ratio:
Measure of cost efficiency which sets operating expenses in relation to operating income before provisioning.

D

➜ Default risk:
The possibility that counterparties in a financial transaction will not be able to repay principal and interest on a timely basis or comply with other conditions of an obligation or an agreement, causing a financial loss to the creditor.

E

➜ Effective interest method:
A method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or expense over the relevant period. The effective interest rate is defined as the rate that exactly discounts the expected stream of future cash flows through the expected life of the financial instrument to the current net carrying amount of the financial asset or liability.

➜ Economic value impact:
The EVI estimates the change in the economic value of the bank (net present value of the bank's future cash flows) after a parallel interest rate shock. The indicator captures long-term interest rate risk and depends mainly on the size and maturity of the repricing gaps as well as on the assumed interest rate change.

F

➜ Fair value:
The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date (the exit price).

G

➜ Goodwill:
Goodwill within the ProCredit group generally represents the excess of the cost of an acquisition over the fair value of the group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition.

I

➜ Interest rate risk:
Interest rate risk specifies the risk that movements in market interest rates will adversely affect the bank's economic value and its interest earnings and eventually its capital.

➜ Interest margin:
The difference between the interest income over average interest-earning assets minus interest expenses over average financial liabilities.

➜ International Financial Reporting Standards (IFRS):
Accounting standards published by the International Accounting Standards Board (IASB). The IFRS as applied in the financial statements are endorsed by the European Union.

L

➜ Liquidity risk:
Liquidity risk (risk of not being liquid) is the danger that a bank within the ProCredit group will no longer be able to meet its current and future payment obligations in full, or in a timely manner.

M

➜ **Market risk:**
The risk of losses in on- and off-balance sheet positions arising from movements in market prices. The ProCredit group defines market risk as interest rate risk and currency risk.

O

➜ **Open currency position:**
A currency position is determined by comparing all assets and liabilities in each currency, other than the functional currency, including all on- and off-balance sheet positions. It can either be closed or open. The latter, i.e. an open currency position (OCP), can be long (positive) when the assets in one currency are larger than the liabilities in the same currency or short (negative) when the liabilities are larger than the assets.

➜ **Operational risk:**
Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, from people and systems, or from external events. This definition includes legal risk as well as reputational risk.

P

➜ **Portfolio at risk (PAR 30):**
The portion of the loan portfolio for which payments (typically instalments composed of principal repayment and interest payment) have not been fully made on time and continue to be delayed for a period of more than 30 days. Even if only a fraction of one instalment is overdue ("in arrears"), the full amount of principal still outstanding under this loan contract, as well as all other loans disbursed to this customer, are considered to be "at risk".

R

➜ **Regulatory capital adequacy ratios**
A regulatory capital adequacy ratio is a measure of a banking group's ability to absorb losses by calculating the ratio of capital to risk. The respective regulator of a banking group tracks its capital adequacy ratios to ensure that its capital cover remains above the minimum required to absorb a reasonable amount of loss. Under Basel III as set forth in the Capital Requirements Directive and Capital Requirements Regulation primarily three regulatory capital ratios are used to assess the capital adequacy of banking groups: Common Equity Tier 1 capital ratio, Tier 1 capital ratio and total capital ratio. The ratios are calculated by dividing the capital components by the risk-weighted assets.

➜ **Risk-weighted assets:**
The risk-weighted assets of a banking group are an expression of risk taken by it. The risk-weighted assets comprise three broad categories: credit risk, market risk and operational risk. The risk-weighted assets of the ProCredit group are computed according to standardised approaches set forth in the Capital Requirements Regulation.

➜ **Return on average equity (ROAE):**
Return on the average equity attributable to the shareholders of ProCredit excluding non-controlling interests. This is calculated by setting net income (profit), attributable to the equity holders of the parent company, in relation to the average balance sheet equity, defined as the average of equity at the beginning and at the end of the period.

S

➜ **Securitisation:**
An off-balance sheet refinancing technique which consists of selecting assets (such as loans, mortgages) based on the quality of their collateral or level of risk, converting those assets into negotiable securities and redistributing them to investors.

➜ **Special purpose vehicle (SPV):**
The SPV is a separate legal entity specifically created to handle a venture on behalf of a company. In the ProCredit group, all SPVs are consolidated because the ProCredit group primarily bears the risks and the rewards for this entity.

T

➜ **Tier 1 capital:**
Tier 1 capital is the sum of CET1 and additional Tier 1 capital. The additional Tier 1 capital of the ProCredit group consists of non-qualifying hybrid instruments (trust preferred securities) subject to phase-out net of transitional deductions.

➜ **Total capital:**
Total capital includes Tier 1 capital and Tier 2 capital. The Tier 2 capital of the ProCredit group consists of qualifying subordinated debt and non-qualifying subordinated debt subject to phase-out.

V

➜ Value-at-risk (VaR):

The standard variable used to quantify market risk is the value-at-risk (VaR). It measures with a given confidence level the largest loss that could be incurred on a given portfolio of financial assets over a set period of time. The VaR is estimated from historical data and the underlying assumption is that the portfolio will behave in the next period in a similar way as in the past. A certain VaR (1 day, 99.9%) means that with 99.9% confidence the stakeholders are not expected to lose more than the VaR from their portfolio on the next day. In other words, in the past the losses were higher than VaR on 1 out of 1000 days.

Y

➜ Yield curve:

A graph depicting the relationship between interest rates (cost of borrowing) and time to maturity of a debt for a given risk category in a given currency.

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