ALFA BANK ANNUAL REPORT 1998

FINANCIAL HIGHLIGHTS

	1998	1997[2]	1996[1]	1995	1994	1993
in USD million						
Total Assets	951.2	1,427.2	518.0	360.9	554.6	294.1
Net Profit	(204.6)	(45.34)	21.3	10.2	1.1	4.1
Members' Equity	50.96	244.5	118.5	58.1	8.8	4.7
Statutory capital	503.1	503.1	87.5	9.9	6.6	3.6
Reserves	226.9	2.5	31.0	8.2	2.2	1.1
Subordinated debt	–	–	–	40.0	–	–
Risk Weighted Capital Adequacy (%)	5.8%	18.5%	28.9%	18.3%	–	–
Operating income	(40.8)	131.9	64.8	56.2	51.8	18.9
Commercial loans	163.0	369.9	165.4	175.8	244.2	67.7
Total Deposits	341.9	526.2	337.7	224.2	441.1	189.9
Related Party Loans	17.22	26.21	32.4	87.3	54.3	
As a % of total capital	33.79%	10.72%	27.4%			
As a % of total commercial loans	10.56%	7.09%	19.6%	35.9%	15.2%	
Related Party Deposits	7.6	86.9	22.9	29.1	57.8	
As a % of total deposits	5.04%	16.52%	6.79%	12.96%	13.11%	
Exchange rate 1USD = RR (excluding capital calculations)	20.65	5,960	5,560	4,640	3,550	1,247

[1] *1993–1996 "Based on Alfa Bank financial statements only".*

[2] *1997–1998 "Based on combined Alfa Bank and Alfa Capital pro-forma financial statements prepared in accordance with IAS 29 Financial Reporting in Hyperinflational Economies".*

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MICHAEL FRIDMAN
Chairman of the Board of Directors of Alfa Bank

LEONARD VID
Chairman of the Executive Board of Alfa Bank

1998 was a year of economic turmoil in Russia and a catastrophic year for Russian banks. The number of licensed credit institutions fell by 221 and bank branches across Russia decreased by 1,900. Alfa Bank emerged from this financial storm by no means unscathed, yet wiser, stronger and more determined than ever to create a world class financial institution in Russia.

In the early summer, in the light of continuing volatility and diminishing liquidity in the securities markets, the Board took a view that the Rouble exchange rate was untenable and consequently reduced the Bank's proprietary GKO/OFZ portfolio from RR 1.3 billion to RR 517 million, the minimum required to maintain its primary dealer status. This was the largest single factor that allows us to maintain our liquidity. Coupled with our planned strategy of diverse revenue streams, prudent lending and low-exposure to the retail sector, these decisions enabled us to withstand the turmoils of the markets in August.

Thus we were able to meet in full every obligation we had in the domestic market. At the height of the crisis, the bank maintained business as usual, continuing to make client payments, issue new loans and trade in securities. Our branches extended their working hours to allow customers access to their accounts; Alfa Bank credit cards – the number in circulation actually increased in 1998 from 22,100 to 47,200 – remained operational throughout as did our ATM machines.

Our international borrowings, which we had raised in 1997, were partially responsible for our ability to maintain liquidity at the peak of the crisis. The Board is pleased to report that despite initial difficulties, the Bank has been able to meet its payments, some rescheduled, to bond holders and counterparties and is not in default on any of its foreign obligations.

The net post-tax result for the year ending 31st December 1998 is a loss of USD 204.7 million. A detailed breakdown is contained in the Management report. Although very disappointing, this result is not surprising after the events of the summer. In many respects, for a young financial institution such as ourselves, it is a commendable outcome. To weather such a storm and to survive intact is no mean achievement.

Based on a very conservative assessment of the continued political and economic uncertainty in Russia, the board has made provisions of USD 101.3 million, mainly for possible credit losses and the diminution in value of investments. It may well be possible to release some of these provisions in the near future.

In the case of the Bank's potential USD 45.5 million exposure to contracts in the NDF market, the board has made a provision of USD 2 million for potential legal expenses. In this respect, the accounts have been qualified by our auditors. The Board's position is fully set out in note 22 to the accounts and, on the basis of current legal advice, the Board believes that it is acting in a prudent and responsible manner.

The revaluation of the Bank's 25.05% holding in Tyumen Oil Company (TNK), one of Russia's largest oil companies, provides substantial strength to the balance sheet. Independent appraisers determined that the fair carrying value of this investment as at the year end was USD 538.9 million. The board has made it clear that it does not intend to keep this investment for the long-term.

Personnel costs, despite the difficult operating conditions, were higher than in 1997, reflecting the continued dynamic expansion of the branch system, both in Moscow and in the regions, and the recruitment of senior professionals throughout the Bank to enhance our effectiveness in the future. The year ended with 60% more staff. Expenses were also higher and include the introduction of high-capacity servers to accommodate the processing of increased daily financial data, continued investment in strategic consultancy and highly successful advertising campaigns.

In many ways, our position strengthened in the aftermath of the crisis. The bank attracted 5,000 new corporate clients; the number of rouble payments made through the bank rose threefold; fee income from corporate finance, including foreign trade transactions, more than doubled. The bank's lending business is now showing encouraging signs of growth. Above all, our reputation as a reliable financial partner – for individuals, for companies and for counterparties – remained unblemished.

The future of Alfa Bank is inseparably linked to the future of Russia. The events of 1998 have shown how vulnerable all Russian financial institutions are to the country's economic management. Today, Alfa Bank is one of the top five financial institutions in Russia and we are now presented with a unique opportunity to enter areas of the market left void after the crisis.

Our strategy of becoming a truly universal banking group, offering a full spectrum of commercial banking, investment banking and asset management services, has proven itself in the post-crisis environment. This strategy provides a natural protection against volatility of the Russian financial markets. While the main engine of growth over the last years has been our successful securities business, the main impetus is now provided by our commercial banking activities.

Our plans for the short term reflect aggressive growth in commercial and investment banking. We plan to maintain our presence in the investment and capital markets, although the allocation of capital to these businesses will be driven by the overall market environment. We are committed to expanding our presence throughout the regions of Russia and have already embarked on an ambitious branch opening programme in key provinces – 12 new branches in 1999 and a new subsidiary in the Ukraine. The plans for the year 2000 are equally exciting.

Alfa Bank faces the new Millenium with a restructured balance sheet, a dominant market position and a confident and enthusiastic team. The next logical step will be an alliance with a strategic western partner and the Bank continues to prepare for this by upgrading its personnel, systems and products. Our declared aim is for a partnership of equals.

Positive international public opinion, particularly amongst the banking and investment communities, is key to the future of Russia. The Board believes that western investment flows will only return after the forthcoming elections if the new government radically tackles the underlying problems of the economy and operates a fair and transparent legal system, thereby improving the image of Russia to the world. The next round of investment must be of a long-term nature in order to develop the incredible potential of Russia's natural resources, competitive industries and talented human capital. There will be much to be gained for all if this scenario can be attained.

The Board would like to thank the Bank's clients, both old and new, for their custom during such a difficult year and special gratitude must be paid to the Bank's management and staff who demonstrated total commitment and loyalty in the dark financial days of last summer, including taking a 40% paycut. Without their professionalism, determination and hard work, we would not have emerged as we have, fitter and confident of our future.

Finally the board offers an apology to the Bank's international partners for the lateness of this English language report; it was exceptionally difficult to assess accurate information after the financial meltdown of the markets and it was the Board's view that accuracy took precedence over timeliness and consequently it was not until 2nd July 1999 that the audited accounts were signed off.

ALFA BANK EXECUTIVE BOARD

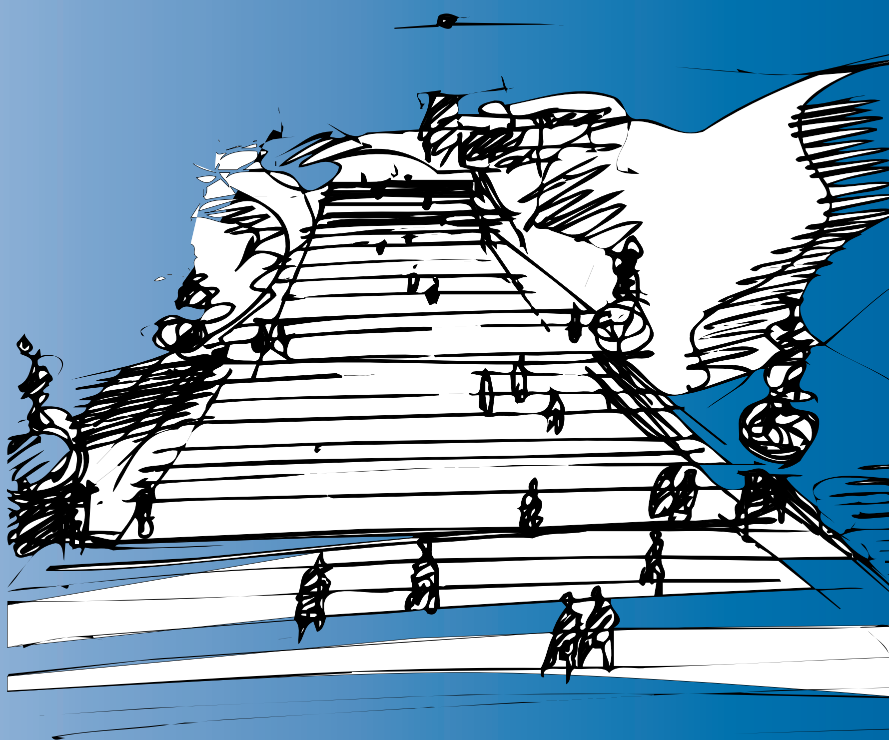
From left to right
Upper row:

Alexander Tolchinsky	*Member of the Board*	Corporate Finance and Bank Advisory
Andrey Sokolov	*Deputy Chairman of the Board*	Credit and Loan, Corporate Banking, debt operations, interbank business
Pavel Gorbatsevich	*Deputy Chairman of the Board*	Russian and International Settlements, Back Office, International banking, Foreign representations management
Ildar Karimov	*Deputy Chairman of the Board*	Planning and Budgeting, Accounting, Reporting and Control, Information Technology
Alexander Abramov	*Deputy Chairman of the Board*	Government Authorities and Political Organizations Relationship

From left to right
Lower row:

Andrey Kosogov	*First Deputy Chairman of the Board*	Merchant Banking and Asset Management
Alex Knaster	*Chief Executive Officer*	General Management, Corporate Finance, Capital Markets, Risk Management, Treasury, FOREX/Money Market, International Relations
Leonard Vid	*Chairman of the Executive Board*	Administration, Legal, Public Relations, Advertising, Bank Audit, Credit and Tariff Policy, Security
Peter Aven	*President of the Bank*	Bank Perspective Development, External Relations
Evgeniy Bernshtam	*Deputy Chairman of the Board*	Branch and Subsidiaries Management and Development, Banking Cards, Banking products for Retail Banking

MILESTONES IN ALFA BANK'S DEVELOPMENT



1990

20th December	Alfa Bank was established as a limited partnership commercial bank.

1991

3rd January	Alfa Bank formally received its domestic banking license from the Central Bank of the Russian Federation.
August	Alfa Bank's first corporate client account was opened.

1992

June	The Russian Central Bank granted Alfa Bank both the standard and extended hard currency licenses which, inter alia, led to the opening of its first nostro accounts with 6 foreign banks.
December	Alfa Bank's first branch was opened in Moscow.

1993

March	The Bank's first foreign shareholder, Altex, a Czech trading house consortium, was officially registered with and ratified by the Russian Central Bank.
	The Bank became a member of the Moscow Interbank Currency Exchange.
April	The Bank received a general banking license from the Russian Central Bank, enabling it to carry out transactions in both roubles and hard currencies. Additionally, Alfa Bank became an official agent of the Moscow City Government.
June	The Bank's statutory capital was raised to RR 1.1 billion (USD 0.9 million).
October	As further evidence of the authorities' growing recognition of the Bank's activities, Alfa Bank became an official agent of the Ministry of Finance and a primary dealer on the Russian Treasury Bill and Ministry of Finance Bond markets. The Bank was one of the most active participants in these markets and was, in fact, the first officially-registered primary dealer on the MinFin bond market.
December	The Bank's statutory capital was raised to RR 4.5 billion (USD 3.6 million).
	The Bank joined the Union Card settlement system.

1994

April	The Bank joined the international credit card system "Europay".
June	Alfa Bank joined the SWIFT system and rapidly became a major participant in this facility for interbank transactions.
July	Alfa Bank's general license was amended to allow it to deal in precious metals (gold and silver).
August	The Board of Directors of Alfa Group adopted a restructuring plan, expanding Alfa Bank's activities from investment banking to a wider range of banking activities.
October	Mr. Peter Aven was appointed President of the Bank.
December	Alfa Bank became the first Russian bank to have a fully owned subsidiary in Almaty,

	officially registered by the National Bank of Kazakhstan.
	Alfa Bank's statutory capital was raised to RR 23.45 billion (USD 6.9 million).

1995

April	Euromoney's Central European awarded Alfa Bank third place in its "Best Bank in Russia" awards for excellence.
August	The Bank emerged from the late August interbank market crisis with increased deposits and an expanded customer base, as many Russian corporations sought relationships with larger and more stable institutions.
September	Alfa Bank opened its Representative Office in London.
	The Bank became a member of Factors Chain International, the largest international factoring organization.
	Alfa Bank joined the Interbank Credit Union, an association made up of a limited number of major Moscow banks.
December	The Bank increased its capital base under international accounting standards through the injection of USD 40 million, structured as long-term subordinated debt.

1996

February	Alfa Bank was authorized as a participating bank in the U.S. Department of Agriculture's GSM-102 program.
	The Board of Directors named Mr. Leonard B. Vid as Chairman of the Executive Board. His previous appointments included Economic Director for the Norilsk Metallurgical Plant (now known as RAO "Norilskiy Nikel"), First Deputy Chairman of the State Planning Commission of the USSR (Gosplan), General Director of the Economic Conjuncture Centre of the Russian Government, and Head of the Executive Committee of the political party "Our Home is Russia" ("Nash Dom Rossija").
March	On March 8t, Russia's leading financial daily 'Kommersant', drawing on the findings of market research, cited Alfa Bank as the market leader in soft currency trading.
May	The Admissions Committee of Euroclear gave official approval to Alfa Bank joining this international clearing and settlement agency – a necessary prerequisite for our Bank to participate in international capital market flows.
	The EBRD granted the Alfa Group Consortium a USD 42 million long-term credit to be utilized by its supermarket chain subsidiary "Perekrestok" (or "Crossroads") for the expansion of its chain of stores in and around Moscow.
June	Visa International's Board of Directors accepted Alfa Bank as a principal member.
July	On July 2, 1996, Alfa Bank received accreditation under the World Bank/EBRD Financial Institutional Development Program from the Central Bank of Russia and the Ministries of Finance and Economics, based on strong recommendations from a World Bank audit team.

August	IBCA (today known as FITCH-IBCA), the London-based bank rating agency, gave Alfa Bank its first review and published its first official report on the Bank.
September	The German state export insurance agency, Hermes, officially appointed Alfa Bank as one of the group of Russian banks authorized to receive funds from German banks for financing Hermes-backed trade transactions.
October	Alfa Bank was one of a few Russian banks to be authorized as an official agent for the first Moscow Government Municipal Bond Issue.
November	Alfa Bank was one of three Russian Banks appointed to co-manage the USD 1 billion Eurobond issue for the Russian Federation, led by J.P. Morgan and SBC Warburg. This event marked the first international debt market issue by Russia since the 1917 Revolution.
	Alfa Bank opened its branch office in Nizhny Novgorod, Russia's third largest city.
	Alfa Bank was the anchor sponsor for a series of sell-out concerts in the Kremlin for the Tina Turner European Tour, continuing a lively tradition of attracting internationally-recognized pop and rock musicians to Moscow.
December	"Alfa Bank – The One to Watch". Merrill Lynch published an analysis of the Russian banking sector and tipped Alfa Bank as one of the three most promising and well-organized banking institutions in Russia.
	The Bank's total capital at year-end reached a level of USD 118 million.

1997

February	Alfa Bank successfully completed a USD 40 million syndicated loan arranged by Morgan Stanley. This facility represented Alfa Bank's first public tapping of the Western debt markets and was 60% oversubscribed, the original syndication target being USD 25 million.
March	Alfa Bank was appointed a co-manager in the first Deutchemark (DM) Eurobond issue of the Russian Federation. The DM 2.0 billion, 7-year issue was lead-managed by Credit Suisse First Boston and Deutsche Morgan Grenfell.
April	Alfa Bank was named "Best Bank in Russia for 1997" by Euromoney's Central European magazine.
	The Ministry of Finance, the Ministry of Agriculture and Food and Alfa Bank signed an agreement allowing the Bank to lend to the agricultural sector under the Federal Government's agricultural program, guaranteed by the Government with funding from the Federal Budget.
June	Alfa Bank became one of the first five Russian banks to be assigned an international rating from all three leading Rating agencies: Moody's (B1), Standard & Poor's (B) and IBCA (BB-).
	Alfa Bank retained its position as Russia's leading cultural sponsor and concert organizer by promoting the Moscow tour of the Canadian rock singer Brian Adams, who performed to a sell-out audience in the Kremlin Palace of Congresses on July 12th.

July	Alfa Bank became the first 100% privately owned Russian bank to enter the Eurobond market. It successfully launched a USD 175 million 3-year issue priced at 425 bp over US Treasury Bills, led by Goldman Sachs International. The bond issue was 75% oversubscribed, reflecting both the growing appetite for Russian paper in the international capital markets and Alfa's unique position as one of Russia's most successful, creditworthy and transparent banks. The Eurobond was launched following a five city, two continent roadshow, led by the Chairman of the Board of Directors of Alfa Bank, Mikhail Fridman, and the President, Peter Aven.
August	In its semi-annual bulletin, Russia's Interfax news agency ranked Alfa Bank the 9th largest Russian bank, measured by total assets.
September	The Board of Directors of the Alfa Group Consortium gave its in-principle go-ahead to the merger of its banking and investment subsidiaries, Alfa Bank and Alfa Capital. It subsequently appointed Credit Suisse First Boston as Corporate Advisor in the merger and, under a subcontract, Boston Consulting Group, as sub-advisor. Alfa Bank opened its branch in St. Petersburg. The Russian Federation Ministry of Economics granted OAO "Nizny Novgorodskaya Leasing Company" a license allowing it to carry out leasing operations in the Russian Federation.
October	Alfa Bank successfully completed a ground-breaking USD 77 million US Commercial Paper Program, arranged by Bank of America International. As the first of its kind for both a Russian bank and indeed for any Russian borrower, this issue was extremely well received by the market, being 40% oversubscribed over its original target of USD 50 million and attracted commitments from more than 26 banks over a wide geographical spread. The L/C issuer was Societe Generale SA and the Issuing and Paying Agent was Bank of Montreal. This Facility brought the total amount of Western debt capital raised by Alfa Bank over the first 10 months to in excess of USD 300 million. Representatives from senior management of Alfa Bank and Alfa Capital signed an agreement with the Administration of the city of Saratov on October 25th to promote further economic development of the Volga Region. The program involves the provision of consulting and financial services to commerce and industry in the region.
November	The Bank won the tender to act as an official financial agent and intermediary to service the contract between the Russian Ministry of Atomic Energy and the People's Republic of China for the construction of a 6 reactor nuclear power station in the PRC. The 1st stage of the project involves the construction of 2 reactors and is estimated to be worth over USD 1.5 billion.
December	Alfa Bank opened its branch office in Samara in further support of its regional corporate banking, financial services and retail banking initiatives. Alfa Bank's capital base ended the year at a level in excess of USD 160 million.

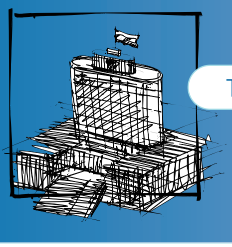
1998

January	The Russian Central Bank ratified the new legal status of Alfa Bank, which transformed the bank from a limited liability company to an open joint-stock company.
April	For the second year running Alfa Bank's achievements were recognised by Euromoney's Central European magazine, which awarded the bank the title "Best Bank in Russia for 1998". Alfa was commended on its continued dedication to transparency, its clear-thinking management and its phenomenal but disciplined growth.
May	Alfa Bank signed a General Agreement of Cooperation with RESO-Guarantee, one of Russia's largest insurance companies. The agreement sets up a joint program, providing private and corporate medical insurance, travel insurance and other insurance services through Alfa Bank's retail branch network.
June	Alfa Group Consortium established "Alfa TV", a holding company for investment in the media, together with Radiosystem-1 and Story First Communications.
July	Alfa Group Consortium announced the restructuring of its financial business. Following the management's decision to diversify and become a universal financial institution, Alfa Bank developed a strategy in the second half of 1997 to combine its operations with those of its sister investment company, Alfa Capital. The restructuring process followed the recommendations of Boston Consulting Group (BCG) and Credit Suisse First Boston (CSFB) and took 9 months to implement fully. On completion of the restructuring Alfa Group was able to combine the resources of its two financial groups into one diversified financial group and build a Western-oriented skill base to take a leading position on Russia's financial and investment markets.
August	Alfa Bank became an official distribution agent for Templeton mutual funds. Alfa Bank also became a participant in the Golden Crown payment system, which issues its plastic cards through Alfa Bank's recently acquired subsidiary in Novosibirsk.
August/September	With the Russian Government's suspension of all trading on the GKO market on August 17th, Russia descended into economic and financial crisis. A sudden devaluation of the rouble and the resulting liquidity and payments crisis within the banking system all contributed to a near collapse of the country's financial infrastructure. Unlike many of it former competitors, Alfa Bank continued to fulfill all of its payment obligations on time and maintained a full range of banking services to an ever increasing customer base.
October	Alex Knaster joined Alfa-Bank as Chief Executive Officer on October 5th 1998. During the previous three years he had been head of CSFB's operations in the FSU and President of its Moscow subsidiary bank. Under Mr. Knaster's leadership, CSFB had expanded its operations to become the dominant foreign bank in the region with leading positions in virtually every sector of the investment banking and securities market.

	Despite the continuation of the financial crisis, Alfa Bank kept to its commitment to sponsor the Kremlin Cup, an annual high profile ATP tennis tournament.
November	Alfa Bank opened its branch in Togliatti, Samara Region.
December	Alfa Bank was nominated as the sole authorized financial agent for the distribution and settlement of the Claims Conference restitution payments to survivors of the Holocaust residing in the Russian Federation.

1999

February	Alfa Bank opened its branch in Irkutsk, Siberia.
April	Alfa Bank was named "Best Bank in Russia for 1999" by Euromoney's Central European Magazine, marking the third year in a row that the Bank has won this prestiguous award. Global Finance Magazine in its annual survey of "Best Emerging Market Banks" named Alfa Bank "Best Russian Domestic Bank".



