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CAPITAL BANK ANNUAL REPORT

FOREWORD BY THE EXECUTIVE MANAGEMENT

Learning lessons from the crisis! That was the central task in 2009. We have faced up to this task with a vengeance, asked lots of questions and changed a great deal. As the Executive Management of a bank, we see things like this: It is high time responsibility was taken. Ultimately, we are in this position not only as decision-makers, but as people with responsibility. And we say: Now is the time to act.

This is why we have taken the initiative and are escaping from the general pessimism. We have examined the weak points of the system and then highlighted and changed them. We are convinced that we were moving in the right direction. The future will show whether we went far enough. Certainly, however, we are convinced that many will follow us on the path we have taken.

We have devoted this Annual Report to our Private Banking business. Questioning the bank-customer relationship is particularly important in this segment, as it involves advising and managing customer assets. Trust is the basic requirement of this interface. You can trust the people. But you have to be able to rely on systems. For this reason, in 2009 we made some significant changes to the Private Banking system for the future. These include, for example, a new customer services model that has introduced fee-based advice in Private Banking and the establishment of a product audit department.

The text that prefixes this Annual Report was written in spring 2010 as the basis for a White Paper on the future of Private Banking and was written by Swiss university Professor Dr. Teodoro D. Cocca. In this text, he puts his fingers directly in the wounds which we are trying to treat.

The comments that describe our ideas and the measures already taken come from us. We hope you enjoy reading it.

Private Banking is a philosophy, a way of life. Private Bankers must believe in themselves and in the fact that they can permanently deliver the best and highest quality in the banking system. In the last few months, this belief was shaken to the core. Customers and bankers themselves were facing difficult tasks that had to be solved. Teodoro Cocca is one of the few to deal with the problematic areas of Private Banking early and who called the emerging situation and risk directly by its name. Nobody makes a more suitable guest author for our Annual Report 2009.

PRIVATE BANKING 2.0: RESTART AFTER SYSTEM FAILURE

by

Professor Dr. Teodoro D. Cocca

We do not stay good if we do not always aspire to be better.
Gottfried Keller, 1819 – 1890
Swiss Author and Politician

What do you think? Has the market turbulence of the last three years caused the banks to reconsider their business models and business strategies? You would think so – naively. By contrast, all too quickly the banking industry seems to hope that it will survive the crisis without great changes. A fallacy. Some even believe that the crisis and its consequences have already passed. Another fallacy. A business model always derives from the general conditions that characterise a company's market. If the market conditions change, the business model inevitably also has to be adapted. Without doubt, the financial crisis represents an epochal change in the financial system. It merely remains to be seen as to which direction the financial world takes. The imminent changes will also impact on the Private Banking business. A special business field, if one considers it from the perspective of a willingness to change in the past. Private banks did not used to abound with innovations and the desire to change. Indeed, the industry is characterised by tradition and constant values, which today means: rarely trying anything new and instead doing things the way they have always been done.

Why should they expose themselves to the risk of a change or of real innovation – the Private Banking industry looks back on decades of successful deals. Consequently, the business models of the providers in Private Banking are all very similarly structured and do not differ significantly. The current crisis also highlights the need for action by just a few providers.

2009 brought great insight for investors. One of these: „Save in Switzerland and confess in times of need“ – for thanks to empty pockets, the states are forcing taxes on their citizens. To this end, we offer discreet advice. For „white is in“, as we call an information sheet about repatriating untaxed illicit earnings.

The unbearable lightness of being revealed here for many banks also has its positive sides, however. The partly frightening strategic inertia of the Private Banking industry represents enormous positioning possibilities for its innovative and visionary banks, for there is displeasure in the industry. Not only about the weakening of banking confidentiality (a subject that is causing sleepless nights for banking colleagues in Switzerland), but criticism about the daily consultation meetings and investment decisions is also growing.

We had this insight some time ago: Sales targets and Private Banking do not get on. Consequently, productive sales do not lead to better pay for an employee. This has been the case for years according to Article VI of our Declaration of Independence. Since December 2009, the regulatory authorities have demanded this from all financial service providers.

Depending on the bank, there are large differences today in terms of the quality and independence of the advice offered. Many financial institutions have degenerated into pure sales machines. This development has nothing to do with the basic philosophy of Private Banking and also threatens the good reputation of those providers, which have not joined in with these developments.

System errors disclosed

As a Private Banking customer, one is faced with having to select the most appropriate bank for the reliable management and appreciation of one‘s assets, Not a simple task in the complex world of finance. The customer should not be blinded by trivialities, but instead should concentrate on the core content of good asset management. The key word „quality“ is happily and strikingly used.

This leads us to the first important question: What does quality mean in Private Banking and what is good Private Banking? Intensive consideration of this question is extremely urgent because of the discovery of the system failures in the industry as a result of the financial crisis.

Good Private Banking is not merely defined as the reference to centuries of existence, majestically fitted consulting rooms, a discreet appearance of the advisors and a broad range of products enriched with some exotic specialities. This must not and – today – will not suffice, at least from the perspective of a critical customer.

The initial situation for 2009 was the bankruptcy of an American system bank and the collapse of the largest financial fraud in history. The resulting losses suffered were reason enough for us to examine the system in which Private Banking is operated. By mid-2009, we had changed our self-image and our business model. With an attempt to address and avoid system failures honestly.

A bank‘s business model has to be examined one level deeper in order to identify the real value drivers or value destroyers. In Private Banking, one inevitably comes across system failures which are deeply rooted in the functioning of the industry. However, it may be time to correct these system failures in order to give rise to a new Private Banking: Private Banking 2.0.

Customer, emancipate yourself!

While the financial crisis hardly affected the behaviour of the banks, it has had a deep impact on the investment behaviour of the customers. Investors are uncertain and sometimes helpless. According to a recent survey, the banking industry has an immensely bad reputation. The personal opinions of the 400 managers asked in Germany show how bad the reputation of the industry is: 60 percent would not be pleased to have a banker in the family. They would also not advise their children to become bankers. 60 percent also believe that bankers live in their own world and deny any reference to the real economy.[1]

[1]) Cf. Spiegel Online, Deutsche Manager für Bankenzerschlagung [German Managers for Destroying the Banks], 18.02.2010, http://www.spiegel.de/wirtschaft/unternehmen/0,1518,678709,00.html.

The banks have lost trust, but the investors do not trust themselves to make changes to their decisions and behaviour. Consequently, some consideration has certainly been given recently to shifting to other forms of investment, without facing up to the much more urgent basic questions, however. The consumers' requirement for transparency and comprehensibility of investment products frequently stands against their own financial behaviour. Following the events of the last few years, the willingness to ask critical questions must increase. Ultimately, this will result in the providers being changed if one‘s own bank has not learnt anything from the crisis, or is unwilling to learn.

With our new transparent model we have triggered lots of reactions among the industry‘s colleagues. We were laughed at, criticised, and even derided. But is has triggered goodwill among customers. Often connected with a little incredulity: „Are you serious, will you carry on like this?“ This is why we have revised our contracts in order to bind us to our new model. We are not only building on your trust, you should also be able to rely on us.

It would be even worse if the bank identified the need to do something, but for opportunistic and shortterm considerations did not take the steps required for change.

As will be seen below, the customer as decision-maker has an immensely important role. A modern private bank also requires a modern customer, an emancipated customer who demands a great deal from their bank, thereby significantly adding to the bank. The supporting power of the customers is often underestimated or neglected in the evolution of banking strategies. Bank strategies too frequently adhere to the principle of internal necessities instead of orienting themselves on the (external) true requirements of the customers. By contrast, if the customer realises that a bank is trying to break out of this rut and is offering new concepts which try to deal with the core of the evil, then the customer can contribute to the improvement of the banking industry by actively choosing the new business model. As a customer, one must be aware of this power and responsibility.

The three cardinal sins

Alongside the perception derived directly from the fiery experiences of the financial crisis, the inadequacies that have characterised the system for years must be discussed:

1. Performance

What have I as a customer really earned net – i.e. after deduction of the bank's fees – with my investments? This is the central question that each customer asks (or should ask).

[2] Cf. Cocca Teodoro and Geiger Hand, 2007, p41.

Quality in Private Banking therefore must include the cardinal elements of investment return. A subject area, however, where the industry has barely generated any added value for the customers over the last few years. Especially if one considers the customer's return after charges and taxes. This is an uncomfortable fact for an industry where conservation of value and appreciation are the central justifications for the high consulting margins. In most cases, the return on investment over the last 10 years, for example, will be not exhilarating and in the best case will total just over zero percent per year. Unfortunately, however, in some cases, value for the customers has also been sustainably destroyed as a result of exposure to excessive risks.

In fact, it has been scientifically documented that there are hardly any financial experts, advisors or investors who can beat the market. On average, for example, the new return by funds managers lies below the benchmark. In a study by the University of Zurich, which compared the return on investment among 250 private banks around the world, an annual return of 0.1 to 0.2 % above the benchmark was achieved – before costs were deducted![2] However, it would be unfair merely to measure the returns achieved, for the bank cannot influence the course of the markets.