THE RUSSIAN ECONOMY AND BANKING SECTOR

1998 will go down in history as a year of economic and financial turmoil in the Russian Federation, culminating in the financial crisis which unfolded in the middle of August. The onset of the crisis led to a sharp fall in the value of the rouble and widespread price increases, a breakdown of payment and money transfer systems, a liquidity crisis among the banks and a significant increase in domestic and foreign debt. Industrial output and investment were both hit as exports and imports fell, leading to a decline in real income and living standards for millions of Russians. At the same time, domestic and international investors alike turned their backs on Russia, having lost confidence in both the government and financial institutions.

The main events which led to the turmoil in Russia's financial markets in 1998 are well known: volatility on Asia's emerging markets, a sharp drop in world market prices for Russia's commodity exports and continuing political volatility.

It is clear that the effects of the Russian crisis would not have been so devastating if the government had taken action on serious economic issues such as taxation reform, investment in industry and social welfare. By failing to implement these reforms, the government ended up with a huge budget deficit, which it could finance only by issuing short-term and extremely expensive treasury bills (GKOs and OFZs). Servicing the national debt escalated to such proportions that in July 1998 almost half of the federal budget was made up of debt servicing. A mass exodus of foreign investors from the Russian capital markets, fearing a financial crisis in Russia, left the government helpless as GKO yields swelled out of control and the amount of debt continued to rise.

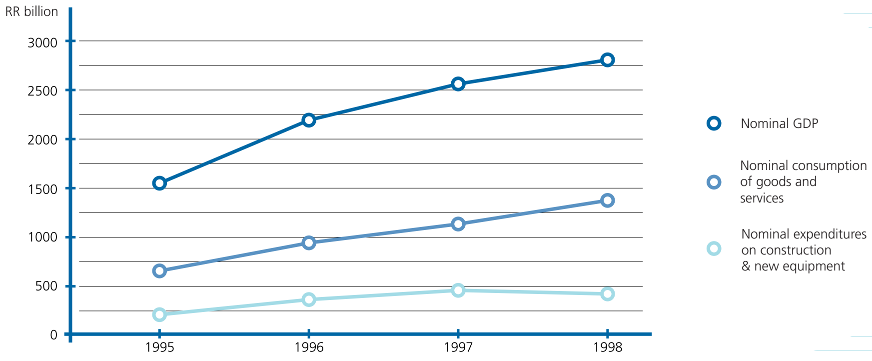
The high yields on short-term Government debt meant that capital was diverted to a large extent away from investment in the real economy, starving Russian companies of cash at a time when high tax obligations were already crippling their operations. At the same time, the Central Bank of Russia adopted a strict anti-inflationary monetary policy by stringently tracking the rouble rate within the framework of a fixed 'corridor', even when it became evident that the domestic currency was overvalued with respect to the parity of its purchasing power. As a result, the government was unable to support the massive GKO pyramid, or the rouble exchange rate, nor was it able to sustain the low rates of inflation and the relative industrial stabilization achieved in the preceding year.

Following a brief spell of economic growth in Russia, 1998 heralded a return to the days of negative GDP growth, – an all too common feature of the post Soviet economy. Total GDP fell by 4.6% to RR 2,684.5 billion, while industrial output fell by 5.2% over the year to RR 1,658 billion. Although industrial output picked up in the first quarter of 1998, with a 1.3% year-on-year increase, a decline was recorded in the remaining quarters of the year of 1.3%, 11.8% and 8.9% respectively.

In December, seasonally adjusted real consumer expenditure on the purchase of goods and services was 16.3% lower than in the same period of the previous year. This was attributed mainly to a decline in the purchase of food products (down by 9%), services (by 10%) and hard goods (by 25.8%). Over the same period seasonally adjusted expenditure on new machinery and industrial equipment fell by 11.5%. Despite a drop in prices, demand for all goods and services has been hit by lower levels of both personal income and company revenues. These factors will continue to undermine the economic advances of 1997 for some time to come.

By the end of the year, however, the industrial production index showed some signs of recovery. December's seasonally adjusted figures were 6.1% higher than September's, although they remained 9.3% lower than December 1997. The upturn in the economy was most evident in the industrial sector where output increased by 11.8% over the period October - December 1998, almost reaching the levels of May 1998. The last three months of 1998 saw industrial output rise by 28% in the machine-building sector, by 24% in non-ferrous metals, by 18% in the food industry, by 13% in ferrous metals and by 11% in the chemicals industry. Output also increased in the agricultural and transportation sectors. Time will tell whether these statistics mark the beginning of long-term growth or just a return to pre-crisis levels.

Annual inflation in 1998 was 97.1%. By December the aggregated producer price index (PPI) had risen by 22.5% over the year (6.5% in the previous month alone). In 1998 as a whole, the industrial PPI rose by 23.3%. The largest growth in PPI was seen in import substituting businesses, particularly in the manufacturing of consumer goods. The industrial PPI rose by 53.4%, while a 64.6% increase was recorded in the animal livestock business. Similar levels of growth were seen in export-orientated businesses. The ferrous metals index rose by 76% while the corresponding figure for the timber industry was 42.6%.



INVESTMENT IN INDUSTRY

Russia's industrial output for 1998 (work and services) totalled RR 1.7 trillion, which represented a 5.2% drop over 1997 levels. Meanwhile total capital investment in industry fell by around 8-10% to RR 402.2 billion.

Figures published for the first half of 1998 show that total foreign investment in Russia totalled USD 7.7 billion, which included USD 1.5 billion direct investment. The amount of direct foreign investment fell significantly (by 46.3%) compared with the same period in 1997. Direct investment as a proportion of total foreign investment decreased to 19.6%.

In August and September 1998 a number of foreign investors withdrew from major construction projects, putting on hold their investment plans. Certain investors, however, held course despite the crisis. One such example is Philip Morris, which is building Russia's largest cigarette factory in the Leningrad region. Other examples are the companies involved in developing the Kharyagin oil field in the Komi Republic.

LABOUR FORCE

According to official Goskomstat data, the number of unemployed in December 1998 was 1,929,000, or 2.7% of the employable population (72.6 million people). However, the International Labour Organization's (ILO) statistics estimated the total number out of work (officially unemployed and those looking for work) at 8,571,000, or 11.8%, representing a 0.7% increase over November levels.

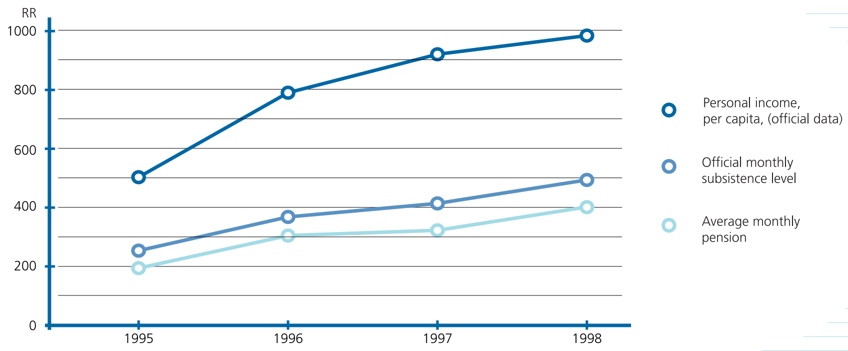
Goskomstat data indicate an increase in unemployment of 3,5% during the year. This figure falls in line with the trend towards a slow down in the rise in unemployment which began in 1997. However this tendency is likely to be reversed in 1999, as witnessed by the rapid growth in unemployment after the August crisis.

According to Goskomstat data, personal after-tax incomes fell by 16.3% in 1998. The sharpest decrease was recorded at the end of the year. The average salary in December 1998 was 13.8% lower than the average for the year, and 39.9% lower than the average for December 1997. This is again evidence of the gains made in 1997 and the subsequent decline in 1998. In real terms, salaries have halved since 1990. According to Goskomstat data, the official subsistence level in the Russian Federation increased by 15.8% in December 1998 to RR 717 per person per month. The monthly subsistence level for the employable population was RR 806, for children RR 724, for pensioners RR 505. The decrease in salary levels over the year was to some extent compensated by payment of wage arrears in both the private and public sectors. Total wage arrears fell by 9.4% in December 1998 to RR 77 billion on 1 January 1999, according to Goskomstat data. The majority, 72.3% or RR 55.7 billion, was due from industry, the remainder from the social sector. Public sector wage arrears represented 25.6% of the total amount outstanding, having fallen by 10.7% in December (11.8% in the social sector and 4.5% in the industrial sector).

A total of RR 8 billion was spent on wage arrears in 1998, representing 15-20% of average salaries. Nevertheless, wage arrears as a proportion of salaries were 25% higher at the end of 1998 than at the 1997 year end. This resulted in strike action particularly among school teachers. In December there were 1,873 officially registered strikes lasting at least one day, 3.4 times as many as in the whole of 1997.

A reduction in real incomes combined with an ever-widening gap between high and low salary levels ought to lead to a drop in living standards. However, Goskomstat does not record an increased proportion of the population living below the poverty line. Most recent data show that 24% of the population were living below the poverty line in 1998, the same proportion as in the four proceeding years, although less than officially recorded in 1992 (31%).

Between 1990 and 1997, the proportion of income made up by salary and social benefits dropped significantly from 89% to 54%. In part this was due to an increase in unemployment, an increase in part-time employment and a continuing problem with wage arrears, but it was also due to an increase in income in the form of home produce, a decrease in tax collections and an increase in unofficial, undeclared income.



FOREIGN TRADE

According to State Customs Committee data, the total value of Russia's foreign trade in 1998 was USD 115 billion (excluding unofficial trade), 16.7% less than in 1997. Exports were USD 71.3 billion (16.2% less than in 1997) and imports were USD 43.7 billion (17.6% less).

Russia's 1998 trade surplus was USD 27.6 billion, USD 4.5 billion less than in 1997.

The breakdown of exports by product type was largely unchanged in 1998. There was, however, a decrease in both exports and imports in all product groups.

The largest category of exports remained oil & energy-related products, representing 41.4% of total exports (47.0% in 1997), followed by metals & metal products – 22.1% (20.8% in 1997), vehicles and machinery – 11.0% (10.2% in 1997), chemicals – 8.4% (8.2% in 1997), timber and pulp and paper products – 5.1% (4.4% in 1997).

The largest drop in exports was in fuel and energy-related products – 27%. Chemical exports fell by 15%, metals and metal products by 12%, machinery by 10%, timber and pulp and paper products by 3%.

Imports can be broken down as follows: vehicles and equipment 35.8% (35.1% in 1997), food and agricultural products – 26.2% (26.3% in 1997), chemicals – 15.2% (14.5% in 1997). Compared with the previous year, imports of these product groups fell by 17%, 19% and 15% respectively.

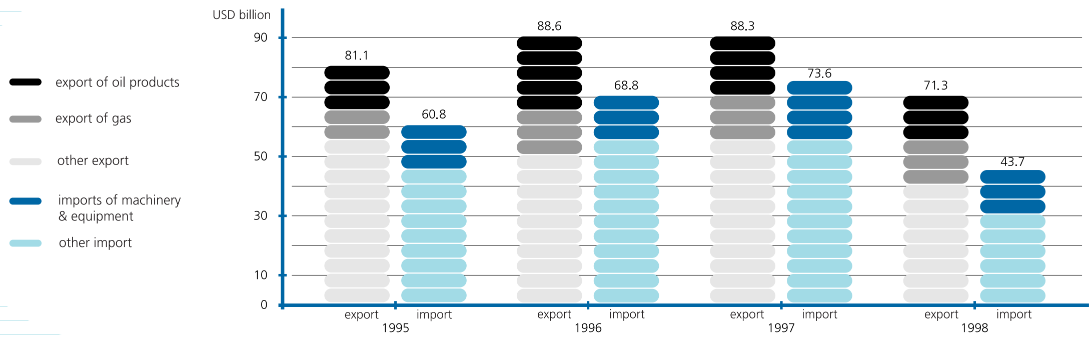
Foreign trade (excluding trade between Russia and its ex-Soviet neighbours) came to USD 90.1 billion in 1998 (USD 57.7 billion of exports, and USD 32.4 billion of imports). Foreign trade with these countries decreased by 16.0% over the year, exports declining by 15.7%, imports by 16.5%.

Russia's trade with its former Soviet neighbours came to USD 24.9 billion in 1998, down by 19.4% from the previous year, and was made up of exports – USD 13.6 billion (down by 18.4%) and imports – USD 11.3 billion (down by 20.5%).

The major part of Russia's foreign trade (34%) in 1998 was conducted with European Union countries (34.5% in 1997) while trade with CIS countries accounted for 21.6% (22.2% in 1997), trade with Asia-Pacific Economic Cooperation (APEC) countries 17.3% (16.1% in 1997) and with Eastern and Central European countries 12.5% (13.5% in 1997).

Russia's 10 largest trading partners were Germany – USD 11.2 billion (85% of 1997 levels), US – USD 9.2 billion (108%), Belorussia – USD 9.2 billion (99.1%), Ukraine USD 8.8 billion (78%), Italy USD 5.1 billion (81%), Netherlands – USD 4.9 billion (85%), China – USD 4.3 billion (83%), UK – USD 4.2 billion (97%), Kazakhstan – USD 3.8 billion (73%), Finland – USD 3.5 billion (76%).

FOREIGN TRADE VOLUME



MONEY SUPPLY

Money supply (money in circulation and mandatory reserves of commercial banks held in the Central Bank) increased by RR 23.5 billion in the fourth quarter of 1998 as a result of emmisions by the Ministry of Finance. In the first week of January 1999 when money supply grew by 4%, new printing of money was kept to a minimum, resulting in a decrease in money supply to RR 202.2 billion as at 25 January 1999.

Servicing the country's external debt remains the biggest burden on the economy. So far Russia has managed to pay the coupon on its USD 319 million Eurobond in January and on its USD 169 million Eurobond in March 1999.

Furthermore, it is likely that Russia will continue to meet its foreign debt obligations, since a total of USD 9.5 billion has been earmarked in this year's budget for this purpose. Russia's gold and hard currency reserves as at year end stood at USD 11.6 billion. It is expected that the government will be in a position to repay its IMF and World Bank loans and its Eurobonds maturing in 1999.

BUDGET

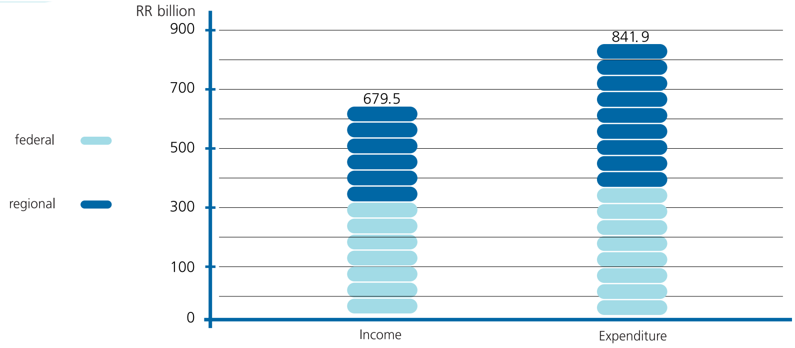
According to IMF estimations, the 1998 budget deficit came to 5% of GDP. Income amounted to RR 679.51 billion or 25.2% of GDP, and expenditure RR 841.85 billion or 31.3% of GDP. However December income increased to RR 29 billion from RR 21 billion in November, the result of a combination of inflation, mutual setoff payments and seasonal factors as well as increased tax collection.

In 1998 as a whole, non-cash tax income came to RR 29.3 billion, of which RR 5.2 billion and RR 14.5 billion were received in November and December respectively. December also saw a significant increase in tax receipts in the form of cash, RR 10.2 billion up from RR 6.3 billion in November, the result of increased foreign trade, seasonal factors (imports traditionally increase at the end of the year) and continuing weakening of the rouble.

Meanwhile, budget expenditures reached RR 49.6 billion in December. RR 10.2 billion alone were used on debt servicing, primarily on Eurobonds. A further RR 10.5 billion was spent on salaries (including wage arrears) and RR 1.6 billion to pay pensions for the armed forces. As of 1 December, total public sector wage arrears came to RR 10 billion, of which RR 6 billion were cleared in December. The remaining RR 4 billion is expected to be repaid at the beginning of 1999. RR 0.9 billion was transferred from the federal budget to regional budgets to help them to clear their wage arrears.

The 1999 Budget was adopted by the state Duma at its fourth reading on 5 February 1999. Expenditure on the President's administration was cut by 20% instead of the proposed 40%. In addition, expenditure on the Duma itself was reduced by 3.7%. The Budget foresees income of RR 473.8 billion, expenditure of RR 575.1 billion and a deficit (after payment of interest) of RR 101.3 billion or 2.53% of GDP. It is envisaged that part of the budget deficit will be financed by Central Bank loans. In addition to this, the government is confident it will receive new foreign loans of USD 7 billion for the purpose of debt servicing.

BREAKDOWN OF INCOME AND EXPENDITURE IN THE 1998 BUDGET



THE BREAKDOWN OF RUSSIA'S EXTERNAL DEBT AS OF 01.01.99 (in USD billion)

Type of debt	Amount outstanding	Debt servicing requirement 1999
Soviet Era debt	79.9	8.2
Including		
London Club	26.1	1.2
Paris Club	40.2	5.4
Russian debt	70.7	7.9
Including		
Eurobonds	16.0	1.7
MinFins	19.7	4.5
World bank loans	5.7	0.2
Total debt	150.6	16.1

On 15 January 1999, the Russian Central Bank re-commenced trading in Russian T-bills after a six month suspension. However, the market has so far attracted few buyers despite yields in excess of 120%, double the re-financing rate. RR 180 billion of new debt has been issued to domestic holders of frozen GKOs and OFZs as part of a new restructuring package. So far, all attempts to revitalise the rouble debt market have been unsuccessful. Meanwhile share prices continue to remain depressed with very low trading volumes, even in the most liquid shares.

The total number of credit institutions licensed to carry out banking activities fell in 1998 by 221 and totalled 1,476 as at the beginning of January 1999. According to Central Bank data, the number of bank branches across the Russian Federation decreased during the year by 1,900 to 4,453.

Evidently the role of the banks in the Russian economy will now be very different from the role they have played in the past, but it remains to be seen exactly how the banking sector will develop.

The August crisis served to highlight the deficiencies of previous economic policies, which prioritized financial gains over economic interests. It was clear that these distortions would remain as long as the government failed to take active control of the economy.

New economic policies will not, however, work without an effective banking system. In Russia the role of the banking system cannot be underestimated, as it accounts for some 25% of total GDP. The Central Bank is in the process of carrying out a restructuring of the banking system, the aims of which can be divided into tactical and strategic. Tactical aims include: transferring to Sberbank customer deposits from the six largest commercial banks, calculating contributions to mandatory reserve funds using exchange rates as of 14 August 1998 and removing the threat of sanctions for those banks whose capital fell below the required minimum as a result of the financial crisis.

Strategic aims include providing liquidity to the banking system, providing capital and resources as well as incentives for banks to finance real sectors of the economy.

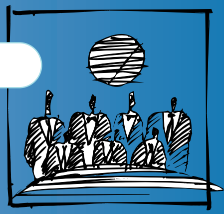
The restructuring of Russia's banking system will require new legislation and new Central Bank regulations to be adopted in order to guarantee its success. Such legislation includes new laws such as "The law on procedures for restructuring Russia's banking system", "The law on guaranteeing individuals' bank deposits", "The law on guaranteeing liabilities of commercial banks". Only recently at the beginning of March 1999 was "The law on bankruptcy of credit organisations" finally adopted. This law should have been adopted before the crisis unfolded, since even then many banks were crippled by huge fines, penalties and actions for damages brought by creditors.

One of the consequences of the banking crisis was that individual depositors could no longer trust the banks as agents for converting their cash into investment in the real economy and this only led to a worsening of the crisis. Since economic growth is to a large extent determined by levels of savings, the government and hence the Central Bank should have had as their aim the restoring of confidence in the banking system and protection of individuals' savings.

At times of crisis when confidence in the banks is lost and their reputation damaged, there is always the risk of a mass withdrawal of deposits and rising social tension. As a general rule a bank can go bankrupt if it loses one third of its deposits in one go. In the past few months, a number of banks have lost a much larger proportion of their clients, which is the reason for many of them losing their liquidity. It should be the role of the government to ensure that this does not happen by providing guarantees to depositors.

For this reason it is vital that the law “On guaranteeing individuals’ bank deposits” should to be urgently adopted. This law should provide for the creation of a guarantee agency to be funded by contributions from member banks. For certain banks, membership should be compulsory and their licenses should be conditional on membership. The creation of the Agency for Restructuring Credit Organisations (ARCO) can be viewed as a positive development since it has been empowered to deal with problem assets and liabilities of credit organisations undergoing a restructuruing.

Thus the present is a time of fundamental restructuring of the banking system, a process which cannot be expected to be completed overnight. The kind of structural reform which Russia needs will be a long-term process with the goal of ensuring that the Russian banking system can meet the economic needs of the country.



In what has undoubtedly proven to be one of the most difficult years in Russia's financial history, 1998 has also turned out be an unprecedented test of Alfa Bank's management strategies and balance sheet strength. Thanks to its early assessment of the growing economic risks and timely actions to protect itself, the Bank emerged from the crisis as one of a handful of Russian banks with equity.

In June 1998, after nearly 9 months of internal restructuring, Alfa Bank completed its operational merger with its sister investment company, Alfa Capital. By integrating the two businesses, the Alfa Group Consortium created a truly universal financial institution able to offer clients a full range of retail, wholesale and investment banking products and services. At the same time, the merger considerably streamlined cost centers such as accounting, risk management and back office, while at the same time eliminating potential areas of competition in capital markets and corporate finance operations.

The key strategic aims of the new Alfa Bank are centered around building a mid-market corporate banking business and VIP retail franchise, coordinating strategy and control across the branch and subsidiary network and ensuring the development of a sales-driven brokerage business in both equity and fixed income products.

For the purposes of financial reporting in 1998, the merged Alfa Bank has issued a combined Alfa Financial Group balance sheet presented herein. Since it is difficult to compare the current statements (see note 3 of the Financial Statements) with the historical-cost-based accounts of previous periods, we will refer to the key parameters in the pro forma accounts in order to examine the effects of last year's financial crisis on the Bank's performance and clarify the strategic aims of the Group going forward into the next millenium.

The Group balance sheet in 1998 was significantly affected by the August financial crisis and as such witnessed a considerable contraction in almost all of the main indicators. The Bank's total assets recorded a substantial decrease of 33.4% to USD 951.2 million from USD 1,427 million at 1997 year-end. This downsizing was the result of the sharp devaluation of the rouble and the collapse of the Russian capital markets. It is worth noting that precautionary steps that were taken by the Management in the lending and trading businesses early in the year considerably reduced the impact of the crisis on the balance sheet of the Bank. These measures which included re-organization of these operations in late spring of 1998, focused on a strategy to enable the Bank to withstand a possible "worst case scenario" in the deterioration of the country's economy. Nevertheless, the events that followed August 17th had a dramatic effect on the year-end results of these core operations. Alfa Bank's corporate loan book was reduced by 56% over 1998 from USD 370 million to USD 163 million while the securities portfolio fell by over 93% from USD 487 million at the end of 1997 to USD 30 million at year end 1998.

The capital of the Bank – as well as being hit by the emerging market crisis in late 1997 (as exemplified by retained deficit of USD 261 million) and the continued volatility in 1998 (net operational loss of USD 204.7 million) – was further eroded as a result of the accounting methodology used to measure Bank's performance. The adjustments made in accordance with IAS 29 (Financial Reporting in Hyperinflationary Economies) have resulted in a translation loss (due to inflation) of more than USD 213 million, representing over 30% of the total year-end charge against equity. Nevertheless, with the support of the Bank's investments, particularly the revaluation gain from the independent appraisal of Alfa Group Consortium's holding in the Tyumen Oil Company (TNK), which the Bank financed in 1997, allowed equity to remain positive at USD 51 million. This facilitated the Bank's risk weighted capital adequacy at year-end to equal 5.8%.

At December 31, 1998 the Bank's total loan portfolio equaled USD 169 million, representing a decrease of USD 258.7 million, or 60% from USD 427.7 million at December 31, 1998. The year-end loan balance consisted of USD 163.0 million of commercial loans and USD 6.0 million of loans and advances to banks. The sizeable downturn in the Bank's credit activity has made a major impact on the role that lending plays in the asset structure of the Bank. Although lending activities witnessed a marginal expansion in early 1999, these operations will be influenced throughout 1999 by increased credit risk, with the financial position of corporate and inter-bank counter-parties continuing to be affected and interest rate and currency risks remaining prevalent.

The customer loan book decreased by USD 207 million or by 60% on 1997 year-end results (USD 163 million against USD 370 million in 1997). Commercial loans represented 96.4% of the total loan book and 17% of total assets. The end of the year loan book is over 80% denominated in dollars – a trend common to the portfolio throughout the year. Some 24% of the aggregate commercial loan portfolio consists of loans distributed under the federal agricultural program, which also accounts for a significant part of the overdue loans at the year end. According to the Agreement signed by the Ministry of Finance, Ministry of Agriculture and Alfa Bank on 5 December 1997, Alfa Bank acts as a commission agent for the federal ministries with responsibility for administering the credit facilities and ensuring their timely repayment to the Special Fund once they have been paid back to the Bank by the federally nominated borrower. From this Agreement it is understood that the Bank does not bear credit risk in regard to the recipient of the agricultural loans.

Loans and advances to banks amounted to USD 6.0 million at the end of the year, representing 0.63% of total assets versus 4% at year-end 1997. The book is dominated by hard currency loans to a very select number of mostly Government-owned banks, a clear indication of the market wide breakdown in trust among interbank counterparties.

Traded securities amounted to USD 30 million versus USD 487 million at the end of 1997. While Alfa began the year with a securities portfolio which was diversified among rouble and foreign currency State debt instruments and Russian corporate shares, the management of the Bank – in light of continued volatility and diminishing liquidity in these markets – adopted a conservative strategy early in the summer by gradually reducing the size of its GKO/OFZ portfolio to the minimum required to maintain its primary dealer status.

At December 31, 1998, the Bank's investment portfolio amounted to USD 610 million, an increase of USD 431.1 or 240.8% from USD 179.0 million at December 31, 1997. The investment book is principally made up of investments in associated companies and in particular the Bank's financing of Alfa Group's purchase of a major stake in Tyumen Oil Company (TNK), which by itself represents more than 88% of the total investment portfolio. The underlying value of this investment has witnessed a considerable appreciation as a result of the much-improved performance of the company and the devaluation effects of the August crisis, all of which have been taken into account by independent appraisers. Consequently, the Bank benefited from a substantial increase in the value of its original investment and recorded a net gain to the Bank's equity of USD 222 million. Reiterating its policy with respect to this transaction, Alfa Bank confirms that its investment into TNK was always intended to be a short-term undertaking, and as such, it will be completely removed from the Bank's balance sheet over the next 3-5 years.

At end of the year Alfa Bank's total liabilities amounted to USD 899 million recording a decline of 23% from USD 1,182 million in 1997. The fall on the liabilities side is primarily attributed to a 34% decline in total deposits from USD 588 million at December 31, 1997 to USD 385 million at December 31, 1998 and a 41% drop in other borrowings (from USD 417 million to USD 247 million over the year). Of total deposits, 64% were in hard currency, 33% in roubles with other currencies making up the balance.

Customer deposits and related and bills of exchange ended the year at USD 291 million and USD 42.7 million respectively, representing moderate reductions of 32.8% and 31% respectively in customer account balances and veksels compared with the previous year. Overall sectoral breakdown of customer deposits continues to be well diversified among different economic sectors with areas such as commerce/trade and finance/investment accounting for a greater proportional decline, in line with the effects of the crisis on operations in these sectors. Deposits from Banks amounted to USD 50 million versus USD 92 million at the end of 1997. As a percentage of total liabilities, deposits from banks fell from 7.7% at the end of 1997 to 5.5% at the end of 1998, reflecting continued volatility in the interbank market.

As a result of a partial retirement and repayment of the Bank's large international borrowing, “other borrowed funds” were reduced by 41% to USD 247 million. The restructured USCP, Medium Term Notes (Eurobonds) and a repo loan received in 1998 represent Alfa Bank's longer-term liabilities, which are partially responsible for its ability to maintain sufficient liquidity at the peak of the financial crisis in the 3rd and 4th quarters of 1998. Since the issue of the USD 175 million Eurobond in July 1997, the Bank has retired USD 24.8 million of MTN debt by purchasing the Notes at discount to face value leaving just over USD 150 million worth of Notes outstanding to maturity on July 2000.

Subsequent to the initial payment of USD 9.9 million on the USD 77 million USCP at the end of 1998, the Bank has successfully restructured the balance of the facility on July 16, 1999 by making an additional payment of USD 20.2 million and rescheduling the outstanding amount over a period of three and a half years. As a result of this restructuring Alfa Bank is not in technical default on any of its foreign obligations.

OPERATING RESULTS

Net interest income rose by more than 15% to USD 23.9 million from USD 20.7 million at year-end 1997 on the back of strong performance of the loan portfolio and prudent management of the Bank's coupon-paying fixed income securities prior to the August market crash.

Non-interest income declined by 160% on the year-end 1997 figure of USD 109 million. The significant losses borne by the Bank from securities trading and translation losses from the steep devaluation of the rouble were partially held back by advances made in foreign exchange trading and fee and commission income late in the year.

Fees and commissions income increased by 52% from USD 33 million in 1997 to USD 50 million for 1998 – a clear sign of the Bank's expanding corporate services and products. The inflow of new clients from “problem banks” in the 3rd and 4th quarters provided for a more than two-fold expansion of trade finance, documentary and cash management services. At the same time, active arbitrage operations on the Electronic Lot Trading System (SELT) morning and afternoon sessions resulted in foreign exchange trading gains of USD 41.6 million, an increase of 231% from USD 12.6 million in 1997.

Alfa Bank's total operating loss of USD 40.8 million in 1998 can to a great extent be explained by the overall economic adversity dominating the operating environment. Salary costs in 1998 increased by 203%, to USD 48.2 million from USD 15.8 million over 1997. The significant increase in this area reflects the Bank's dynamic personnel expansion at the regional branch level, in corporate client services, information technology and banking card departments. Keeping in mind the fact that salaries were reduced by 40% for all employees following the drastic downturn in economic conditions after the August crisis, the Bank actually ended the year with 60% more staff than it employed in January 1998. Consequently, the Bank ended the year with a loss before taxation of USD 207.7 million, compared to a profit before income tax of USD 52.4 million in 1997.

Bank wide provisions increased by USD 101.3 million or 544% from USD 18.6 million in 1997 to USD 119.9 million 1998. The lion's share of provisions were allocated towards possible credit losses (34% of total provisions) and diminution in value of investments (48% of total provisions).

As mentioned in the auditors' report, the management has not provided fully for the Bank's potential exposure to the domestic non-deliverable (index) foreign exchange forward market (NDF). When entering into NDF contracts, the parties agree to deliver only the difference in price of foreign exchange between the date of trade and maturity which implies the absence of the transfer of funds for the full amount of the contract at the date of settlement. These transactions were concluded when the development of the Russian banking sector was stable and the relatively calm financial markets facilitated transactions based on mutual trust between banks. Arbitrage courts have referred to the Russian Civil Code, which classifies these transactions as “gambling/betting” and as a result refused to offer legal support for the participating counterparties by not giving them a hearing.

As their execution is not compulsory under current legislation it is the view of the management that unrealized losses do not require provisions or unrealized gains recognition in the Bank's financial statements. Subsequently, a USD 2 million provision is allocated towards potential legal expenses which might arise from unilateral legal action from some of the Alfa Bank's forward counterparties.

The Bank's very conservative assessment of the continued financial and economic uncertainty, as reflected in provision allocation, have produced a post tax loss of USD 204.7 million.

ALFA BANK CLIENT BASE

Maintaining its drive toward building Russia's premier corporate banking business, Alfa Bank has established a solid client base made up of some of Russia's most reputable companies engaged in a wide range of different businesses. By offering its customers high quality, traditional corporate banking services, and introducing new, innovative products, the Bank was able not only to weather the financial crisis of 1998, but also to expand significantly its client base towards the end of the year. Against a backdrop of a severe nationwide economic turmoil, Alfa Bank has emerged as one of the very few Russian banks to remain stable, maintaining a full range of banking services to over 18,500 corporate customers, 5,000 of which joined us during the last few months of 1998.

The crisis was probably the best test of the Bank's reliability and the competence of our staff. It was at this time that the Bank strove to understand every aspect of its clients' businesses, with corporate account managers developing customized products to facilitate problem-free banking.

The Bank developed a model for optimizing client payment flows and assisting with settlement of overdue and current payments to state and federal budgetary institutions, including social insurance and pension funds, as well as payments to local government and utility companies.

At the same time the Bank offered companies engaged in foreign trade consulting services, professional tax advice and advice on filing the necessary transaction documents such as "trade passports" and currency control applications.

Being a market-maker in trading of "clearing currencies" and currencies of FSU countries (CIS and Baltic currencies) has allowed Alfa Bank to offer its clients immediate settlement of corporate transactions in any CIS/Baltic country currency, as well as hard currency FX, money market deals and swaps with couterparties in these countries. Alfa Bank's subsidiary and its 2 branches in Kazakhstan has strengthend Alfa's position on the Kazakh market – one of Russia' most important economic and political partners.

As in previous years, the Bank invested considerable time and energy in its work with federal agencies and state corporations. Close ties with the State Customs Committee and its regional divisions helps our clients to minimise payment processing time and ensure efficient settlement of accounts with Customs.

Throughout 1998, the Bank continued to participate – as financial consultant and lender – in a number of Government-sponsored domestic and international programs. In particular, the Bank was engaged as financial partner in export construction projects entered into by the Ministry of Atomic Energy.

Despite the effects of the financial crisis, Alfa Bank has managed to expand considerably and has succeeded in diversifying its range of corporate banking products and services, to include the following:

- free opening and operating of rouble and foreign currency accounts for both resident and non-resident corporations and individuals;
- settlements in roubles and hard currencies;
- settlements in soft currencies with Ukraine, Belorussia, Kazakhstan and other CIS countries;
- hard currency foreign exchange operations, including spot, forward and options contracts;
- all forms of currency conversions – roubles, hard and soft currencies;
- deposit and credit facilities in soft currencies;
- rouble and hard currency loans for individual and corporate clients;
- financing of export-import transactions, including pre-export financing;
- promissory notes and certificates of deposit;
- rouble and hard currency corporate loans;
- currency-of-settlement import trade financing under inter-governmental agreements between the former USSR and foreign states;
- a range of short and long-term company financing ;
- corporate and project finance, including joint-venture projects with foreign partners;
- transactions with precious metals on international markets;
- commercial and traveler's cheque transactions;
- bank card services for Eurocard/MasterCard, Diners Club, UnionCard;
- custody services;
- Ministry of Finance and Vnesheconom debt brokerage services on the Russian and international markets;
- guarantees for Customs Authorities;
- financial consulting and other services.

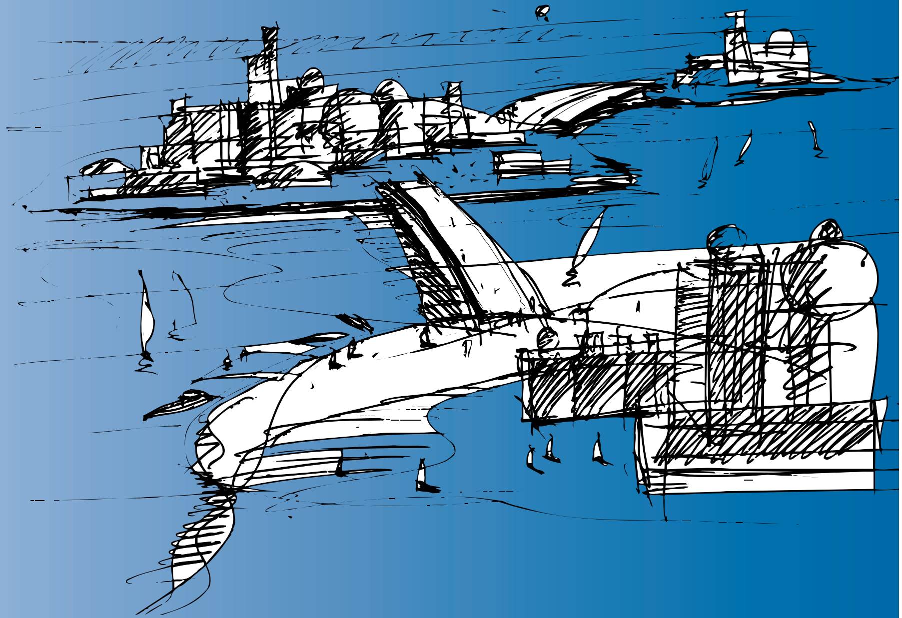
Client-Importer services provided by Alfa Bank

- opening of letters of credit for up to 180 days covered by securities, deposits and third party guarantees. In some cases, the Bank is prepared to offer guarantees for longer maturities;
- financing under the US government GSM 102 program for agricultural exports from the United States;
- advice on international trade counterparties;
- trade finance facilities in the form of loans.

Client-Exporter services provided by Alfa Bank

- post-export financing and payment on bills of acceptance;
- trade finance consulting and document preparation;
- opening of special “S” type hard currency accounts for non-residents;
- advice on international trade counterparties.

BRANCH NETWORK



The events of the second half of 1998 had a major impact on Alfa Bank and its regional branch network. However the Bank successfully implemented a strategy for the management of financial and credit risk, enabling it to minimise losses in the financial markets during the crisis.

At the peak of the crisis, it was "business as usual" at Alfa Bank's branches and subsidiaries as they continued to offer clients uninterrupted payments and withdrawals of deposits in roubles and foreign currency. Strong performance of the Bank's retail network in such adverse financial conditions has considerably strengthened client trust and subsequently led to the expansion of the customer base.

MOSCOW BRANCHES

With the opening of the "Krasnaya Presnya" branch in March 1998, the number of Alfa Bank's branches in Moscow totalled 18. Throughout the year, the branch manangement department actively developed its network of exchange points and cash machines located within the premises of corporate clients' retail outlets. Later in the year, clients of the so called 'problem' banks saw that Alfa Bank was one of the few retail banking groups left unshaken by the financial meltdown of August and was continuing to provide a full range of banking services and products. As a result, Alfa Bank's Moscow branch network witnessed rapid expansion as the number of corporate clients doubled over 1997 levels to a figure in excess of 18,000. Active marketing of the Bank's expanded range of services and corporate banking products has, as at the year end, resulted in more than a 100% increase in revenues from fees and commissions generated by the Moscow branch network.

REGIONAL BRANCHES

Faced with increased credit and market risk, the regional branches were forced to turn away from commercial and interbank lending and capital markets acivities to concentrate on developing new "crisis-proof" products and services in order to maintain existing corporate relationships and attract new clients. Some of these more refined products include facilities such as accelerated fund transfers and anti-inflationary individual rouble savings programs. The introduction of 'same-day' cash transfers services between the regions and Moscow attracted new corporate clients with operations spread across the country.

Over the course of the year, our branches in Samara and St. Petersburg were fully integrated into the Union Card payment system. Together with the Nizhni Novgorod branch and Alfa Bank-Novosibirsk, they are active participants in the regional interbank foreign exchange markets. Alfa Bank-Bashkortostan has applied to become a member of the St. Petersburg Currency Exchange (SPCE). Membership of regional branches in the interbank currency exchanges allowed Alfa Bank to attract new corporate clients involved in international business.

As a result of Alfa Bank's strong performance in the regions in 1998, its branch network was able to attract over 3,000 new corporate clients, more than half of which joined Alfa after 17th of August. Aggregate account balances held at regional branches as of 1st January 1999 showed a 2.1 fold increase over the same period a year before.

SUBSIDIARY BANKS

Alfa Bank's subsidiary network currently comprises three banks: Alfa Bank (Kazakhstan) – established in 1994, Alfa Bank Bashkortostan – operating since 1997 and Alfa Bank Novosibirsk (formerly Sibirsky Khlebny Bank) – created in October 1998.

DEVELOPMENT OF BRANCH NETWORK

In addition to the regional branches in St. Petersburg, Nizhni Novgorod and Samara, another branch in Togliatti was opened to service one of Alfa Banks's most important corporate clients, AVTOVAZ, Russia's largest automobile manufacturer and one of the biggest companies in the country. The first quarter of 1999 saw the opening of the Irkutsk branch in Sibiria.

A considerable amount of planning work was carried out in regard to the opening of five more branches in the regional centres of Volgograd, Ekaterinburg, Omsk, Kurgan and Tyumen. In addition, Alfa Bank's Board of Directors approved future expansion of the regional branch network into the following major industrial and agricultural centres: Orienburg, Saratov, Kazan, Rostov-on-Don, Perm, Vladivostok and Krasnodar.

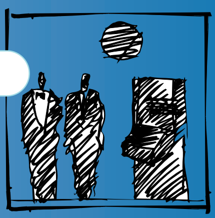
Further expansion of the branch network will strengthen Alfa Bank's position in the Russian financial markets and will enable the Bank to offer improved services to clients, especially those having a regional presence across Russia.

ALFA BANK'S BRANCH AND SUBSIDIARY NETWORK

ALFA BANK

- 18 MOSCOW BRANCHES
- REGIONAL BRANCHES AND SUBSIDIARIES
  - ST. PETERSBURG
  - SAMARA
  - TOGLIATTI
  - NIZNY NOVGOROD
  - NOVOSIBIRSK
  - UFA
  - IRKUTSK
- CIS SUBSIDIARIES
  - ALMATY
- BRANCHES TO BE OPENED IN 1999
  - TYUMEN
  - KURGAN
  - OMSK
  - ORIENBURG
  - VOLGOGRAD
  - VLADIVOSTOK
  - EKATERINBURG
  - PERM
- BRANCHES IN DEVELOPMENT
  - KRASNODAR
  - ROSTOV-ON-DON
  - SARATOV
  - KAZAN
- BRANCHES UNDER CONSIDERATION
  - KRASNOYARSK
  - CHELYABINSK
  - STAVROPOL
  - TOMSK
  - KALININGRAD
  - MAGNITOGORSK
  - IZHEVSK

BANKING CARDS

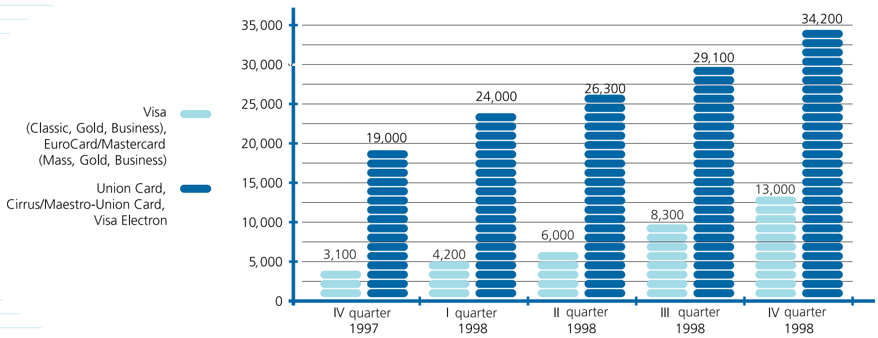


As with other business units, the results of the banking card division can be reviewed separately: before and after 17th August. The first period was characterised by tough competition for market share, which required an extensive advertising campaign for promoting Alfa-Bank's existing product range and an investment in new product development. During this period Alfa Bank achieved a considerable increase in market share and in the number of new cards issued. Subsequently Alfa Bank obtained from Visa International the right to the independent marketing of Visa cards to retailers, making Alfa Bank banking cards more attractive to customers.

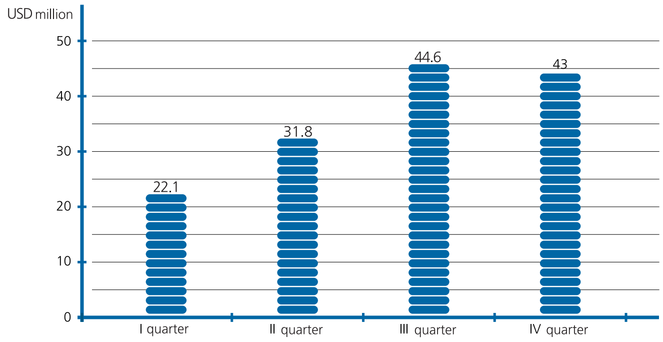
Despite the economic turmoil in August, which caused many leading Russian banks to suspend their card operations, Alfa Bank continued issuing rouble and dollar cards which were to be accepted not only nationwide by more than 900 retailers, all of the Bank's branches, subsidiaries and 47 automated teller machines (ATM), but also world-wide under international payment systems. During the crisis the Bank managed to maintain timely payroll services for all existing corporate clients and as a result now provides salary payment mechanisms to some of Russia's most prominent domestic and international corporations.

It is worth noting that during the period 1st August to 1st December 1998, 9,000 new international cards were issued, bringing the total number of Alfa cards in circulation at the end of 1998 to 47,200 (compared with 22,100 at the end of 1997). Thus during 1998 the Bank issued a total of 25,100 new cards operating under leading international and Russian payment systems.

ALFA BANK BANKING CARDS IN CIRCULATION



ALFA BANK BANKING CARD MERCHANTS’ VOLUME IN 1998



LENDING

1998 was a successful year for Alfa Bank's lending business. The improved performance in this area of the Bank's activities was a direct result of a cautious and conservative lending policy and the prudent approach of the Bank's credit committees. During the year the Loans and Credit Department further advanced its credit review process, implemented new loan approval systems and improved risk monitoring procedures.

In fact, even before the onset of the Russian economic crisis, the Bank had already tightened its lending policies, resulting in the effects of the crisis having a limited impact on the loan portfolio of the Bank.