An important clarification: We cannot foretell the future! Do not expect any forecasts of the type „This will rise, that will fall.“ We do not know, and nor does anybody else. Keep away from everyone who claims otherwise. You cannot expect any more, or any less, than advice which is honest and professional. Without ulterior motives. Independent of commission interests. Only with the aim of bringing your assets undamaged through the uncertain future. But before you become incredulous, read on to find out how we ensure that …

The bank can certainly steer the type of products and the associated risk entered into. This is the concept of advice per se.

The measurement of performance should be based on this. Which risks were entered into, when and why? Which loss limitation strategies have been planned? Have I, as the customer, been sold really sensible products? Do the advisors understand the products they are selling? In light of these questions, the bank‘s performance can be evaluated. Magic cannot be expected from the bank. Even the best investment experts do not have crystal balls and can make mistakes. The question is only whether the advisors are aware of this and orient the strategy for the customer accordingly – with all humility before the complexity of the financial markets and their unpredictability.

First of all, you can expect your advisor to be professional. The capital markets demand that the methods and theories be constantly developed further. Dealing with the science is in our blood. Our advisors are introduced to the relevant finance theories in a banking degree. And in asset management we secure professionalism as a result of close cooperation between industry and teaching. But that has always been the case.

New paths in the asset management process and in asset allocation, as well as in formulating investment strategies must be found outside traditional finance theory (which comes fairly tarnished from the financial crisis).

2. Fees structure

In order to be able to take a bank‘s performance into account appropriately, an understanding of the fees that the bank earns is critical. However, strict opacity traditionally dominates the banking world. Hidden fees can be earned for the bank on several levels and mostly so that the customer is not aware of this. This opacity leads to inefficient decision-making, both for the customer and for the bank. Without price transparency, the customer cannot even choose a price-performance offer appropriate for them. An opportunistic area for action can open up for the bank if it does not provide the most suitable product for the customer, but instead focuses on its own commission income.

The risk potential of this initial situation has been a thorn in the side of law-makers for many years and some work has already been performed in this direction.

However, the leeway for banks continues to exist.

[3] Cf. Blahusch Marc Oliver, Preismanagement in Privatkundengeschäft der Banken [Price management in private customer business], Doctoral Dissertation, University of Linz, 2010.

Secondly, you can expect honesty in the advice. We make sure – beyond the statutorily mandating small print – there is transparency with regard to the commission that we earn as a bank. Whoever receives what from product providers such as external investment companies, but does not disclose this as part of the advice, is at risk of losing the customer's confidence. And rightly so. For what was the motivation for the recommendation? Was the focus on the commission or the customer' interest? If there are subsequent losses, the suspicion that the advice was not truly honest is difficult to eliminate. We are better than that. Through voluntary transparency. This creates trust and avoids subsequent doubt. This is new and a lesson from the crisis.

However, the trend follows a clear direction: Along the regulatory path, further transparency will be imposed. But it is not only the anticipated intensification of legislation that should be critical for a bank to reconsider its fee structure. Transparency is the best way to recover the lost trust. Banks which have an open and transparent fee structure have an advantage over their competition in respect of customer relationship and customer acquisition, as the latest research shows.[3]

Thirdly, we offer fairness. So that the advisor is in the same boat as the customer, the fee can be paid exclusively from the profits. With a fixed rate of 15 % of the actual asset apprecia-tion – after all costs and capital gains taxes. And if there are losses? We go without. And we work until profits are earned again. Because we believe that over the long-term we are right. And it is fair as well!

The measures for promoting price transparency, therefore, are having an effect for a bank‘s shareholders in a sustainable manner by increasing customer loyalty, and thus profitability. Fairness towards the customers also means that the bank‘s fees are paid depending on the bank‘s performance, i.e. on the return on investment achieved for the customer. This payment principle is surprisingly uncommon, but will heavily influence the future of the price model.

Without doubt, this will make a bank‘s income from Private Banking more volatile. However, the effect will be smoothed over the full cycle.

[4] Cf. Bahar and Thévenoiz, 2007, p4.

[5] Cf. Chen and Chen, 2009, p1425.

3. Conflicts of interest

In part, today's bank advisors are servants to two masters – their employer and their customer. Indeed, around the world banks also act as issuers of financial products.[4] They set up investment funds and develop structured products. The flood of products is immense. These so-called inhouse products earn a particularly high margin for the issuing bank compared to the sale of a third party product, as the entire added-value lies within the bank and all issue margins and management fees can be retained. This is why the advisor's task frequently involves promoting the sale of the bank's own products. Inhouse products a priori are not a drawback for a portfolio. However, they must be suitable for the customer's investment strategy, have reasonable fees and deliver a better return than the market average. But one could be even stricter and demand that inhouse products are only sold if they are demonstrably the best products in their category. Particularly blatant outgrowths have been observed in the last few years in the recommendation of „alternative investments" such as hedge funds. Because of their umbrella construction and several fee levels, these products are particularly expensive.[5]

In Private Banking, it has become standard when giving advice to be open to external products from third party providers. This is right and this is how we do things. But in the last 15 years this trend has secretly led to a doubling of internal funds costs. The reason for this lies in the sales costs: Funds companies have to lure the banks with hidden stock commission. Up to half the management fees here goes to the customer‘s bank. But typically they do not see any of this. This is the practice through the industry. But is it fair?