The Bank's end of year loan portfolio was relatively well balanced, not only in terms of risk diversification, but also in terms of industrial sector, amount, term, as well as type of collateral. Before approving any loan, the Bank carries out extensive due-diligence of the potential borrowers' financial status, a full business evaluation, an analysis of the liquidity and quality of the security being offered, all of which has led to a significant reduction of credit risk exposure. Furthermore, the Bank managed to restructure its loan portfolio ahead of the economic crisis by converting a major part of rouble loans into hard-currency loans, enabling it to avoid major currency losses as a result of the devaluation of the rouble.

Some of the borrowers were severely affected by the crisis, causing them to default on their loans. However, a significant reduction in the number of non-performing loans by the year-end can be attributed to the Bank realising the value of assets used as security and negotiating constructively with borrowers in default. The continuing efforts of the Bank's credit management division gives the Bank confidence that practically all outstanding loans will be repaid in the medium term.

In spite of the crisis, the Bank maintained timely settlement of all accounts with clients and lending activities were virtually unaffected. By continuing to serve clients at this difficult time, the Bank was able to attract a large number of new corporate clients. The Bank offers a wide range of different financial instruments and tailor-made credit products orientated to the needs of specific borrowers.

The Bank offers unsecured loans to a limited number of clients with solid financials and long standing credit history with the Bank. In 1998 the Bank actively provided loan facilities against government guarantees and participated in state-sponsored lending programmes under mandates to channel funds on behalf of federal agencies. In many cases, the Bank lent against the guarantee of large, financially sound corporates.

Since 1997 the Bank has been a participant in the government's agricultural loan program, distributing federal funds from the Ministry of Agriculture and the Ministry of Finance. The Bank's role has been to distribute these funds prudently to a large number of borrowers, carry out diligent financial analysis of all potential borrowers, with the aim of minimizing credit risk, and of guaranteeing repayment of these loans to the federal budget. Alfa Bank was particularly successful in weeding out loss-making and insolvent businesses from the list of applicants. In 1998 the Bank managed a RR 1.2 billion portfolio of facilities across 23 regions of the Russian Federation, with interest rates set at nominal levels and loans secured in a variety of ways. Due to the Bank's proven success in managing these funds last year, its mandate, as an agent of the federal agricultural loan program, has been extended for a another year.

Alfa Bank anticipates a further improvement of its lending activities over the coming year as a result of a conservative credit and risk management policy, a highly professional team of qualified loan officers and a commitment to expand this area of operations.

PROJECT FINANCE

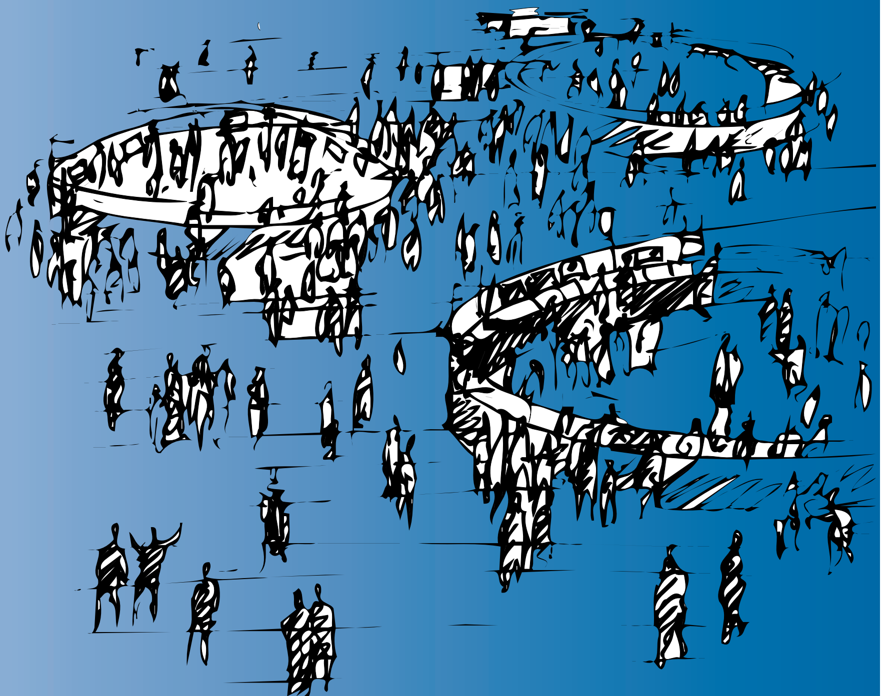
The project finance department performed well in 1998 in spite of the huge capital outflows from the country that began after the onset of the August crisis. The Bank was successful in raising funds from abroad for the residential construction sector, food industry, timber industry and other manufacturing industries.

The project finance department concentrated on identifying viable projects across Russia and securing funding from the World Bank, the EBRD and other foreign investors as well from the bank's own resources. The residential development "Rozhdestveno" reached the completion stage thanks to significant investment on the part of the Bank. In 1999 the Bank plans to commit further funds to this project and participate in a second phase of its development.

The Bank also committed its own resources to complete the modernization of the Moscow region dairy company "Smile International", enabling the company to successfully compete in the local market and achieve a significant increase in sales. The Bank is confident that its funding of this project will enable the company to optimize production and access foreign investment.

In 1998 Alfa Bank provided a project finance loan for the development of the "Tatoilgas" Tatneft oil field. A loan was provided to the timber processing company "Lands", a primarily export-orientated business. Alfa Bank was also a participant in the Moscow housing-construction program, a part of the Russian Federation Housing Project, which is being financed together with the World Bank. This program consists of two housing projects being constructed by "Mospromstroy", the leading construction company in Moscow. In 1998, the Bank financed the completion of phase 2 of the modernization of the "Tverskaya" hotel, as well as providing funds for the construction of a luxury apartment block in the centre of Moscow. The Bank continued to offer equipment lease and purchase financing for consumer goods and services industries in conjunction with a number of leasing companies.

CAPITAL MARKETS



CURRENCY AND MONEY MARKETS

In 1998 Alfa Bank was successful in maintaining a dominant position in currency and money market trading, both in international and CIS-member-state currencies.

Despite the banking system plunging into chaos as a result of the crisis, Alfa Bank managed to remain a major player on the interbank market. This period of time was characterised by a general loss of confidence in the banking system, leading to a fragmentation of the market and a drastic fall in volumes. In spite of this, Alfa Bank's trade volumes on the interbank market remain at pre-crisis levels of around RR 300 million a day, and thus the Bank is able to maintain short-term liquidity and take advantage of arbitrage opportunities.

During the periods of finanacial volatility late last year, Alfa Bank was able to secure repayment of all inter-bank loans owed to the Bank – a reflection of the effective risk management systems.

Throughout the year the Bank was a primary dealer in foreign exchange transactions, trading both for its own account and on behalf of clients. Alfa Bank is a long-standing member of the Moscow Inter-bank Currency Exchange (MICEX), enabling it to trade for its clients on the Electronic Lot Trading System (SELT). The Bank has been successful in maintaining a dominant position on this market, has increased its client base and developed a comprehensive correspondent banking network, enabling it to offer flexible currency conversion terms and low commission rates. According to Moscow Interbank Currency Exchange data, Alfa is one of the top banks in terms of trading volumes, with monthly turnover for 1998 averaging USD 350 million.

The Bank uses the latest technology for currency trading and financial analysis to enhance its currency trading ability. The bank employs effective currency risk management systems which have enabled it to avoid liquidity problems, honor all client payments, survive the non-payment problems and bankruptcy of some of the largest banks, and maintain an effective capital markets operation.

The Bank is an active player in the forward currency market, hedging currency risk both for its own account and for clients. Since the Bank had no short positions in forward trades, it was able to avoid the losses suffered by other banks when the devaluation of the rouble struck. Recognising that the country is set to integrate further into the world economic system, the Bank closely monitors operations on all world currency markets. Alfa Bank began trading in the Euro, as it recognized the need to offer its clients enhanced currency management by using the Euro as a means of avoiding currency risks. The Bank is able to deal in any currency for its clients and offers advisory services on currency trading.

Alfa Bank has consolidated its position in the soft currency markets and benefits from a large correspondent banking network within the CIS-countries and in the Baltics. Thus the Bank is able to offer clients new and innovative services in soft currencies. It is able to assist companies dealing with partners in these countries. Its experience in dealing in currencies of CIS and Baltic Republics has enabled it to amass valuable expertise in soft currency dealing and become a major market-maker in this niche. The Bank also serves a number of financial institutions of former Soviet

Republics, especially Ukraine, Belorus and Kazakhstan, offering trading services and deposit taking in these countries' national currencies. Experience in these markets has enabled the Bank to offer its clients assistance in dealing with these markets.

Alfa Bank is active in Kazakhstan where it owns a subsidiary bank, enabling it to maintain its dominant position in trading in the Kazakh Tenge in Russia.

SECURITIES MARKET

Fixed Income Trading

In 1998 Alfa Bank was active in all areas of Russian and foreign securities. Before August the Bank was most active in fixed income products, trading in domestic T-bills (GKO), federal bonds (OFZ), government savings bonds (OGSZ) and Ministry of Finance domestic bonds (MinFins), as well as bonds of other bodies and municipalities in the Russia Federation. Alfa Bank has been a primary dealer on the GKO/OFZ markets for the last three years, holding sizeable volumes for its own account, carrying out repo and lombard loan operations with the Bank of Russia.

Throughout the year the Bank continued to offer a full brokerage service in goverment bonds, trading on the behalf of 1,500 individual clients through its 18 branches in Moscow and three regional branches. Predicting that the financial markets were about to collapse, the Bank took the decision to restructure its proprietary portfolio of GKOs/OFZs and slashed the volume of its proprietary portfolio of government t-bills from RR 1,300 million to the minimum that could be held to remain a primary dealer – RR 517 million. This is the largest single factor which helped the Bank survive the financial meltdown and retain liquidity.

As a result of the financial crisis and disappearance of the GKO/OFZ markets, the Bank was forced to change its strategy in the securities business.

Immediately after the crisis the Bank continued to offer brokerage services to its clients and the number of clients actually grew as Alfa managed to attract new clients from insolvent banks. Alfa Bank continued to honor repayment of and payment of interest on non-frozen bonds. Meanwhile trading volumes in domestic hard-currency bonds and foreign debt obligations of the Russian Federation in fact increased as the Bank offered its clients new products:

- Investing in foreign government securities
- Hedging currency and trading risks by buying and writing of futures and options on the London, Frankfurt, Chicago and New York markets (contracts for Deutsche Mark, Japanese Yen, oil, metals, grain and other)
- Arbitrage deals through the most liquid forward contracts (interest rate, index, commodity price, currency)
- Dealing in debt instruments of insolvent banks

TRADING LEVELS IN FIXED INCOME PRODUCTS:

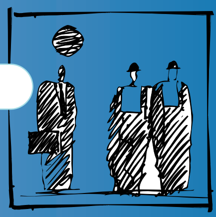
INSTRUMENT	1997	VIII-1998	1998
GKO/OFZ proprietary deals (RR million)	29,840	19,400	–
GKO/OFZ broker deals (RR million)	5,560	2,375	–
Government savings bonds (RR million)	410	–	76
Russian Central Bank lombard loans (USD million)	–	420	–
Moscow Oblast bonds (RR million)	–	70	–
Domestic hard-currency bonds and external debt obligations of the Russian Federation (RR million)	550	–	1,040

EQUITY TRADING

In 1998 the Bank was an active trader in all categories of Russian equities in each of the major trading systems. Being a market maker in the Russian Trading System (RTS) before the crisis, Alfa Bank/Alfa Capital retained its position after the crisis as one of the ten largest dealers in the system. The Bank offers a full brokerage service in corporate securities.

The Bank was saved from huge losses when Russian equity prices plummeted after the crisis by its decision to reduce its proprietary portfolio before the crisis. However, Alfa Bank, remaining a key equities dealer, was hit by the drop in trading volumes both for the Bank's own account and for the account of its clients. Nevertheless, trading volumes are picking up as the Bank attracts new clients from former market participants, which are now insolvent.

CORPORATE FINANCE



In 1998 both Alfa Bank and Alfa Capital, recognizing the traditional importance of investment banking as one of their core activities, committed significant resources to a number of high-profile investment projects. Prior to the merger of the two companies, Alfa Bank earned a reputation for having one of Russia's most experienced debt capital markets and structured finance teams, while Alfa Capital's investment banking unit focused on advisory services for multinationals and Russian companies (including Alfa group companies). At the peak of their activity both entities employed over 20 top investment banking professionals.

During the course of the year, Alfa Bank together with Alfa Capital provided structured financing to projects in such regions as Tyumen, Tatarstan, Samara, Bashkortostan, Saratov and Moscow. The Bank was retained as advisor/consultant for such companies as Procter and Gamble, Tyumen Oil Company, Alfa Cement and Story First Communications.

In July 1998, following the merger of Alfa Bank and Alfa Capital, the two investment banking divisions were consolidated into one, and in October 1998, Alex Tolchinsky, former Head of Investment Banking at CSFB Moscow, was brought in to manage the newly created Alfa Bank Corporate Finance Department. The department was completely reorganized, a number of new staff were recruited, and a new strategy was developed to reflect the new market conditions. Currently, Alfa Bank has one of the largest and most professional investment banking teams in Russia with over 10 professionals, combining western and Russian experience and education.

Today, Alfa Bank Corporate Finance department is focusing mainly on advisory work for a number of select Russian and western companies (including M&A, corporate restructuring and general advisory work) as well as capital raising activities for a number of Russian companies. Alfa Bank intends to further strengthen its current position in this area with a view to achieving the leading position in investment banking services in Russia.

ALFA CAPITAL UKRAINE

1998 was a year of upheaval in Ukraine but a year in which Alfa Capital Ukraine successfully diversified into new areas of business.

The onset of the Russian crisis in August sent shockwaves throughout the region, sending the Ukrainian stock market into a downward spiral. Alfa Capital Ukraine was quick to respond by switching into fixed income products.

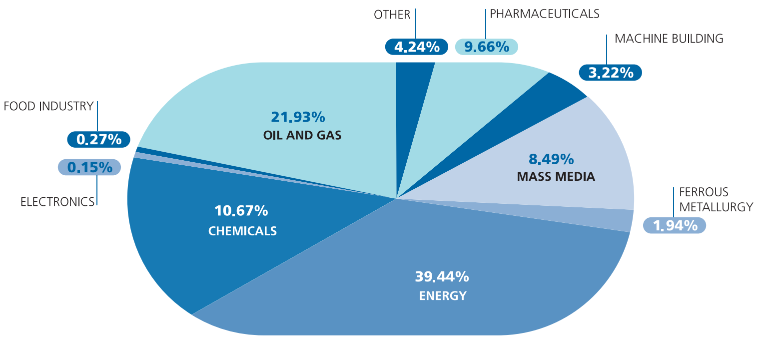
The company was also quick to change its investment strategy, focusing primarily on new projects and active management of existing projects in media and pharmaceuticals. It is particularly noteworthy that Alfa Capital Ukraine is the only major venture capital investor in the country. It is committed to the venture capital business, not least because the private sector now accounts for almost half of the Ukrainian economy.

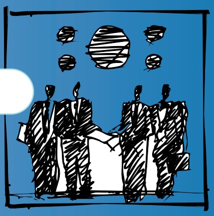
The main areas of business are investment banking, asset management, proprietary direct investment, securities trading, fixed income trading, depository and custodian services and research.

In 1998 Alfa Capital Ukraine was once again rated "most dependable and competent securities house" by the DAR research centre and the "most active securities dealer" by the Off-exchange Stock Trading System (OSTS). In 1998, the company had 26% of the market in equity dealing and 38% of the market in promissory note trading.

The company is highly regarded internationally, evidenced by the awards given to the company of "Best Brokerage Company in Ukraine" by Central European magazine in April 1998, and "Best Securities House" by Euromoney magazine in July 1998. The company also received the "Euromarket Award 1998" from the Centre for European Market Research in Brussels. In the words of the vice president of the Centre, Mrs I Miller:
"The company has achieved remarkable growth, having increased its assets, profits, funds under management as well as the number of clients".

BREAKDOWN OF ALFA CAPITAL UKRAINE'S PROPRIETARY INVESTMENT'S AS OF 1st JANUARY 1999





Alfa Bank's correspondent banking relationships with domestic and international financial institutions developed further in 1998, continuing the strategy begun in 1997. Strong expansion of the correspondent banking network and Alfa products and services was only slightly hindered by the effects of the financial crisis in the second half of the year.

Despite the difficulties faced by the financial sector in Russia, which followed the turmoil on global emerging markets late in 1997, Alfa Bank remained committed to refining its correspondent network, in order to offer our clients uninterrupted commercial banking services. By providing extensive information on market conditions and the financial position of the Bank in 1998, our international partners were able to maintain significant credit limits for Alfa Bank's trade finance and capital markets operations.

Working with more than 300 banks from Russia, the CIS and Baltic States in the beginning of 1998, Alfa Bank was able expand its correspondent "loro account" network by 12.5% before August 17th and by 8% during the rest of the year. As a result, the volume of international settlements at year-end increased by 12% compared with the previous year. At the peak of the financial crisis, the domestic correspondent banking department was able to leverage off the financial stability of the Bank and provide special netting settlement services to assist its own clients and clients of other institutions in recovering funds from banks which had suspended operations as a result of liquidity problems.

On the international front, Alfa Bank's operations early in 1998 were only marginally affected by the repercussions of the emerging market volatility observed in late 1997. As many international correspondents began to get nervous with their Russian exposure, Alfa Bank – in its traditional proactive manner – began providing regular, no-nonsense updates on its own financial position and the goings-on in Russia (political, economic and financial), which helped calm these sentiments. This informational transparency allowed international financial institutions and rating agencies to form an objective opinion on the true state of the Russian banking system and led them to regard Alfa Bank as one of the most trustworthy and reliable Russian banks.

Against this ever-changing operational background in 1998, the Bank continued to participate in the Financial Institutions Development Program (FIDP) conducted under the supervision of the World Bank and the Russian Ministry of Finance. As part of the Institutional Development Program within the FIDP, consultants from the First Union National Bank (previously CoreStates Bank) and the Royal Bank of Scotland spent more than 50 weeks working with officers and managers from practically every department of the Bank.

Alfa Bank's efforts to honor all of its commitments have given our institution a high profile on both domestic and international markets. As an example for the third year running Alfa Bank has been awarded "Best Bank in Russia for 1999" by the Euromoney's Central European Magazine while Global Finance Magazine in its annual survey of the "Best Emerging Market Banks" named Alfa Bank "Best Russian Domestic Bank".

THE MAJOR FOREIGN CORRESPONDENTS OF ALFA-BANK:

Austria

BANK AUSTRIA
ING-BANK
RAIFFEISEN ZENTRALBANK

India

CANARA BANK

Denmark

DEN DANSKE BANK

Great Britain

MIDLAND BANK
MOSCOW NARODNY BANK
NATIONAL WESTMINSTER BANK

USA

BANK OF NEW YORK
BANK OF AMERICA
REPUBLIC NATIONAL BANK
OF NEW YORK
FIRST UNION BANK INTERNATIONAL

Norway

DEN NORSKE BANK

France

BANQUE NATIONALE DE PARIS
B.C.E.N.EUROBANK

Belgium

GENERALE BANK

Italy

BANCA NAZIONALE DEL LAVORO

Turkey

DISBANK

Sweden

SVENSKA HANDELSBANKEN

Japan

BANK OF TOKYO-MITSUBISHI

Canada

ROYAL BANK OF CANADA

Germany

COMMERZBANK AG
DRESDNER BANK AG
BAYERISCHE HYPO-UND VEREINSBANK

Finland

MERITA-BANK

Switzerland

BANK JULIUS BAER
UNION BANK OF SWITZERLAND

Spain

BANCO CENTRAL
HISPANOAMERICANO

THE MAJOR CORRESPONDENTS OF ALFA BANK IN THE C.I.S.AND BALTIC STATES:

Azerbajan

International Bank of Azerbajan, Baku

Armenia

Central Bank of Armenia, Erevan
Ardshinbank, Erevan
Armimpexbank, Erevan
Konversbank, Erevan
United Bank, Erevan

Belarussia

Belarusbank, Minsk
Belbusinessbank, Minsk
Belvnesheconombank, Minsk
Belarussian Stock Exchange Bank, Minsk

Georgia

National Bank of Georgia, Tbilisi
Bank of Georgia, Tbilisi
TBS-Bank, Tbilisi
TbilComBank, Tbilisi

Kazakhstan

Almaty Trade and Finance Bank, Almaty
Kazcommercbank, Almaty
People’s Savings Bank of Kazakhstan, Almaty
Turanalem, Almaty
Centr-Credit Bank, Almaty
Export-Import Bank, Almaty

Kyrgyzstan

Bishkek, Bishkek
Kyrgyzkramdsbank, Bishkek
Kyrgyzpromstroybank, Bishkek
Kurulushbank, Bishkek
Eridan, Bishkek

Latvia

The Baltic Trans Bank, Riga
VEF-Bank, Riga
Lateco Bank, Riga
Pareks Bank, Riga
Rietumu Bank, Riga
Saules Bank, Riga

Lithuania

Vilnius Bank, Vilnius
Germis Bank, Vilnius
Lithuanian Savings Bank, Vilnius
Snoras Bank, Vilnius
Ukio Bank, Vilnius

Moldova

Savings Bank of Moldova, Chisinau
Pridnestrovsky Republic Bank, Tiraspol
Mobiasbank, Chisinau

Turkmenistan

Central Bank of Turkmenistan, Ashgabad
State Bank of Foreign Economic Activity, Ashgabad
Investbank, Ashgabad

Uzbekistan

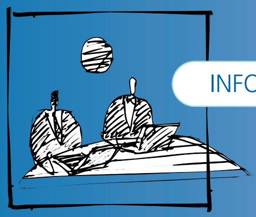
National Bank of Foreign Economic Activity of Uzbekistan Republic, Tashkent
Uzprombank, Tashkent

Ukraine

Aval, Kiev
First Ukranian International Bank, Donetsk
Privatbank, Dnepropetrovsk
Bank Ukraine, Kiev
Ukreximbank, Kiev

Estonia

Optiva Bank, Tallin
Hansa Bank, Tallin
Estonian Credit Bank, Tallin



INFORMATION TECHNOLOGY

Alfa Bank, as a modern and diversified financial institution, is committed to high quality information technology.

Continuing along the strategic path set by the Board of Directors 3 years ago, the information technology department has continued in 1998 to refine the Bank's computing infrastructure with the help of resources provided by the World Bank's Financial Institutions Development Program (FIDP).

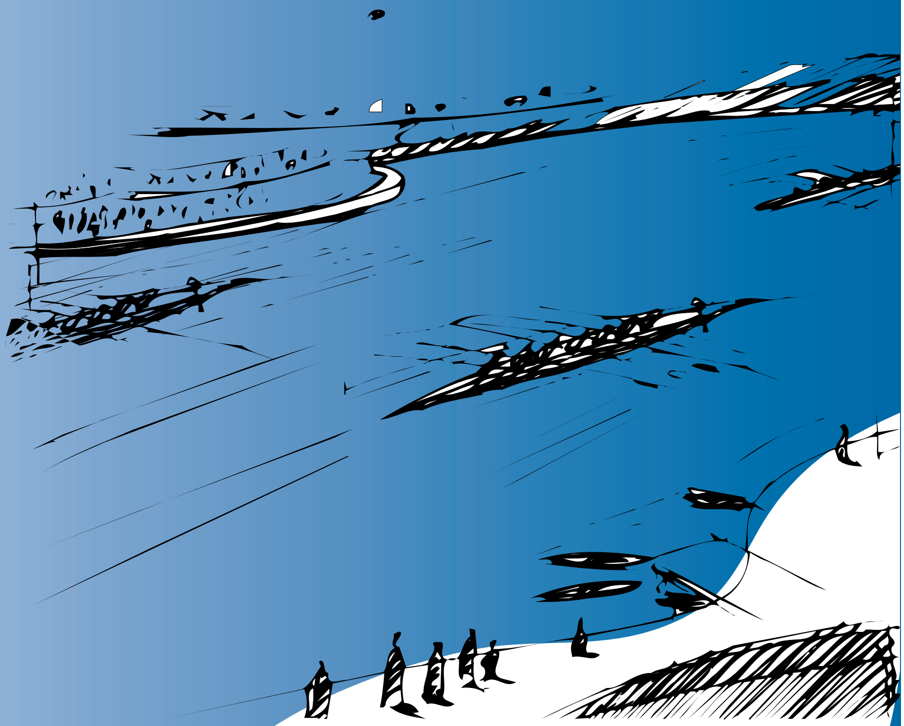
One of the key objectives on this strategy has been to implement an IT organizational structure common to that of leading western financial institutions. Following an initial analysis of Alfa's current IT capabilities, consultants from the First Union National Bank and the Royal Bank of Scotland prepared an intensive 2-3 week program of visits for Alfa's IT managers to their respective banks. This program was tailored to the needs of the Bank and aimed to tackle specific areas which, in the opinion of the consultants, needed to be addressed in order to assure Alfa Bank's future operational development.

First-hand experience gained from these visits helped our IT managers formulate a blueprint for the expansion of the Bank's computing and communications infrastructure. Utilizing our twinning partners' wealth of experience, extensive supporting literature and manuals provided by consultants allowed the Bank to define a plan of action needed to accommodate a smooth transition to new and more powerful systems.

Thus, to accommodate the processing of daily financial data, which has increased in volume more than two fold in 1998, high capacity Hewlett Packard V-2000 servers were brought into operation. In addition, the IT department completed the development of a new generation banking system based on the RDBMS INFORMIX platform. In line with the expansion of the Bank's retail sector, all of the newly established regional branches have been fully equipped and integrated into existing operational systems, while Alfa's proprietary remote electronic banking system "Alfa Bank - Client" witnessed the connection of more than 750 new customers. The merger of Alfa Bank with its sister investment bank Alfa Capital required the unification of two information systems with a single high-speed network.

Strong growth in Alfa Bank's commercial banking activities in the "post crisis" Russian financial system and a sophisticated FIDP-backed strategy will assure that the development of information technologies will remain one of the management's top priorities. With year 2000 issues already resolved, thanks to the newly installed systems, Alfa Bank is now well positioned to become Russia's premier private universal financial institution.

HUMAN RESOURCES



Alfa Bank operates a human resources policy similar to that of any major interantional organization but tailored to the specifics of the local commercial environment Such a policy has served the bank exceptionally well over the past year.

There has been a commensurate increase in the number of staff, in line with the expansion of the bank's branch network and the increase in transaction volumes. As of 1st January 1999 the Bank employed 2,500 professional and support staff, representing an increase of 60% over the previous year. Much of this increase can be attributed to the aggressive expansion of the Bank in the regions. There are some 1,413 employees working in Alfa Bank's branches, representing 45% of the Alfa Bank's total staff.

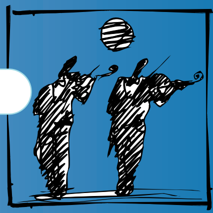
The Bank is meticulous in its appraisal of the professional attributes of its officers. In 1998 all newly created positions required candidates to have university level education. University or equivalent educated employees currently make up more than 60% of all Bank staff. Meanwhile more than 8% of staff are engaged in post-graduate level studies while working full time for the Bank. The majority of the professional staff are all graduates from the country's leading educational institutions, including the Moscow State University, State Financial Academy, State Academy of Administration and the Plekhanov Economic Academy.

The average age of the employees at the Bank is 34 while the average age of the Board Members is 44.

In determining its HR strategies, the Bank pursues a set of objectives based on the formation of a highly qualified core team of specialists, fluent in all aspects of international banking operations. The current methods of staff training incorporate seminars and conferences, both at the Bank as well as at specialized educational institutions. Many managers regularly partake in seminars and courses held both in Russia and abroad, arranged by leading international banks.

With the rapid development of its global banking management strategy and the implementation of new technology, Alfa Bank has invested heavily in new training programs for its employees. This has been partially achieved through the arrangement of internships taken by senior Alfa Bank managers in leading US and UK banks under the Financial Institutions Development Program, conducted by The World Bank and The European Bank for Reconstruction and Development.

SPONSORSHIP AND CHARITABLE ACTIVITY



In 1998, as in previous years, Alfa Bank focussed on key priorities for its sponsorship and charitable work, which were aimed at supporting social, economic and cultural issues in the many urban and regional communities it serves.

Despite the crisis in the financial and banking sector during the past year, Alfa Bank did not back away from any of its long-term charitable commitments. Programs such as post secondary academic scholarships “Alfa Chance” and other initiatives to support child and youth housing and education have been the focal point of the Bank’s charitable work from the early years of its operation.

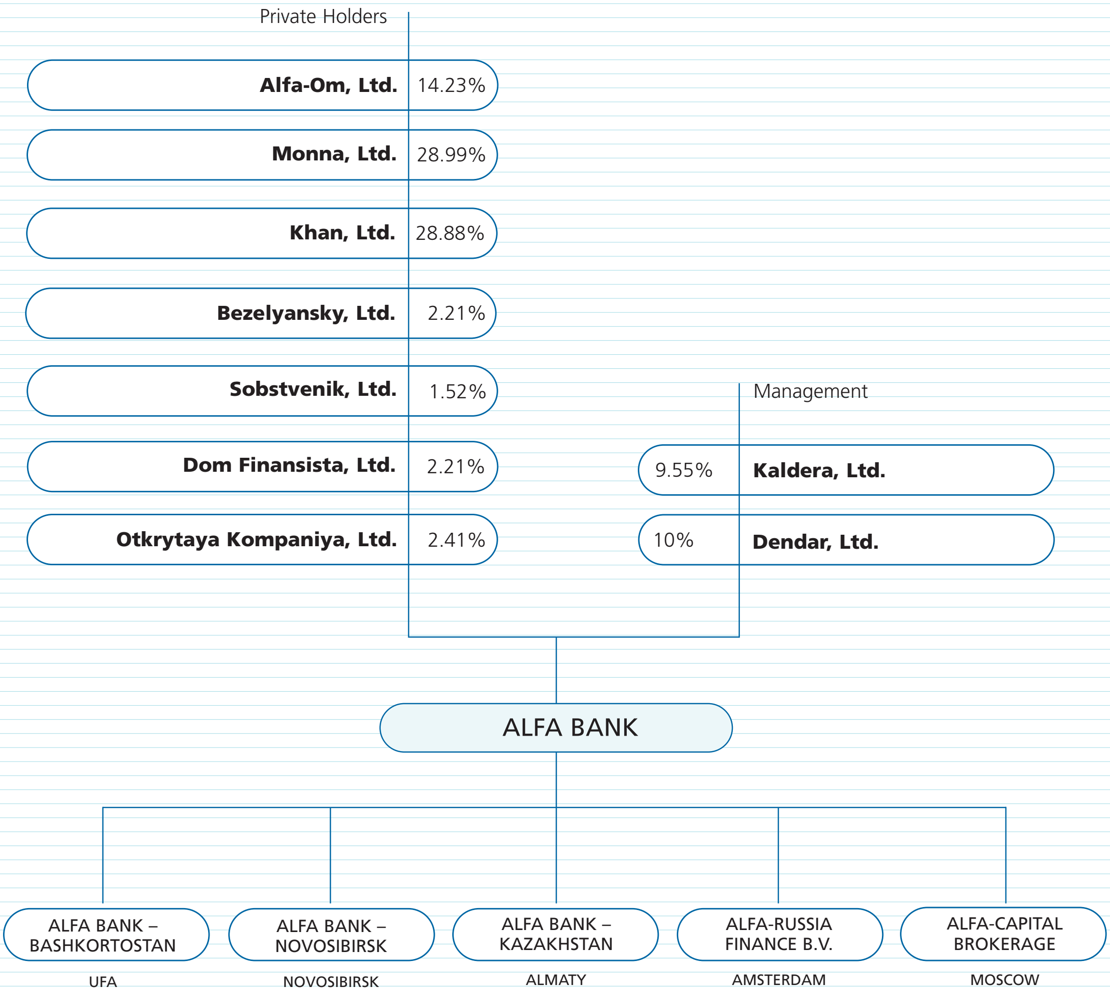
Strengthening its traditional ties with the Russian Orthodox Church, Alfa Bank continued to assist in the reconstruction of Moscow churches as well as in the opening of hostels and old people’s homes under the supervision of the Patriarchy – all part of the Bank’s efforts in supporting the work of the church in the community.

Municipal organizations, law enforcement departments and veterans’ associations are considered by the Bank to be vitally important for the welfare of the public and as such benefit from the Bank’s sponsorship programs. Of special note during the past year was Alfa Bank’s key participation in the Moscow’s Business Association’s campaign “Moscow businessmen for Moscow Police” where contributions were made to the families of law enforcement officers killed in the line of duty. Later in the year, when the financial turmoil following the events of August 17th was at its peak, the Bank was able to respond to a request from the Mayor of Moscow, Mr. Yuri Luzkov, to participate as a sponsor in the prestigious Kremlin Cup – an annual ATP tennis tournament.

On the back of strong regional expansion in 1998, Alfa Bank paid special attention to the needs of the many regional centers where it has branches and subsidiary offices. In St. Petersburg benefit concerts by famous Russian performers were organized by the Bank to celebrate WW2 victory while in Samara Alfa Bank provided 13 top prizes for a professional theatre competition and awarded the Grand Prize to one of Russia’s most famous actresses, Mrs. Ershovoy, for her life time achievements.

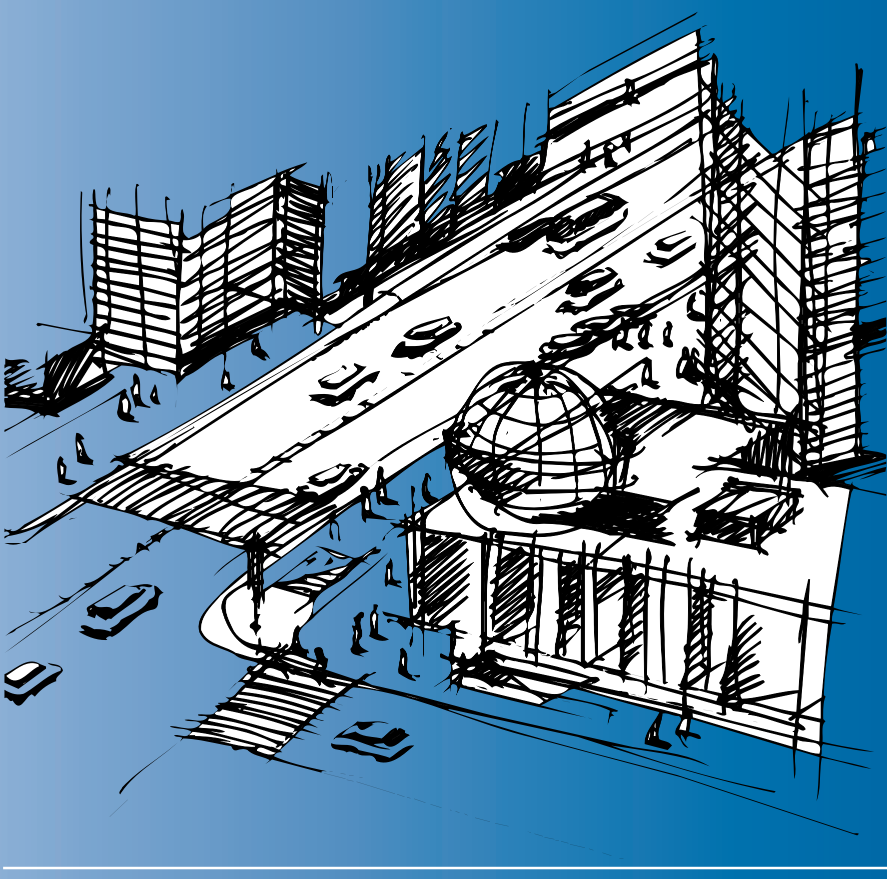
An important event in the cultural life of St. Petersburg and Moscow in 1998 has the February gala performance of the “Bejart Ballet Lausanne”, headed by one of the most famous names in modern choreography, Mr. Marice Bejare. At the invitation of the Bank, the ballet company performed two different works to the music of Mozart, American composers and the rock group “Queen” at sold out “Bolshoi” and “Mariinski” theaters. According to Maestro Bejare, the performances were a realization of his long time dream to present his ballets to very knowledgeable Russian audiences.

ALFA BANK – IAS SHARE CAPITAL STRUCTURE



Alfa Bank Subsidiaries

COMBINED FINANCIAL STATEMENTS AND AUDITORS' REPORT



PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers Audit
Nikoloyamskaya ul. 13
109240 Moscow
Russia
Telephone +7 (095) 967 6000
Facsimile +7 (095) 967 6001

Auditors' Report

To the Shareholders and Board of Directors of Alfa Financial Group:

1. We have audited the accompanying combined balance sheet of Alfa Financial Group (the "Group" as defined in Note 1 to the combined financial statements) as at 31 December 1998, and the related combined statements of operations, of cash flows and of changes in shareholders' equity for the year then ended. These combined financial statements are the responsibility of the Group's Management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

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

3. As described in Note 22, the Group entered into index forward foreign exchange contracts whereby it agreed to buy or sell Roubles in exchange for other currencies at a fixed rate of exchange at some future date. As a result of economic conditions in the Russian Federation, the value of the Rouble against other currencies has declined significantly. At 31 December 1998 the total contracted loss in respect of the Group's unsettled domestic index forward foreign exchange transactions amounted to USD 45 495 thousand, if measured at the contractual exchange rates as required by International Accounting Standards. Management of the Group, however, has only recorded a charge of USD 2 000 thousand in this respect within the accompanying combined financial statements based on their best estimate of the expected ultimate loss. Thus, the Group's total liabilities are understated and its profit for the year and shareholders' equity are overstated by USD 43 495 thousand.

4. In our opinion, except for the effect on the combined financial statements of the matter referred to in the paragraph above, the accompanying combined financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 1998 and the combined results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

5. Without further qualifying our opinion, we draw attention to the following:

• The Group incurred a net loss of USD 204 618 thousand during the year ended 31 December 1998. Also, as noted in paragraph 3 above and further explained in Note 2 to the accompanying combined financial statements, the Group has not recorded a provision of USD 43 495 thousand with respect to index forward foreign exchange contracts contracted with counterparties located in the Russian Federation. Accordingly, there is substantial doubt about the Group's ability to continue as a going concern. The accompanying combined financial statements have been prepared, however, assuming that the Group will continue as a going concern and, consequently, do not include any adjustments that might be required if the Group proves not to be a going concern. Management's plans regarding improving the financial condition and performance of the Group are described in Note 2 to the accompanying combined financial statements;

• As described further in Notes 9 and 23 to the accompanying combined financial statements, the Group has significant transactions with related parties; and

• As stated in Note 2 to the accompanying combined financial statements, the operations of the Group, and those of similar financial groups operating in the Russian Federation, have been significantly affected, and will continue to be affected for the foreseeable future, by the country's unstable economy.

Moscow, Russia
2 July 1999

COMBINED BALANCE SHEET AS AT 31 DECEMBER 1998

ASSETS	Note	1998	1997
Cash and short term funds	5	59 206	192 733
Mandatory cash balances with the CBRF		12 507	26 311
Loans and advances to banks	6	6 014	57 760
Loans and advances to customers	7	163 018	369 940
Securities	8	30 030	487 138
Investments	9	610 113	179 019
Other assets and receivables	10	32 050	87 229
Premises and equipment	11	38 260	27 048
TOTAL ASSETS		**951 198**	**1 427 178**
LIABILITIES			
Deposits from banks		50 366	92 049
Customer accounts	12	291 524	434 124
Bills of exchange		42 706	62 152
Obligations under derivative financial instruments	22	2 000	-
Other borrowed funds	13	247 470	417 066
Payables and other liabilities	14	87 171	170 240
Deferred tax liability	18	178 365	7 046
TOTAL LIABILITIES		**899 602**	**1 182 677**
MINORITY INTEREST		**635**	**1**
SHAREHOLDERS’ EQUITY			
Share capital	15	503 136	503 136
Revaluation reserve for investments	9	222 672	-
Revaluation reserve for premises and equipment	11	4 195	2 467
Retained deficit and other reserves	16	(679 042)	(261 103)
TOTAL SHAREHOLDERS’ EQUITY		**50 961**	**244 500**
Total liabilities and shareholders’ equity		**951 198**	**1 427 178**

COMBINED STATEMENT OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER 1998

	Note	1998	1997
Interest income on loans		74 231	99 156
Interest income on securities		21 633	7 428
Interest expense		(71 985)	(85 864)
Net interest income		**23 879**	**20 720**
Gains less losses arising from securities		(141 133)	63 415
Gains less losses arising from dealing in foreign currency		41 698	12 595
Foreign exchange translation gains less losses		(31 527)	(439)
Fee and commission income, net	23	50 591	33 300
Other operating income		15 650	2 353
Operating (loss)/income		**(40 842)**	**131 944**
Staff costs		(48 214)	(15 880)
General, administrative and other operating expenses	17	(54 329)	(39 919)
(Loss)/profit before provisions and taxation		**(143 385)**	**76 145**
Provision for losses on loans	6, 7	(41 158)	(15 866)
Provision for diminution in value of investments	9	(58 454)	(2 750)
Provision for losses on forward foreign exchange contracts	22	(2 000)	-
Provision for credit related commitments	22	(7 910)	-
Provision against receivables	10	(10 405)	-
Monetary gain/(loss)		55 597	(5 052)
(Loss)/profit before taxation		**(207 715)**	**52 477**
Taxation	18	3 025	(8 483)
Cumulative effect of change in accounting for taxes		-	1 350
(Loss)/profit after taxation		**(204 690)**	**45 344**
Minority interest		72	(1)
Net (loss)/profit		**(204 618)**	**45 343**

COMBINED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 1998

	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received	73 811	96 823
Income received from securities	21 633	7 428
Interest paid	(64 936)	(79 324)
Income received from dealing in securities, net	(58 993)	55 264
Income received from dealing in foreign currency	41 698	12 595
Foreign exchange translation gains less losses	(31 527)	(439)
Commissions received	101 391	50 801
Commissions paid	(50 800)	(17 501)
Other income	15 650	2 353
Staff costs paid	(44 810)	(15 880)
General administrative and other operating expenses paid	(49 236)	(33 324)
Income tax paid	(2 129)	(3 792)
Operating profits before changes in operating assets and liabilities	**(48 248)**	**75 004**
(INCREASE)/DECREASE IN OPERATING ACTIVITIES		
Net decrease/(increase) in dealing securities	358 801	(54 765)
Net decrease/(increase) in CBRF reserves	13 804	(13 578)
Net decrease/(increase) in loans and advances to banks	52 212	(17 038)
Net decrease/(increase) in loans and advances to customers	167 842	(327 661)
Net decrease/(increase) in receivables	44 774	(76 320)
Net (decrease)/increase in deposits from banks	(41 683)	49 635
Net (decrease)/increase in customer accounts and bills of exchange	(162 046)	401 991
Net (decrease)/increase in payables	(100 688)	62 829
Net cash from operating activities	**284 768**	**100 097**
CASH FLOWS FROM INVERSTING ACTIVITIES		
Purchase of premises and equipment	(22 358)	(5 118)
Proceeds from sales of investments	91 840	-
Purchases of investments	(185 584)	(85 836)
Net cash used in investing activities	**(116 102)**	**(90 954)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital contributions from members	-	114 375
Repayment of borrowings	(199 596)	(33 981)
Proceeds from borrowings	30 000	74 605
Dividends paid	-	(6 000)
Net cash (used in)/from financing activities	**(169 596)**	**148 999**
Effect of exchange rate changes on cash and cash equivalents	**(132 597)**	**8 530**
Net (decrease)/increase in cash and short term funds	**(133 527)**	**166 672**
Cash at beginning of the year	192 733	26 061
Cash and short term funds at the end of the year	**59 206**	**192 733**

COMBINED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEAR ENDED 31 DECEMBER 1998

	Share capital	Share premium	Revaluation reserve for investments	Revaluation reserve for premises and equipment	Retained deficit and other reserves	Total shareholders' equity
Balance at 1 January 1997	**338 761**	**9 539**	**-**	**2 641**	**(280 691)**	**70 250**
Share issue (Note 15)						
– Nominal value	114 375	-	-	-	-	114 375
Restructuring of the share capital (Note 15)	50 000	(9 539)	-	-	(40 461)	-
Reclassification of depreciation charged in respect of revaluation reserve	-	-	-	(174)	174	-
Net profit for the year	-	-	-	-	45 343	45 343
Dividends						
– Ordinary shares	-	-	-	-	(15 039)	(15 039)
Translation differences	-	-	-	-	29 571	29 571
Balance at 31 December 1997	**503 136**	**-**	**-**	**2 467**	**(261 103)**	**244 500**
Loss for the year	-	-	-	-	(204 618)	(204 618)
Revaluation of investments, net of deferred tax (Note 9)	-	-	222 672	-	-	222 672
Revaluation of premises and equipment, net (Note 11)	-	-	-	1 882	-	1 882
Reclassification of depreciation charge in respect of revaluation reserve	-	-	-	(154)	154	-
Translation differences	-	-	-	-	(213 475)	(213 475)
Balance at 31 December 1998	**503 136**	**-**	**222 672**	**4 195**	**(679 042)**	**50 961**

1. PRINCIPAL ACTIVITIES OF THE ALFA FINANCIAL GROUP

Alfa Financial Group (the "Group") is part of the Alfa Group Consortium (the "Consortium") and comprises two main sub-groups – Alfa Bank Group and Alfa Capital Holdings. These sub-groups are being reorganised to be majority held by a subsidiary of the Consortium and this intended holding company of the Group (the "SPV") is to be based in Luxembourg. The SPV is to be controlled (68.75%) by CTF Holdings Limited, a company registered in Gibraltar, and which is the ultimate parent company of the Alfa Group Consortium.

Though the merger of the combined entity is not legally completed as of the date of these combined financial statements, these combined financial statements have been prepared on a pro forma basis as if the Group existed as one reporting entity for all years presented. The SPV along with other members of Alfa Group Consortium control all of the entities of the Alfa Financial Group. As a consequence, these combined financial statements have been prepared to present the assets, liabilities, results of operations and cash flows of the two sub-groups on the basis of the "economic entity" concept of combination.

Alfa Group Consortium comprises CTF Holdings Limited and its subsidiaries (together the "CTFH Group"), and companies in which the CTFH Group together with members of Alfa Group Consortium have majority interest and control. The Consortium is involved primarily in trading in oil, oil products and sugar in addition to its financial activities which are reflected in these combined financial statements.

A substantial part of the Consortium's and that of the Group's activities are carried out in Russia.

A summary of the constituent entities within the Alfa Financial Group is set out below.

ALFA BANK GROUP

Alfa Bank (the "Bank") is an open joint stock commercial bank. It is registered in the Russian Federation to carry out banking and foreign exchange activities and has operated under a full banking license issued by the Central Bank of the Russian Federation ("CBRF") since 1991. The Bank operates in all sectors of the Russian financial markets including inter-bank and retail deposits, foreign exchange operations and debt and bond trading. In addition, a complete range of banking services is provided in Roubles and foreign currencies to its clients.

The Bank had 4 branches within the Russian Federation at 31 December 1998 and has opened an additional six branches during 1999. The Bank also had 17 subbranches at 31 December 1998. Additionally, the Bank has a representative office in London.

The Bank's registered office is located at 7b1 Novatorov Str., Moscow 117425. The Bank's principal place of business is 9 Mashi Poreyvaevoy Str. Moscow 107078.

The Bank's wholly owned subsidiaries comprise Alfa Capital Brokerage AOZT, Alfa Trust, Alfa Bank Kazakhstan, and Alfa Russia Finance BV.

Joint stock company Alfa Capital Brokerage AOZT was incorporated in the Russian Federation in 1996. Alfa Capital Brokerage AOZT performs both brokerage and proprietary trading in Russian securities.

Alfa Russia Finance BV is a wholly owned special purpose vehicle through which Alfa Bank obtained Euro Medium Term Notes and US Commercial Paper. See Note 13 for further detail.

The other subsidiaries of Alfa Bank are not material to the Alfa Financial Group. Accounting records of the material entities of the Alfa Bank group are maintained in Russian Roubles.

ALFA CAPITAL HOLDINGS

Alfa Capital Holdings (BVI) Limited, a company registered in the British Virgin Islands, is the parent company of the Alfa Capital Group, the activities of which include proprietary trading and brokerage activities, investment and merchant banking and asset management with a primary emphasis on securities within the Russian Federation and Ukraine. In 1997, the securities operations of the Alfa Group Consortium were consolidated into Alfa Capital Holdings (BVI) Limited and its subsidiary, Alfa Capital AOZT. This reorganisation was effected as follows (see Note 3 for a description of accounting for the reorganisation):

- the issued share capital of Alfa Capital AOZT was gifted from Crown Trade & Finance Inc. to Alfa Capital Holdings (BVI) Limited effective 30 June 1997,

- the assets and liabilities related to securities operations were gifted from Crown Trade & Finance Inc. to Alfa Capital Holdings (BVI) Limited effective 30 June 1997.

Alfa Capital Holdings (BVI) Limited's wholly owned subsidiaries comprise Alfa Capital Ukraine, Alfa Capital Investments Limited, Alfa Capital Holdings (Cyprus) Limited, Alfa Capital Asset Management AOZT, Alfa Asset Management (BVI) Limited, and Alfa Capital AOZT.

Joint stock company Alfa Capital Ukraine was incorporated in 1995 in the Ukraine and performs both brokerage and proprietary trading in Ukrainian securities. Alfa Capital Ukraine was acquired by Alfa Capital Holdings Limited in 1996.

Alfa Capital Investments Limited was incorporated in the British Virgin Islands as a limited liability company in 1997 with an objective to trade primarily in shares/equities of legal entities in the Commonwealth of Independent States.

Alfa Capital Holdings (Cyprus) Limited was incorporated in Cyprus for the purpose of trading in shares/equities of legal entities in the Commonwealth of Independent States. Alfa Capital Asset Management AOZT was incorporated in the Russian Federation for the purpose of providing asset management to investment funds. Alfa Asset Management (BVI) Limited was incorporated in the British Virgin Islands in 1997 for the purpose of providing asset management services. Alfa Capital AOZT was incorporated in the Russian Federation and its activities include fund management and investment banking.

The reporting currency of the Alfa Capital Group is the United States Dollar (USD) and the books and records are maintained in USD. The registered office of Alfa Capital Holdings Limited is PO Box 146, Road Town, Tortola, British Virgin Islands.

Also included within these combined financial statements are the results and operations of two companies, Fairfax Services Limited and Atrium Consolidated Limited; these entities are not directly owned by Alfa Financial Group entities and have been combined on an economic entity basis.

2. EFFECT OF ECONOMIC CONDITIONS IN THE RUSSIAN FEDERATION ON THE COMBINED FINANCIAL STATEMENTS AND GOING CONCERN

During 1998, the Russian Federation entered a period of severe economic difficulty. The impact includes, but is not limited to: a steep decline in the price of debt and equity securities, a significant devaluation of the currency, increasing rates of inflation and defaults on certain government and corporate borrowings. The impact on the Alfa Financial Group was significant and is summarised in the following paragraphs.

The financial condition of the Group has been adversely affected during 1998, and continues to be adversely affected in 1999. As described in more detail in Notes 8 and 9, the Group has significant investments in securities issued by the Ministry of Finance of the Russian Federation, various regional and municipal governments in the Russian Federation and corporate shares. Certain of these securities are recorded at market value or the lower of cost or market. Because of the decline in the fair value of these securities, the Group has recorded substantial provisions in its combined statement of operations to reduce the carrying value of the securities to their estimated market values. Certain securities were carried at cost. However, since Management believes that the declines in value are other than temporary, provisions have been recorded in the combined statements of operations to reduce the carrying value to estimated market values.

Economic conditions have caused a significant decline in the volume of activity in the markets. Market quotations may not be reflective of the values for securities which would be determined in an efficient, active market involving willing buyers and willing sellers. Management has therefore used the best available information to adjust market quotations to reflect their best estimate of fair values.

As described in Notes 6 and 7, the Group granted significant loans to other banks, as well as to individuals, businesses and governmental bodies. The economic conditions in the Russian Federation have had a significant adverse effect on the ability of many borrowers to comply with the repayment schedules on their loans. Some borrowers have sought to renegotiate the terms of the loans, while others have defaulted. The Group took steps to reduce its commercial loan portfolio during 1998. The Group has recorded substantial charges, based on Management's best estimates of the current circumstances, in the combined statements of operations to adjust the provision for loan losses to a level which Management believes is sufficient to cover losses inherent in the loan portfolio.

As described in more detail in Note 22, the Group, primarily operating through the Bank, entered into index forward foreign exchange contracts, with mainly domestic banks. As a result of the financial crisis and the subsequent effect on the foreign currency market, the Group had to adopt specific accounting policies to address the valuation of these contracts. These accounting policies are described in more detail in Note 4. For contracts where the Group had agreed to sell other currencies in exchange for Roubles, the Group has incurred significant contractual losses. For contracts where the Group had agreed to sell Roubles in exchange for other currencies, the Group has significant contractual gains. Credit risk associated with the collectability of these gains has been assessed by Management, and necessary provisions have been established in the combined financial statements.

As a result of the Russian economic crisis, the limited volumes traded since August 1998 and other factors unique to the Russian banking system, there have been instances when larger participants on the currency market have, by virtue of the volume of their trades, been able to influence currency prices. Currency rates used by the Group during the period since August 1998 may reflect this market volatility depending on specific contract maturity dates.

Going concern. As a result of the economic conditions in the Russian Federation, the Group recorded significant charges in its combined statements of operations and has incurred a net loss of USD 204 618 thousand for the year ended 31 December 1998. In addition, the Bank defaulted on repayments of a USD 77 million credit line with a consortium of western banks and is currently negotiating to reschedule such repayments. See Note 13 for further details.

In addition, these combined financial statements do not include adjustments necessary to recognise unrealised losses on index forward foreign exchange contracts with domestic counterparties, which are described in more detail in Note 22. There is uncertainty regarding the legal basis of these transactions. However, if the Group has to settle these contracts at the contractual exchange rates and measure and record its losses on this basis as required by International Accounting Standards, the Group would incur an additional loss of USD 43 495 thousand. As a result, the Group’s total liabilities would increase by USD 43 495 thousand and the Group’s shareholders’ equity would decrease by the same amount. Management, however, does not believe that this loss will be realised by the Group based on their assessment of current market practice in Russia regarding domestic index forward foreign exchange contracts. Management has estimated the possible amount that the Group would have to pay to settle the outstanding deals and has established a provision of USD 2 000 thousand within these combined financial statements.

In the course of preparing these combined financial statements, Management of the Group assumed that the Group will continue its activity for at least twelve months following the reporting period, and that there are no intentions or necessity to terminate or substantially shrink its business.

The Bank continues to operate under a license granted by the CBRF. Despite the difficulties detailed above, the banking operations have continued during the crisis. All settlement requests from depositors have been met, many new corporate and private customers have joined the Bank and liquidity has been maintained, albeit in a finely balanced manner.

Management believes that the investment in Tyumen Oil Company provides substantial strength to the balance sheet of the banking operations and is optimistic that credit lines will be restructured, enabling the banking operations to maintain sufficient liquidity.

As a result of the plans and actions being undertaken by the Group in an effort to improve its financial and operating situation, the Management believes the above measures mitigate doubts about the capability of the Group to continue its activity and perform its obligations for at least twelve months after the reporting period, and thus, have prepared these combined financial statements on the basis that the Group will continue as a going concern. These combined financial statements do not include any adjustments that might be necessary if the Group is unable to continue as a going concern.

3. BASIS OF PRESENTATION

BASIS OF PREPARATION

The combined financial statements of the Group are prepared in accordance with International Accounting Standards (“IAS”).

The SPV holding company of the Group is to be domiciled in Luxembourg. The reporting currency of the SPV is USD because a significant portion of the transactions of the SPV and its significant subsidiaries are denominated in USD; in addition there is a significant level of activities between the Group and Alfa Group Consortium, whose reporting currency is USD.

The Bank maintains its accounting records in accordance with Russian banking regulations. Certain other members of the Group (Alfa Capital AOZT, Alfa Capital Brokerage AOZT, Alfa Capital Asset Management AOZT and Alfa Trust) maintain their accounting records in compliance with Russian Accounting Regulations and Alfa Capital Ukraine maintains its accounting records in accordance with Ukrainan Accounting Regulations. These combined financial statements have been prepared from those accounting records and adjusted as necessary in order to comply in all material respects with International Accounting Standards (“IAS”) issued by the International Accounting Standards Committee. Accordingly, the accounting policies set out in Note 4 have been adopted.

Effective 1 January 1998, the Russian Government redenominated the Rouble downward on a one thousand to one basis (redenominated Rouble referred to as “RR”). All Rouble amounts in these combined financial statements have been adjusted to reflect the redenomination of the Rouble for all periods presented. At 31 December 1998 the official rate of exchange of the Central Bank of the Russian Federation was US dollar 1 = RR 20.65 (1997: US dollars 1 = RR 5.96) and the average exchange rate for 1998 was US dollar 1 = RR 9.81 (1997: US dollar 1 = RR 5.785). Exchange restrictions and controls exist relating to converting Russian Roubles into other currencies. At present, the Russian Rouble is not a convertible currency outside of the Russian Federation.

The Group has adopted IAS 1 (Revised 1997) “Presentation of Financial Statements”.

REORGANIZATION OF ACH

Effective 30 June 1997, the securities operations of the Alfa Group Consortium, which included Alfa Capital Holdings Limited, were reorganised under a legal reorganisation by the Consortium parent, CTF Holdings Ltd. The reorganisation involved creating new legal entities as subsidiaries of Alfa Capital Holdings Limited, transferring the assets and liabilities dedicated to the securities operations of Crown Trade & Finance Inc. and all of the issued common stock of Alfa Capital AOZT held by Crown Trade & Finance Inc. to Alfa Capital Holdings Limited and its newly formed subsidiaries.

This was a transfer of assets among entities under common control, and as such, was accounted for by use of the uniting of interests method. Accordingly, the assets and liabilities in the reorganisation described above were transferred to Alfa Capital Holdings Limited at amounts carried by Crown Trade & Finance Inc. The financial statement items of the combining entities are included in these combined financial statements as 1997 corresponding amounts as if the combination had occurred on 1 January 1997.

COMBINATION

Subsidiary undertakings, being those companies in which the Group directly or indirectly, is able to exercise control over the operations, have been fully combined. The carrying value of investments in combined subsidiaries is offset against the respective shareholders' equity at acquisition, while assets and liabilities of such subsidiaries are combined on a line by line basis. All intercompany accounts, transactions and profits have been eliminated upon combination. Separate disclosure is made of minority interests. Also, all transactions and profits between the companies forming part of the Alfa Financial Group have been eliminated.

Refer to "Accounting for the Effect of Hyperinflation" below for an explanation of the conversion of the Bank's Rouble accounting records to US dollars. The local currency financial statements of all other subsidiaries have been translated to US dollars on the following basis as the impact of these subsidiaries is immaterial:

- Monetary assets and liabilities are translated at closing exchange rates and non monetary items are translated at historic exchange rates. The statement of operations is translated at the weighted average exchange rate for the period.

- Foreign exchange differences arising on the translation of the financial statements of foreign operations are taken to the combined statements of operations. Foreign operations of the Group's subsidiaries are in the Russian Federation and Ukraine.

ACCOUNTING FOR THE EFFECT OF HYPERINFLATION

A significant proportion of the Group's activities are carried out in the Russian Federation which has in recent years been experiencing high levels of inflation. The country remains a hyperinflationary economy on a cumulative basis over the last three years.

The Bank maintains its accounting records in accordance with Russian banking regulations in the national currency of the Russian Federation, the Russian Rouble ("RR"). As the activities of the Bank represent approximately 80% of the total assets of the Group, in accordance with IAS 21 "The Effects of Changes in Foreign Exchange Rates", the Bank is considered a foreign entity with respect to the Group. Thus, the accounts of the Bank have been adjusted for hyperinflation and then translated into US dollars at the year end exchange rate as required by IAS 21.

Accounting for hyperinflation in accordance with IAS 29 "Financial Reporting in Hyperinflationary Economies" is intended to reflect the effect of changes in the general purchasing power of the Russian Rouble on the financial capital employed through restating the financial statements from their historical amounts to amounts expressed in the equivalent purchasing power of the Russian Rouble at the current balance sheet date. The application of this principle results in an adjustment to the statement of operations for the loss of purchasing power of the Russian Rouble.

The restated financial information of the Bank has been prepared by indexing the balances reported in the historical balance sheet and statement of operations by changes in the general price index up to the balance sheet date, and by indexing the corresponding figures for 1997 prepared under this methodology by the change in the general price index between the balance sheet dates, using 1998 as the base year. The restatement was calculated using conversion factors derived from the Russian Federation Consumer Price Index ("CPI"), published by the Russian State Committee on Statistics ("Goscomstat"). The official inflation rates for Russia over the past three years were 84.4% for 1998, 10.99% for 1997 and 21.85% for 1996. In 1998 the devaluation of the RR against the USD was 246% (1997: 7.2%).

The Bank's financial records have been maintained with the principal objective of preparing historical cost financial information. This information has been updated to reflect the effects of inflation as required by IAS 29 applying the following assumptions and methodology, and thereafter included in the combined balance sheet and statement of operations using the year end exchange rate for translation into US dollars.

All amounts including corresponding figures are stated in terms of the measuring unit (i.e. Russian Rouble) current at 31 December 1998. Monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at 31 December 1998. Non-monetary assets and liabilities (items which are not expressed in terms of the monetary unit current at 31 December 1998) and shareholders' equity, including ordinary share capital, are restated by applying the relevant conversion factor. The effect of inflation on the Bank's net monetary position is included in the combined statement of operations as a monetary gain or loss.

Profit and loss amounts have been indexed by the change in the general price index based on following assumptions:

- inflation did not occur evenly over the year as there was a significant peak occurring in August – September 1998 and thus quarterly inflation averages have been used for the first, second and fourth quarters, and a proportionally weighted average has been used for the third quarter;

- income and expenditures have accrued evenly over the year except for the provision in diminution in value of investments and securities, provision for possible loan losses and provision for off-balance sheet instruments, all of which have been treated, for the purpose of this calculation, as occurring at the period end.

An external US dollar based market appraisal was used as a basis to value the Bank's branch network. Equipment has been indexed by the change in the general price index from the approximate date of purchase. Where a precise purchase amount or date is not known, an estimate of current replacement cost has been used. Where large acquisitions or disposals in the year were known, indexation has been applied from that date. In all other cases, an average indexation has been applied to acquisitions and disposals. An assessment has been made of the potential impairment in the carrying value of premises and equipment, and where applicable such assets have been reduced to their recoverable amounts.

Other non-monetary assets (principally investments in non-combined subsidiaries and associates) have been indexed from the date that they were originally recorded.

With the exception of the Bank, the reporting currency of all other material subsidiaries of the Group is the United States dollar.

4. SIGNIFICANT ACCOUNTING POLICIES

The following accounting policies have been used by the Group in preparing historical cost financial statements of the individual entities forming part of the Group. Alfa Bank, the major subsidiary, has also used these policies in preparing its historical cost financial information which has been adjusted for the effects of inflation in accordance with IAS 29 (refer to Note 3) and thereafter incorporated in the accompanying combined financial statements.

CASH AND SHORT TERM FUNDS

Cash and short term funds include cash on hand, balances with the CBRF and correspondent accounts, including overnight deposits and short term placements with other banks.

Mandatory balances with the CBRF. Mandatory balances with the Central Bank of the Russian Federation represent mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and short term funds for the purposes of the cash flow statement.

SECURITIES

GKO and OFZ government securities are carried at market value. As at 31 December 1998, as further described in Note 8 to these combined financial statements, Management has estimated the market value of these securities using a discounted cash flow model. Corporate shares are also carried at market value. Other types of securities are either held to maturity or for long term purposes and hence are stated at cost less provision for diminution in value, created in cases where the value of a security has declined, and Management believes that the decline is not temporary in nature. The values are derived either from market quotations or from the Management's assessment of future collectability of these securities.

INVESTMENTS

Investments include those of the Group's investments in subsidiaries and associated companies, which have not been accounted for on a combination basis or on an equity accounting basis, and trade investments held for the long term purposes. These investments, including loans granted to these companies, are carried at cost less any permanent diminution in value. Income derived from these investments is accounted for on a cash basis.

The Group's investments in Tyumen Oil Company ("TNK") are stated at an independent appraisal obtained to support a revision in the carrying value of the investments. This revision in carrying value, net of applicable deferred income taxes, has been reflected as a separate component of shareholders' equity. Although the Group's investments in TNK is over 20%, it has not been accounted for under the equity method in these combined financial statements, as the Group does not exert management influence on TNK since control is exercised at the ultimate holding company level (Alfa Group Consortium), which will account for the Consortium's interest in TNK on an equity basis.

SALE AND REPURCHASE AGREEMENTS

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are included in investments. The corresponding liability is presented under deposits from banks. Securities purchased under agreements to resell ("reverse repo") are recorded as loans and advances to banks or customers as appropriate. The differences between the sale and repurchase prices are treated as interest and accrued evenly over the life of the repo agreement.

Loans and provisions for bad and doubtful debts. Loans are stated at the principal amounts outstanding net of provisions for losses on loans.

Provisions for losses on loans are based on the evaluation by Management of the collectibility of loans and advances. Specific provisions are raised against debts whose recovery has been identified as doubtful. A general provision is raised against the latent bad and doubtful loans which are inherent in the loan portfolio but which at the date of preparing the financial statements have not been specifically identified. The aggregate provisions raised during the year are recognised in the combined statement of operations.

Estimates of losses require the exercise of judgement and the use of assumptions. The principal factors considered in determining the loan loss provision are the growth, composition and quality of the loan portfolio, the ability of the individual borrowers to repay the loans, the past performance history of the individual loans, the level of past due loans, current economic conditions and the value and adequacy of collateral.

Loans and advances that cannot be recovered are written off and charged against the provision for losses on loans. Such loans are written off after all the necessary legal procedures have been completed and the amount of the loss has been determined. Recoveries of amounts previously provided for are treated as income by reducing the provision for possible losses on loans for the year.

RECEIVABLES FROM CUSTOMERS

Receivables from customers represent receivables for the sale of securities and advances made for purchases of securities. Receivables are stated net of provisions for bad and doubtful debts and provisions made during the year are included in the combined statements of operations.

PREMISES AND EQUIPMENT

Premises, leasehold improvements and equipment are stated at cost or revalued amounts, less accumulated depreciation.

Premises and equipment of the Bank's branch network have been revalued to market value as of 31 December 1996 and branches placed into service in 1997 have been revalued as of 31 December 1997. The respective appraisals have been updated as of 31 December 1998. The revaluations were performed on the basis of an appraisal performed by a professional, western real estate appraisal company which has an office in Russia.

Construction in progress is carried at cost less provision for any permanent loss of value. Upon completion, assets are transferred to premises and equipment at cost. Construction in progress is not depreciated until the asset is available for use.

DEPRECIATION

Depreciation is applied on a straight line basis over the estimated useful lives of the assets using the following rates:

Buildings 2.5% per annum;

Fixtures and fittings 10% per annum;

Computer technology 13% per annum;

Motor vehicles 14–18% per annum.

BILLS OF EXCHANGE

Bills of exchange issued by the Group to its customers, more commonly known as "veksels", carry a fixed date of repayment. These may be issued against cash deposits or as a payment instrument which the customer can discount in the over-the-counter secondary market. Bills of exchange issued by the Group are recorded at nominal value with the corresponding discount recorded to other assets and amortised to the combined statements of operations using the effective interest rate method.

The Group also purchases bills of exchange from its customers or in the market. These bills are carried at cost and the discount against the nominal value is accrued over the period to maturity. Provision is made, based on Management assessment, for bills that are considered uncollectable. Bills of exchange are included in securities or loans to customers, depending on their substance.

INCOME TAXES

The revised International Accounting Standard 12 "Income Taxes" (IAS 12 (Revised 1996)) was approved by the Board of the International Accounting Standards Committee in 1997. The revised Standard is effective for all organisations beginning on or after 1 January 1998 and early adoption was permitted. The Group adopted the revised Standard effective for 1 January 1997. The effects of the accounting change were applied prospectively in the prior year financial statements with the cumulative effect of the change in accounting presented in the combined statements of operations for the year ended 31 December 1997.

IAS 12 requires the use of a balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date. Valuation allowances are provided for deferred tax assets that are not expected to be realised.

INTEREST INCOME AND EXPENSE

Interest income and expense are recognised in the combined statements of operations on an accruals basis. Interest income is suspended when overdue by more than 30 days and is excluded from interest income until received.

Interest income on securities includes coupons earned on fixed income investment securities and accrued discounts on federal short-term zero coupon bonds and federal loan bonds (more commonly referred to as GKOs and OFZs). The accrued discounts on GKOs and OFZs have been included in interest income on securities for the period through August 1998 when they ceased to be actively traded. The accounting system of the Group does not allow for the segregation of revaluation due to market fluctuations from revaluation due to interest income accretion, and therefore both elements are included in the interest income from securities. However, the negative revaluation of GKO and OFZ portfolio arising from the period subsequent to August 1998 is recorded in the combined statements of operations separately within gains less losses arising from securities.

Derivative financial instruments. Derivative financial instruments include forward and spot transactions in foreign exchange markets. These transactions are generally undertaken by the Bank and its normal policy is to measure these instruments using contractual rates, with resultant gains or losses being reported within gains less losses arising from dealing in foreign currency. Because of the current economic circumstances in Russia, the Bank has modified its accounting policy with regard to domestic index forwards.

Gains and losses on domestic index forwards have been calculated applying the exchange rate on the contractual maturity date. Where settlements have been negotiated with counterparties, the gain or loss has been recognised based on the settlement amounts. For contracts which have not been settled, Management has recognised the gain or loss at the amount at which they believe the contract could be settled. When the Bank had contracts to both buy and sell foreign currencies with the same counterparty, the gains and losses have been offset.

The Group also trades in futures and options in securities. All related gains and losses are reflected within gains less losses arising from securities.

Offsetting. Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Pension costs. The Bank contributes to the Russian Federation state pension schemes, social insurance and employment funds in respect of its employees. The Bank’s pension scheme contributions amount to 28% of employees’ gross salaries, and are expensed as incurred.

Year 2000 costs. External and internal costs specifically associated with modifying internal-use software for the year 2000 are charged to the combined statements of operations as incurred.

Corresponding figures. Where necessary, corresponding figures have been adjusted to conform with changes in presentation in the current year. Combined financial statements were not prepared by the Group in 1997. The 1997 corresponding information is prepared on the basis that the Group existed as one reporting entity during 1997.

5. CASH AND SHORT TERM FUNDS

	1998	1997
Cash on hand	16 780	8 844
Cash balances with the CBRF (other than mandatory reserve deposits)	8 646	17 190
Correspondent accounts and placements with other banks		
– Russian Federation	3 110	35 682
– Other countries	30 670	131 017
Total cash and short term funds	**59 206**	**192 733**

6. LOANS AND ADVANCES TO BANKS

	1998	1997
Current loans	2 992	58 704
Rescheduled (current) loans	3 500	-
Less: Provision for possible losses on loans	(478)	(944)
Total loans and advances to banks	**6 014**	**57 760**

Movements in provision for possible losses on loans are as follows:

	1998	1997
Provision for possible losses on loans at 1 January	**944**	**309**
Charge against profits for possible losses on loans in the year	-	635
Recoveries of amounts previously provided against	(466)	-
Provision for possible losses on loans as at 31 December	**478**	**944**

The interest rates on loans and advances to banks outstanding as at 31 December 1998 ranged from 0% to 5%.

Geographical and currency analysis of loans and advances to banks is disclosed in Note 19. The maturity structure of the loan portfolio is detailed in Note 21.

7. LOANS AND ADVANCES TO CUSTOMERS

	1998	1997
Current loans	67 624	276 830
Rescheduled (current) loans	47 802	114 132
Overdue loans	107 922	228
Less: Provision for possible losses on loans	(60 330)	(21 250)
Total loans and advances to customers	**163 018**	**369 940**

Movement in provision for losses on loans are as follows:

	1998	1997
Provision for possible losses on loans at 1 January	**21 250**	**6 019**
Charge against profit for possible losses on loans in the year	41 624	15 231
Loans written off during the year as uncollectable	(2 544)	-
Provision for possible losses on loans as at 31 December	**60 330**	**21 250**

Economic sector risk concentrations within the customer loan portfolio are as follows:

	1998		1997	
	Amount	%	Amount	%
Government bodies	35 461	16	99 199	25
Manufacturing	13 410	6	15 057	4
Energy & oil	-	-	125 478	32
Investments	39 431	18	46 555	12
Trade 23 965	11	24 515	7	
Agricultural	55 229	25	43 002	11
Construction	16 366	7	8 435	2
TV industry	22 720	10	21 958	6
Individuals	9 984	4	1 408	-
Other	6 782	3	5 583	1
Total loans and advances to customers (aggregate amount)	**223 348**	**100**	**391 190**	**100**

The Group has 9 borrowers with aggregated loan amounts above USD 5 000 thousand. The aggregate amount of these loans is USD 88 942 thousand or 40% of the gross loan portfolio.

Alfa Bank is an authorised bank of the Russian Government for the purposes of distribution of loans to agricultural entities under the Ministry of Agriculture and Ministry for Finance Program. As at 31 December 1998, the amount of agricultural loans outstanding was RR 1 071 million (USD equivalent: 51 878 thousand). Alfa Bank acts as an agent as the loans are channelled by the Bank to the approved borrowers in the agricultural sector out of the funding received under the federal special purpose fund of the Russian Government.

The interest rates on loans and advances to customers outstanding as at 31 December 1998 ranged from 4% to 63%.

Geographical and currency analysis of loans and advances to customers is disclosed in Note 19. The maturity structure of the loan portfolio is detailed in Note 21. The Bank has several loans to related parties. The relevant information on related party loans is disclosed in Note 23.

8. SECURITIES

	1998	1997
Federal short term zero coupon bonds (GKO)	3 446	78 628
Federal loan bonds (OFZ)	2 413	2 757
Federal Saving Bonds (OGSZ)	-	140
Treasury Bills (Kazakhstan Bonds)	4 457	5 340
NRBK notes (Kazakhstan Bonds)	2 992	-
Corporate shares	9 856	97 557
VneshEconomBank 3% coupon bonds (VEB)	1 909	1 676
Vnesh debts	-	12 726
Principal When Issued	-	134 502
Eurobonds	-	125 972
Other securities	4 957	27 840
Total dealing securities	**30 030**	**487 138**

GKO, OFZ and OGSZ bonds are Rouble denominated government securities issued and guaranteed by the Ministry of Finance of the Russian Federation. GKOs are primarily short-term and are issued at a discount to face value. OFZ bonds have a medium to long-term maturity period and are otherwise identical to GKOs but with a coupon rate of approximately 10-20% for fixed coupon bonds, and 17-99% for variable coupon bonds in 1998, depending on the type of bond issue. OGSZs are savings bonds with maturities ranging from 1999 to 2000 sold by the Ministry of Finance to banks for resale to the general public.

As discussed in Note 2, the economic conditions in the Russian Federation caused a sharp decline in the price of government securities, as well as a significant decline in the volume of activity in the markets. Additionally, the Ministry of Finance has set limits on the amount of discount which may be applied to Russian government securities which are traded on an exchange, causing the volume of trade activity to decline further. These events have caused Management to rely on estimates in determining the value of these securities, whereas in previous years values were established based on market values obtained from the Moscow Interbank Currency Exchange (MICEX).

At 31 December 1998, the Bank’s holdings comprised RR 687 646 thousand nominal value (USD 33 300 thousand) in defaulted GKO and OFZ obligations of the Russian government. The Bank has elected to participate in the Russian government’s debt restructuring program, whereby the Bank will receive cash and newly issued state securities. At present, the market for both the restructured securities (for those banks which have not yet accepted the government’s restructuring offer) and the newly issued state securities (for those banks which have accepted the government’s restructuring offer) has been illiquid. In the absence of readily available and reliable price quotations for these securities, Management has estimated their fair value using a discounted cash flow model.

The accrued discount on GKO and OFZ bonds is reflected in the statement of operations within interest income on securities. The negative revaluation of the GKO and OFZ bonds in the Bank’s portfolio has been reflected within gains less losses arising from securities in the combined statement of operations.

VEB bonds are US dollar denominated bearer securities which carry the guarantee of the Ministry of Finance of the Russian Federation, and are commonly referred to as "MinFin bonds". The bonds are purchased at a discount to nominal value and carry an annual coupon of 3%. The bonds have maturity dates from 1999 to 2011. VEB bonds are stated at market value based on quotes obtained from MICEX.

Corporate shares are shares of Russian and Ukrainian companies. They are reflected at year-end market value, which has been estimated by the Management using (1) last traded prices; (2) maximum bid prices; and (3) minimum ask prices obtained from the Russian Trade System (RTS) and over-the-counter market. However, the market for most of these shares has been illiquid, and therefore the prices used may not reflect the value of these shares that could be obtained in a transaction between a willing buyer and a willing seller.

Treasury Bills and the NBRK Notes are government securities issued and guaranteed by the government of the Republic of Kazakhstan. These securities are freely tradable in the Republic of Kazakhstan. The average interest rate on these government securities during 1998 ranged from 14% to 25.5%.

In 1997 the Group entered into secured financing transactions. The Group purchased Eurobonds and Principal When Issued securities which were, in part, financed by a group of western banks. Refer to Note 13. These secured financing transactions were settled during 1998 and the Group recognised losses of USD 52 551 thousand which is reflected within gains less losses arising from securities.

In 1997 the Bank traded in restructured debts of the former Soviet Union ("Vnesh debts"). At 31 December 1998 the Group owned USD 23 986 thousand of Vnesh debts which Management has fully provided for. This provision is recorded within gains less losses arising from securities.

The Bank is licensed by the CBRF as a primary dealer at MICEX for dealing and trading in government securities.

9. INVESTMENTS

	1998	1997
Securities sold under repurchase agreements	47 609	-
Investment in non-combined subsidiary companies	30 626	24 773
Investment in associated companies	559 342	90 516
Trade investments (including loans granted)	37 853	69 802
Other investments	491	1 282
Less: Provision for diminution in value	(65 808)	(7 354)
Total other investments	**610 113**	**179 019**

A summary of the movements in the provision for diminution in value is as follows:

	1998	1997
Provision for diminution in value as at 1 January	**7 354**	**4 604**
Charge for diminution in value of investments	58 454	2 750
Provision for diminution in value as at 31 December	**65 808**	**7 354**

In 1998 the Group entered into a sale and repurchase agreement with a western credit institution. The original agreement was for USD 60 000 thousand. During 1998, due to the decline in value of the underlying securities, the Group has made margin calls amounting to USD 30 000 thousand. Refer to Note 13. In September 1998 the Group entered into a new agreement whereby it gave additional collateral, and therefore, no further margin calls were required. Management has recorded these securities at cost less provision for diminution in value. These securities consist of investments primarily in Russian companies in the pharmaceutical and cement manufacturing sectors.

For the year ended 31 December 1998, the non-combined subsidiary and associated companies have not prepared financial statements in accordance with IAS. These investments are carried at cost less provision for diminution in value and have not been combined within these combined financial statements nor accounted for under the equity method, as the effect would not materially alter the combined financial position of the Group as at 31 December 1998 or the results of its operations or cash flows for the year then ended.

The principal non-combined subsidiary companies are:

Name	Nature of business	Country of registration	Percentage of equity controlled	Cost of investment company	Loans granted to company	Deposits taken from
Yasenevo	Construction	Russia	100	-	9 742	-
NCU TV	TV	Ukraine	80	2 783	4 398	-
TOP	Construction	Russia	100	-	2 432	2
Alvis	Tobacco	Russia	53	2 319	-	-
Lubyatovo	Food	Russia	88	1 352	-	-
IP Kiev	Investment	Ukraine	50	1 179	1 089	-
Kongurs	Trade	Russia	100	630	-	-
Sosny	Recreation	Russia	100	614	-	31
Molochnye Brothers	Food	Russia	100	991	221	32
Other			1 058	1 818	86	
Total				**10 926**	**19 700**	**151**

The principal associated companies are:

Name	Nature of business	Country of registration	Percentage of equity controlled	Cost/fair value of investment	Loans granted to company	Deposits taken from
TNK	Oil extraction	Russia	25	538 900	2 067	423
Siracuze	Construction	Russia	30	1 648	8 623	132
TV Service	Television	Russia	35	4 700	-	-
Nashe Radio	Radio	Ukraine	40	353	1 528	-
Other			1 523	-	818	
Total				**547 124**	**12 218**	**1 373**

Investments in associates include the Group's investment in Tyumen Oil Company, one of the Russian Federation's largest oil companies. The group owns 25.05% of TNK and 11% directly of Nizhnivarstokneftegaz ("NNG"), a majority owned subsidiary of TNK and the main production facility. In 1997 the Group obtained a 20% interest in TNK and the additional interests were acquired during 1998. The historical purchase price of this investment is USD 238 660 thousand (USD 143 096 thousand restated) and was made in conjunction with an equal joint venture partner who also acquired a direct investment in TNK.

Though the Bank has partly financed the acquisition, significant influence is only exerted at the Alfa Group Consortium level, and thus, the Bank has accounted for this investment as a long term investment in accordance with IAS 25 "Accounting for Investments". TNK, including all subsidiaries, was revalued by independent appraisers as at 31 December 1998. This appraisal, based on crude oil reserve reports, was done on a discounted cash flow basis. The Group used this appraisal in order to determine the fair carrying value of their investment in TNK and NNG, amounting to USD 538.9 million as at 31 December 1998. A deferred tax of USD 175.2 million was calculated with respect to this fair value adjustment. Refer to Note 18. This has resulted in a net credit to equity of USD 222 672 thousand. Management's intention is to hold this investment for a three to five year period.

The principal trade investments are:

Name	Nature of business	Country of registration	Cost of investment	Loans granted to company	Deposits taken from company
AOOT "Alfa Capital"	Investment	Russia	16 984	-	-
Borsky Glass	Glass production	Russia	1 638	-	-
Tverchimvolokno	Chemicals	Russia	9 205	6 114	-
Other			3 912	-	-
Total			**31 739**	**6 114**	**-**

AOOT Alfa Capital is a specialised investment fund (the "Fund") in which the Group has a majority investment. Management has valued the underlying securities in order to determine the carrying value of their share of the Fund's net assets. This mark to market adjustment has been reflected within the provision for diminution in value of investments.

10. OTHER ASSETS AND RECEIVABLES

	1998	1997
Receivables on operations with securities	22 426	71 167
Trade debtors and prepayments	5 212	6 895
Settlements on foreign operations	3 551	511
Debtors on plastic card operations	2 856	840
Accrued interest income	2 753	2 333
ATM debtors	1 880	487
Prepaid taxes	431	268
Other	3 865	5 247
Subtotal	**42 974**	**87 748**
Less provisions	(10 924)	(519)
Total other assets	**32 050**	**87 229**

A summary of the movements in the provision for receivables is as follows:

	1998	1997
Provision for diminution in value as at 1 January	**519**	**519**
Charge against profit for the provision for receivables	10 405	-
Provision for diminution in value as at 31 December	**10 924**	**519**

11. PREMISES AND EQUIPMENT

	Premises	Leasehold	Office and Improvements	Intangible computer equipment	Construction assets	Total in progress
Net book amount as at 31 December 1997	**12 816**	**2 271**	**9 038**	**464**	**2 459**	**27 048**
Cost or valuation						
Opening balance	13 080	2 334	15 862	544	2 459	34 279
Additions	2 742	949	9 596	404	8 667	22 358
Revaluation	3 055	-	-	-	-	3 055
Disposals/transfers	(819)	(124)	(3 666)	-	(4 331)	(8 940)
Closing balance	**18 058**	**3 159**	**21 792**	**948**	**6 795**	**50 752**
Accumulated depreciation						
Opening balance	264	63	6 824	80	-	7 231
Depreciation charge	416	65	5 373	147	-	6 001
Disposals	(12)	(1)	(727)	-	-	(740)
Closing balance	**668**	**127**	**11 470**	**227**	**-**	**12 492**
Net book amount as at 31 December 1998	**17 390**	**3 032**	**10 322**	**721**	**6 795**	**38 260**

Construction in progress consists mainly of construction and refurbishment of branch premises and equipment. Upon completion, assets are transferred to premises and equipment at cost.

Land and premises of the branch network had been independently valued at 31 December 1996 and 1997. The valuation was carried out by an independent firm of valuers, American Appraisers. The respective appraisals have been updated as of 31 December 1998. Included in the above net book value of premises is USD 7 360 thousand representing revaluation surplus relating to the branch network of the Bank. A cumulative deferred tax of USD 3 165 thousand was calculated with respect to this fair value adjustment. Refer to Note 18.

12. CUSTOMER ACCOUNTS

The average interest rate on customer accounts during 1998 ranged: for current and settlement accounts in Roubles from 0% to 15%; in foreign currency – from 0% to 7%; for term deposits in Roubles – from 5% to 40%; and in foreign currency – from 4% to 15%.

Currency analysis of customer accounts is disclosed in Note 19 and maturity analysis is provided in Note 21.

Economic sector concentrations within customer accounts are as follows:

	1998 Amount	%	1997 Amount	%
Government bodies & municipals	23 843	8%	42 799	10%
Manufacturing and construction	89 891	31%	72 873	17%
Finance & investment companies	14 095	5%	26 065	6%
Trade and commerce	56 816	19%	104 809	24%
Agriculture	59 852	21%	136 618	31%
Mass media	11 093	4%	9 540	2%
Individuals	28 628	10%	21 140	5%
Other	7 306	2%	20 280	5%
Total customer accounts	**291 524**	**100%**	**434 124**	**100%**

Included in customer accounts are deposits of USD 11 280 thousand (1997: USD 27 228 thousand) held as collateral for irrevocable commitments under import letters of credit. Refer to Note 22.

13. OTHER BORROWED FUNDS

	1998	1997
Term borrowings from other banks	247 470	417 066
Total other borrowed funds	**247 470**	**417 066**

During 1997 the Group obtained a borrowing of USD 175 000 thousand in the form of Euro Medium Term Notes. The contracted maturity of the borrowing is 28 July 2000 and interest is charged at the rate of 10.375%. In 1997 and 1998 the Group purchased Notes with a face value of USD 24 830 thousand for a cost of USD 21 598 thousand. The purchase has been accounted for as a retirement of debt with the gain reflected in gains less loss arising from securities. The outstanding balance as at 31 December 1998 was USD 150 170 thousand (1997: USD 87 499 thousand restated). In addition, during 1998 related parties of the Alfa Group Consortium have purchased Notes with a face value of USD 28 513 thousand. The Group is holding these Notes in a nominee capacity for these related parties of the Alfa Group Consortium.

The Group obtained a term loan in the amount of USD 77 million with a maturity date of 29 October 1998. The Group was unable to timely comply with their obligation to reimburse the issuing banks. At 23 December 1998 the Bank signed a Framework Rescheduling Agreement. According to the agreement, Alfa Bank made an interim payment of USD 9.9 million from its own funds and paid USD 2 million from the proceeds of subordinated loans received by a related company of the Alfa Group Consortium. The restructuring terms for the remaining amount have not yet been finalised. The outstanding balance at 31 December 1998 was USD 67 300 thousand (1997: USD 40 996 thousand restated). In the maturity table in Note 21 this amount has been included as on demand.

In 1998, under a sale and repurchase agreement, the Group obtained a loan in the amount of USD 60 000 thousand. The maturity date is 29 November 1999 and interest is accrued at 13%. At 31 December 1998 the Group had repaid USD 30 000 thousand on this facility. Refer to Note 9.

In 1997, Alfa Capital Holdings Limited obtained a term loan in the amount of USD 75 000 thousand. The loan was repaid in 1998. Interest was accrued at a rate of LIBOR plus 3.5%. Also included in other borrowed funds at 31 December 1997 is USD 213 571 thousand related to secured financing transactions. Refer to Note 8.

14. OTHER LIABILITIES AND PAYABLES

	1998	1997
Payable on operations with securities	26 150	57 495
Amounts owed to customers	21 771	34 771
Accrued interest expense	12 537	6 540
Provision for credit related commitments	7 910	-
Settlements on foreign exchange transactions	6 019	35 352
Accrued bonus expenses	3 403	-
Plastic card creditors	2 153	179
Taxation payable	1 831	2 574
Deferred income	-	4 381
Other	5 397	28 948
Total other liabilities	**87 171**	**170 240**

15. SHARE CAPITAL

Statutory capital authorised, issued and fully paid comprises:

	1998 Number of shares	Amount	1997 Number of shares	Amount
Alfa Bank Group	750 549	453 136	200 000	453 136
Alfa Capital Holdings (BVI) Limited Group	50 000 000	50 000	50 000 000	50 000
Total share capital	**50 750 549**	**503 136**	**50 200 000**	**503 136**

Contributions to the Bank's share capital were made in the form of cash (both Roubles and foreign currency) or from re-investment of dividends. As at 31 December 1997, 200 000 ordinary units were issued having a nominal value of RR 3 753 thousand per unit, ranking equally and carrying one vote. On 29 January 1998, the Bank was re-registered as an open joint stock company with 750 549 issued shares with a nominal value of RR one thousand each.

In accordance with the Letter No 415 of the Central Bank of the Russian Federation date 24 February 1997, all commercial banks were required during 1997 to convert all non-Rouble units into Rouble units. Accordingly, from 1 July 1997 shareholders' capital of all banks was denominated in Roubles. The Bank converted its non-Rouble share capital into Roubles on 30 June 1997.

As at 31 December 1998 25.78% of the Bank's shares were pledged as collateral to the European Bank for Reconstruction and Development (the "EBRD") with respect to a USD 42 million loan that the EBRD granted to an Alfa Group Consortium company.

As at 31 December 1996, Alfa Capital Holdings Limited had share capital of USD 100 and share premium of USD 9 539 thousand. During 1997, and as part of the reorganisation of Alfa Capital Holdings Limited, share capital was increased to USD 50 000 thousand by capitalising the whole of the share premium and a portion of retained earnings as at 31 December 1997.

The Alfa Capital Group has 50 million shares of USD 1 par common stock authorised, issued and outstanding.

16. RETAINED DEFICIT AND OTHER RESERVES

In accordance with Russian Law on Banks and Banking Activity, the Bank must distribute all profits as dividends or transfer them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. The Bank's reserves under Russian Accounting Rules as at 31 December 1998 are RR 2 492 984 thousand (1997: RR 301 455 thousand).

17. GENERAL, ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	1998	1997
Depreciation	6 001	3 233
Consulting & Professional services	6 057	3 274
Advertising and marketing	1 873	704
Travel expenses	1 152	724
Taxes	12 023	7 993
Rent, heat and utilities	6 091	4 454
Computer telecommunications expenses	4 669	980
Maintenance	7 029	6 854
Penalties	804	-
Other	8 630	11 703
Total general, administrative and other operating expenses	**54 329**	**39 919**

18. INCOME TAXES

Income tax expense is comprised of the following:

	1998	1997
Current tax expense	4 021	3 792
Movement in deferred taxation	171 319	6 683
Less deferred tax recorded directly to equity	(178 365)	(1 992)
Total taxation for the year	**(3 025)**	**8 483**

The income tax rate applicable to the majority of the Alfa Bank Group's income is 43 percent (1997: 43 percent). The income tax rate applicable to the majority of the Alfa Capital Holdings Group's income is 35 percent (1997: 35 percent). A reconciliation between the expected and the actual taxation charge is stated below.

	1998	1997
IAS (loss)/profit before taxation	**(207 715)**	**52 477**
Theoretical tax charge	(89 317)	17 198
Tax effect of items which are not deductible or assessable for taxation purposes:		
– Provision for diminution in value of investments	12 990	-
– Non deductible expenses	85 463	6 507
– Income which is exempt from taxation	(96 854)	(11 701)
– Income on government securities taxed at different rates	13 007	1 085
– Income earned in tax free jurisdictions	(38 189)	(22 075)
– Negative taxable base which has no future income tax benefit	8 312	1 530
– Other IAS adjustments that have permanent nature	72 654	6 226
Valuation allowance on net deferred tax asset	28 909	9 713
Income tax expense/(benefit)	**(3 025)**	**8 483**

Differences between IAS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profits tax purposes. The tax effect of the movement on these temporary differences is primarily recorded at the rate of 43%, except for income on state securities that is taxed at 15%.

	1997	Movement	1998
TAX EFFECT OF DEDUCTIBLE TEMPORARY DIFFERENCES			
Provision for losses on loans	6 822	(979)	5 843
Revaluation of securities	1 182	23 998	25 180
Premises and equipment	81	112	193
Accruals	2 812	2 986	5 798
Provision for off balance sheet commitments	-	4 261	4 261
Other	1 842	(203)	1 639
Gross deferred tax asset	**12 739**	**30 175**	**42 914**
TAX EFFECT OF TAXABLE TEMPORARY DIFFERENCES			
Accruals	(1 003)	851	(152)
Gain on revaluation of securities	(5 364)	5 364	-
Fair valuation of TNK	-	(175 200)	(175 200)
Revaluation of fixed assets	(1 992)	(1 173)	(3 165)
Other	-	(2 427)	(2 427)
Subtotal	**(8 359)**	**(172 585)**	**(180 944)**
Net deferred tax asset/(liability) before allowance	**4 380**	**(142 410)**	**(138 030)**
Less valuation allowance on net deferred tax asset	(11 426)	(28 909)	(40 335)
Total net deferred tax liability	**(7 046)**	**(171 319)**	**(178 365)**

A valuation allowance has been recorded against the net deferred tax asset as Management believes it would not be prudent to recognise such an asset which, in the light of the current economic crisis, is unlikely to be realised in the foreseeable future. A deferred tax liability of USD 178 365 thousand has been recorded in the combined balance sheet in respect of the fair valuations of TNK and the Bank’s branch network. Refer to Notes 9 and 11, respectively.

19. GEOGRAPHICAL ANALYSIS AND CURRENCY RISK

Geographical analysis. The Group extended loans and received deposits within the following regions:

	1998 Loans	Deposits	1997 Loans	Deposits
Russia	193 346	204 325	375 085	346 755
Europe	20 178	122 456	35 084	165 572
United States	17	444	35 725	-
CIS	10 395	13 428	4 000	13 846
Other	5 904	1 237	-	-
Total	**229 840**	**341 890**	**449 894**	**526 173**

Currency analysis. Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. At year end, the Group had balances in US dollars and other currencies. Other currencies represent mainly amounts in Russian Roubles and German Deutschemarks. Effective 1 January 1998 the Euro replaced the German Deutschemark and certain other currencies in Europe. Subsequent to year end, the European Community released the new currency – the Euro, which is expected to replace, in time, most other currencies in Europe.

At 31 December 1998, the Group had the following positions in foreign currencies:

	RR	USD	DM	Other currencies	Provisions	Total
ASSETS						
Cash and short term funds	15 779	35 365	1 691	6 371	-	59 206
Mandatory cash balances with the CBRF	12 507	-	-	-	-	12 507
Loans and advances to banks	-	5 583	-	909	(478)	6 014
Loans and advances to customers	79 788	131 837	9 837	1 886	(60 330)	163 018
Securities	6 699	15 769	-	7562	-	30 030
Investments	52 621	623 268	-	32	(65 808)	610 113
Other assets and receivables	6 755	23 004	98	2 193	-	32 050
Premises and equipment	32 161	4 984	-	1 115	-	38 260
LIABILITIES						
Deposits from banks	(3 765)	(37 348)	(7 234)	(2 019)	-	(50 366)
Customer accounts	(124 366)	(156 875)	(3 095)	(7 188)	-	(291 524)
Bills of exchange	(1 428)	(41 278)	-	-	-	(42 706)
Obligations under derivative financial instruments	(2 000)	-	-	-	-	(2 000)
Other borrowed funds	-	(247 470)	-	-	-	(247 470)
Deferred tax liability	(3 165)	(175 200)	-	-	-	(178 365)
Other liabilities and payables	(26 408)	(58 545)	(1 352)	(866)	-	(87 171)
Net balance sheet position	**45 178**	**123 094**	**(55)**	**9 995**	**(126 616)**	**51 596**
Credit commitments	**12 102**	**385 733**	**-**	**14 401**	**-**	**412 236**

The provisions for possible losses on loans and advances to banks and to customers and investments have been presented in a separate column, as Management is unable to allocate the general element of the provision between respective currencies. All other provisions have been matched with the respective currencies.

The Group's investment in TNK and the related deferred tax liability has been reflected in the USD column as the investment was made with dollar denominated promissory notes and the Group views this investment as a dollar investment as a majority of TNK's revenues are dollar based.

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price.

The estimated fair values of financial instruments have been determined by the Group using available market information and appropriate valuation methodologies, where they exist. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange. As described in more detail in Note 2, the Russian Federation is in a period of economic difficulty which has caused a significant decline in the volume of activity in financial markets. While Management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realised in the current circumstances.

Management does not believe that it is practicable to estimate the fair value of loans and term deposits. These instruments are not currently traded in the Russian financial markets and an objective estimate of fair value is not available. The instability of the interest rate and exchange rate environment significantly affects the fair value of financial instruments. The current uncertain economic conditions have caused significant increases in the rates of interest and a significant decrease in the value of the Rouble when compared to fully convertible currencies. Some financial institutions have been unwilling to lend to or invest in Russian companies, thus limiting information which might otherwise be available to Management to assist in estimating fair values. Because of these factors, Management does not believe that an objective basis for the fair value of loans and term deposits can be obtained with sufficient reliability on a cost effective basis to provide meaningful information to users.

Management does not believe that it is practicable to estimate the fair value of forward foreign exchange contracts. Currently these instruments are not actively traded in the Russian financial markets and an objective estimate of fair value is not available. The following methods and assumptions were used to estimate the fair value of the Bank's other financial instruments.

FINANCIAL ASSETS

For monetary assets, excluding loans and amounts due from other banks, fair value approximates the carrying value. The fair value of corporate shares is considered to approximate their carrying value. Investment in non-combined subsidiaries and associates are accounted for at cost less provision in these financial statements and Management believes this carrying value approximates their share of equity in the investments disclosed in Note 9.

FINANCIAL LIABILITIES

For monetary liabilities, excluding term deposits and Euro Medium Term Notes, fair value approximates the carrying value.The fair value of deposit liabilities without a stated maturity is the carrying amount. Euro Medium Term Notes are carried at nominal value. The market price of these debt securities fluctuates according to market conditions.

21. INTEREST RATE, LIQUIDITY AND CREDIT RISK

Interest rate risk. The Group is exposed to interest rate price risk, principally as a result of lending and advances to customers and other banks, at fixed interest rates, in amounts and for periods which differ from those of term deposits and other borrowed funds at fixed interest rates.

In practice, interest rates that are contractually fixed on both assets and liabilities are often renegotiated to reflect current market conditions. Management does not believe it is practicable, therefore, to present reliable quantitative information on interest rate risk.

Average rates applicable to the major components of the balance sheet have been disclosed within the notes relating to these components.

LIQUIDITY RISK

Liquidity risk is defined as risk when maturity of assets and liabilities does not match. The table below shows assets and liabilities as at 31 December 1998 by remaining contractual maturity. Some of the assets have a longer term nature; for example, loans are frequently renewed and accordingly short term loans can have a longer term duration.

The liquidity position of the Group as at 31 December 1998 is set out below.

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Overdue	No stated	Provisions	Total
ASSETS								
Cash and short term funds	54 206	-	5 000	-	-	-	-	59 206
Mandatory cash balances with the CBRF	-	-	-	-	-	12 507	-	12 507
Loans and advances to banks	3 911	752	70	-	-	1 759	(478)	6 014
Loans and advances to customers	3 058	44 716	31 574	49 994	94 006	-	(60 330)	163 018
Securities	20 171	-	-	4 000	5 859	-	-	30 030
Investments	227	1 762	-	20 570	6 114	647 248	(65 808)	610 113
Other assets and receivables	20 016	600	-	8 370	-	3 064	-	32 050
Premises and equipment	-	-	-	-	-	38 260	-	38 260
Total assets	**101 589**	**47 830**	**36 644**	**82 934**	**105 979**	**702 838**	**(126 616)**	**951 198**
LIABILITIES								
Deposits from banks	(39 551)	(8 042)	(773)	(2 000)	-	-	-	(50 366)
Customer accounts	(182 307)	(28 967)	(12 129)	(68 044)	-	(77)	-	(291 524)
Bills of exchange	(14 729)	(14 626)	-	(684)	-	(12 667)	-	(42 706)
Obligations under derivative financial instruments	-	-	-	-	-	-	(2 000)	(2 000)
Other borrowed funds	(67 300)	-	(30 000)	(150 170)	-	-	-	(247 470)
Deferred tax liability	-	-	-	-	-	(178 365)	-	(178 365)
Other liabilities and payables	(73 568)	(3 403)	-	-	-	(2 290)	(7 910)	(87 171)
Total liabilities	**(377 455)**	**(55 038)**	**(42 902)**	**(220 898)**	**-**	**(193 399)**	**(9 910)**	**(899 602)**
Net liquidity gap	**(275 866)**	**(7 208)**	**(6 258)**	**(137 964)**	**105 979**	**509 439**	**(136 526)**	**51 596**
Cumulative liquidity gap	**(275 866)**	**(283 074)**	**(289 332)**	**(427 296)**	**(321 317)**	**188 122**	**51 596**	

CREDIT RISK

The Group's maximum exposure to credit risk, excluding the value of collateral, is generally reflected in the carrying amounts of financial assets on the balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

22. CONTINGENCIES, COMMITMENTS AND DERIVATIVE FINANCIAL INSTRUMENTS

YEAR 2000 – EXTERNAL FACTORS

It is unclear whether the Russian government and other organisations who provide significant infrastructure services have addressed the Year 2000 problem sufficiently to mitigate potential disruption to these infrastructure services. A substantial disruption of these services would have an adverse effect on the operations of the Group. Furthermore, the current financial crisis as discussed in Note 2 could affect the ability of the government and other organisations to fund Year 2000 compliance programs.

General claims. From time to time and in the normal course of business, claims against the Group are received from customers. Such claims are resisted by the Group's Management who are of the opinion that no material unaccrued losses will be incurred.

LEGAL PROCEEDINGS

As at 31 December 1998 the Group was engaged in no material litigation proceedings.

TAX LEGISLATION

Due to the presence in Russian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgement of business activities, Management's judgement of the Group's business activities may not coincide with the interpretation of the same activities by tax authorities. If a particular treatment was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest, which can be significant. Tax years in Russia remain open to review by the tax authorities for six years.

CREDIT RELATED COMMITMENTS

The credit related commitments comprise loan commitments, letters of credit and guarantees. The contractual amount of these commitments represents the value of risk should the contract be fully drawn upon, the client defaults, and the value of any existing collateral becomes worthless. In general, the Group's import letters of credit are collateralised with cash deposits or collateral pledged to the Group and accordingly the Group normally assumes minimal risk. Outstanding credit related commitments as at 31 December 1998 are:

	1998	1997
Undrawn credit lines	158 743	122 013
Export letters of credit	144 363	30 612
Import letters of credit (Note 12)	22 901	18 470
Guarantees issued	86 229	78 465

Management evaluated the likelihood of possible losses arising from credit related commitments and concluded that a provision of USD 7 910 thousand was necessary as at 31 December 1998 (1997: nil). This provision is disclosed within other liabilities.

DERIVATIVES FINANCIAL INSTRUMENTS

At 31 December 1998 the Group, primarily operating through the Bank, had outstanding contracts with other Russian banks whereby it had agreed to buy or sell Roubles in exchange for another currency at an exchange rate agreed to at the date of the contract. These contracts matured during 1998 but have not yet been settled. The Group has calculated the outstanding exposure on these contracts using the exchange rates ruling on the maturity dates of the contracts as the Group has historically settled domestic derivatives in Roubles.

Foreign exchange off balance sheet financial instruments are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. The nominal amounts for off balance sheet financial instruments are not reflected in the combined balance sheet.

The following table provides an analysis of the principal or agreed amounts of contracts outstanding at the year end and loss or gains arising. The table includes the contracts for which the date of maturity is past due and no settlements had been effected as of 31 December 1998. The table below reflects the gross position before the netting of any counterparty position. The Group only had open positions with counterparties resident in the Russian Federation (domestic).

	Principal or agreed amount	Domestic Loss	Gain
INDEX FORWARDS			
– sale of foreign currency	198 000	61 384	-
– purchase of foreign currency	197 300	-	60 223
Total gross position	**700**	**61 384**	**60 223**

The table below reflects netting of counterparty position, where applicable. The profit and loss effect on forward contracts for 1998 can be analysed as follows:

	Net P&L effect
Gross domestic counterparty losses	(61 384)
Offset by counterparty gains	8 990
Obligations under forward contracts	**(52 394)**
Gross foreign counterparty gains	60 223
Offset by counterparty losses	(8 990)
Less: Provision	(44 334)
Amounts receivable under forward contracts	**6 899**
Total net loss – not recorded in the combined financial statements	**(45 495)**

Due to a significant decline in the value of the Russian Rouble against foreign currencies, mutual obligations between Russian commercial banks, participants of the domestic forward market, have considerably increased. Also, at present there is uncertainty regarding the legal basis of the domestic index forward transactions.

Management believes that it is possible that index forward contracts between Russian banks may become void or other remedial measures may be available. In a recent decision dated 8 June 1999 taken by the Presidium of the Supreme Arbitrage Court of the Russian Federation involving two Russian banks, the Court upheld an earlier decision of the Moscow Arbitration Court that index forward transactions fall under the definition of a wager, thus, under the Russian Federation Civil Code Article 1062, are not subject to any legal remedies. Whilst court decisions in Russian Federation do not create precedence for legal purposes, the Management of the Group believes that this decision further supports the basis on which provisions have been made in the combined financial statements for domestic index forward transactions. Additionally, no claims have been received by the Group from any of the domestic counterparties in relation to outstanding index forward contracts.

At present there is also uncertainty in Russia with respect as to how, and on which basis, the derivative contracts will be settled; only a small proportion of outstanding domestic index forward contracts have been settled in the market. Such settlements have been made at rates substantially below the contractual rates.

The economic conditions in the Russian Federation have had a significant adverse effect on the ability of many banks to fulfil the their contractual obligations. Management has recorded provisions against the amount of gains arising based on the evaluation of the creditworthiness of the counterparties.

Based on the above, the Group has provided USD 2 000 thousand as an estimate of the actual loss that Management expects to incur in respect of the calculated net loss of USD 45 495 as reflected in the table above.

Fiduciary assets. These assets are not included in the Bank's balance sheet as they are not assets of the Bank.

	1998 Nominal value
Shares in companies held in custody	919 886
Client CBR on account with NDC (National Depository Center)	49
Client RAO VSM held on account with NDC	984
Client GKO securities held on an account with NDC	31 433
Client OFZ securities held on an account with NDC	29 393

23. RELATED PARTY TRANSACTIONS

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

Group transactions are entered into in the normal course of business with significant shareholders, directors, subsidiaries and companies with which the Group has significant shareholders in common.

During 1998, a number of transactions were entered into with related parties in the normal course of business. These included settlements, loans, deposit taking, trade finance and foreign currency transactions. Some of these transactions were priced at preferential rates. The outstanding balances at the year end and interest expense and income as well as other transactions for the year with related parties are as follows:

	1998	1997
LOANS		
Loans outstanding as at year end	17 218	26 212
Interest income	6 117	
DEPOSITS		
Outstanding balance as at year end	7 601	86 933
Interest expense	866	
Guarantees issued by the Group	**37 493**	**96 630**
Income received from issued guarantees	**800**	
Incomes on other operations	1 490	
Expenses on other operations	15	

The Group's systems were unable to segregate related party income and expense for 1997.

The Group is holding USD 28 513 thousand of its Euro Medium Term Notes in a nominee capacity for related parties of the Alfa Group Consortium. Refer to Note 13.

In 1998 the Group recorded income of USD 15 308 thousand within gains less losses arising from securities with respect to promissory note operations with entities of the Alfa Group Consortium.

In 1998 the Group recorded income of USD 78 499 thousand within fee and commission income, net as commission received from related parties of TNK with respect to the purchase on their behalf of TNK Group shares on the open market from third parties.

In 1997, included within other income, the Group received USD 20 million as compensation for funding costs incurred by the Alfa Group Consortium on behalf of the Group's joint investor in TNK. In addition, in 1997, included within other income, the Group received USD 15 million as compensation from a related party for trading losses incurred in connection with securities transactions.

CORPORATE DIRECTORY

HEADQUARTERS

107078, Moscow, ul.Mashy Poryvaevoy, 9 Tel.: (095) 974-2515, (095) 207-6001
Fax: (095) 207-6136; Telex: 412089 ALFARU; www.alfabank.ru

MOSCOW BRANCH OFFICES

"Bakouninskaya"
107082, ul. Bakouninskaya, 26/30
Tel.: (095) 267-7162
Fax: (095) 265-0482

"Arbat"
121019, ul. Arbat, 4-1
Tel.: (095) 202-3535
Fax: (095) 202-1747

"Pokrovka"
101000, ul. Pokrovka, 3/7
Tel.: (095) 921-5437
Fax: (095) 923-2681

"Medvedkovo"
129224, ul. Ostashkovskaya, 22
Tel.: (095) 476-2332
Fax: (095) 476-2435

"Krasnaya Presnia"
123022, ul. Krasnaya Presnia, 12-1
Tel.: (095) 755-8222
Fax: (095) 755-8223

"Koutouzovsky Prospect"
121165, Koutouzovsky pr., 30/32
Tel.: (095) 913-9759
Fax: (095) 913-8372

"Polyanka"
109180, ul. B. Polyanka, 13-1
Tel.: (095) 974-3725
Fax: (095) 974-3720

"Sirenevy Boulevard"
105425, Sirenevy blvd., 15
Tel.: (095) 913-5074
Fax: (095) 164-5920

"Yakimanka"
109180, ul. B. Yakimanka, 19-1
Tel.: (095) 974-1002
Fax: (095) 974-7275

"Prospect Mira"
129085, pr. Mira, 91-2
Tel.: (095) 742-0174
Fax: (095) 742-0196

"Perovo"
111141, ul. Perovskaya, 33-1
Tel.: (095) 913-8262
Fax: (095) 368-9509

"Tverskaya"
103006, ul. Tverskaya, 16/2
Tel.: (095) 937-5374
Fax: (095) 937-5376

"Leninsky Prospect"
117261, Leninsky pr., 78
Tel.: (095) 742-0033
Fax: (095) 742-0026

"Polyarnaya"
129221, ul. Polyarnaya, 3-1
Tel.: (095) 472-3109
Fax: (095) 913-3375

"Baumanskaya"
107005, ul. Baumanskaya, 38-2
Tel.: (095) 784-7315
Fax: (095) 755-9191

"Pyatnitskaya"
109017, ul. Pyatnitskaya, 40-1
Tel.: (095) 959-0400
Fax: (095) 959-0405

"Otradnoe"
127562, ul. Decabristov, 10-3
Tel.: (095) 907-1644
Fax: (095) 903-8365

"Kuznetsky Most"
103031, ul. Kuznetsky most, 9/10-2
Tel.: (095) 923-2577
Fax: (095) 923-1523

REGIONAL BRANCH OFFICES

St.-Petersburg
198095. Nab. kanala Griboedova, 6/2
Tel.: (812) 329-8050
Fax: (812) 329-8060

Nizhny Novgorod
603005, ul. Piskunova, 45
Tel.: (8312) 30-09-55
Fax: (8312) 30-09-81

Samara
443001 ul. Molodogvardeiskaya, 151-1
Tel.: (8462) 42-06-24
Fax: (8462) 42-06-25

Togliatti
Revolutsionnaya ul., 2a
Tel./fax: (8482) 33-50-22

Irkutsk
664000 Gagarin bld, 38
Tel./fax: (3952) 24-05-14

Volgograd
400066, Soviet ul., 7
Tel.: (8442) 93-60-40
Fax: (8442) 93-61-56

Tyumen
625035 Tyumen, ul. Respubliki, 162
Tel.: (3452) 32-35-75
Fax: (3452) 32-32-40

Kurgan
640000 Gogol ul., 61
Tel.: (3522-2) 323-44
Fax: (3522-2) 360-73

Omsk
644001 Kuybashev st., 79
Tel.: (3812) 53-51-76
Fax: (3812) 54-75-92

Ekaterinburg
620062 Lenin pr., 99a
Tel.: (3432) 74-51-51
Fax: (3432) 75-64-60

SUBSIDIARY

Alfa Bank - Kazakhstan
480012 Republic of Kazakhstan,
Almaty, ul. Masanchy, 57a
Tel.: (3272) 67-00-12
Fax: (3272) 50-78-03

Alfa Bank - Bashkortostan
450000 Bashkortostan, Ufa, ul. Lenina, 28
Tel.: (3472) 23-04-45
Fax: (3272) 22-52-10

Alfa Bank - Novosibirsk
630007, Novosibirsk, Dimitrova pr., 1,
Tel.: (3832) 23-88-85
Fax: (3832) 23-97-39

Astana Branch
473000, Republic of Kazakhstan,
Astana, Kirov ul., 81
Tel.: (3172) 32-84-68
Fax: (3172) 32-84-73

Ust-Kamenogorsk Branch
492000, Republic of Kazakhstan,
Ust-Kamenogorsk, ul., Gorkogo, 52
Tel./Fax: (3202) 26-41-87

Karaganda Branch
470055, Republic of Kazakhstan,
Karaganda, pr. N.Abdirova, 36/3
Tel.: (3212) 55-07-56
Fax: (3212) 48-01-96

REPRESENTATIVE OFFICE

City Tower Level 4 40 Basinghall Street, London EC2V 5DE
Tel.: 44 (171) 588 8400; Fax: 44 (171) 588 8500

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