In addition, many do not correlate greatly to the usual investments and do not fulfil the promise of additional risk distribution. Many of these products are merely ways to earn higher fees. Banks are happy to refer to the fact that because of the open product architecture, customers are shown all products upon request, subject to the corresponding qualification and appropriate place of domicile of the customer.

According to this best-in-class approach, investment advisors could select any product corresponding to the customer‘s requirements. This must be examined critically. The best-in-class approach is publicly prescribed by many banks, but adhering to it is always a tightrope walk for the advisor – especially in economically difficult times. For his job and, in particular his bonus, depend on personal profitability. Customer advisors are credited with more income from the sale of inhouse products, which creates corresponding incentives. The advisor mutates into a simple product-seller. In addition, with regard to the best-in-class approach, the question is what sales commission do the banks receive for third party products. Insofar as there are differences here between providers of third party products, the conflict of interests is certainly not eliminated. The Austrian Financial Market Authority (FMA) has also come to this conclusion:

[6] FMA, FMA-published circular on conflicts of interest in incentive systems for the sale of investment products, press release, Vienna, 08 December 2009.

„Sales targets, through which the employee is rewarded more for the sale of named products than for other comparable products, certainly represent an insoluble conflict of interest.“[6]

Our advisors have long discussed and finally opted for our new model. Not all, but most of them. Consequently, some have also left. The sale was more important to them than the advice. And new ones have applied to join us because they have had enough of sales-oriented financial advice. It is a process of changing the thinking. In the right direct, we believe.

Independent financial service providers offer themselves as alternatives and emphasis their independence from sales, as most of them do not issue their own products. However, even an independent financial services provider receives commission from the issuers, whose products they sell. Moreover, the overall situation is also very burdensome for the advisors themselves at the emotional level: The bank pursues the goal of short-term profit maximisation (especially publicly listed banks), the customers wants long-term asset optimisation. In between are the private bankers and they try the impossible balancing act.

The important thing is the coordination of incentives

The most economically important criterion when assessing a bank is the incentive structure which influences the advisors. Are the incentives set such that the advisors' own interests correspond to the interests of the customer? In principle, sales commission is not objectionable as long as the administrators discloses all the elements of the custodial account, transaction, purchase and management fees to their customers, that they receive from the banks – in addition to the fees agreed directly with the customer. For only in this way can the customer form a picture of how independent and objective the recommendations really are. If a bank really places the customer in the centre of all its activities, it must devote itself to this. Whoever strives for such a position will have to deal with the question of internal incentive systems and the profile of the customer advisor as well as the relationship with their own products. At the European level, the MiFID Directive (Markets in

[7] Directive 2004/39/EC of 21 April 2004. S. 19 para. 1.

[8] Directive 2006/73/EC of 10 August 2006, para. 26.

Financial Instruments Directive) regulates this group of subjects. With regard to conflicts of interest, it maintains that an investment company should act honestly, candidly and professionally in the best possible interests of its customers when providing investment services for its customers.[7]

Initially this sounds good. After further consideration about this sentence, the careful reader will raise the question as to the meaning of the open formulation of „best possible“ and why such self-evident concepts have to be mentioned specifically. With regard to the incentives, the EU Directive also states, „for incentives, it should be assumed that the acceptance of a commission by an investment company in conjunction with investment advice or with general recommendations encourages enhanced quality of the investment advice to the customer, insofar as the advice or recommendations are provided without bias despite the acceptance of the commission.“[8]

Furthermore, the handling of commission from third parties (known as inducements[9] according to MiFID) is regulated: „Member States shall ensure that investment companies are not deemed to be acting honestly, candidly and professionally in the best possible interests of a customer if, in conjunction with the provision of investment services or related services for the customer, they pay or receive a fee or commission or if they grant or accept any non-cash inducements offered."[10]

So far, so good, you would think. But sadly the corresponding Section goes further and maintains, inter alia, that inducements to improve the quality of services are excluded if they are unmistakeably disclosed to the customer before the respective investment or related services are provided and „the payment of the fee or commission or the granting of non-cash inducements offered must be designed to improve the quality of the service provided to the customer, and they must not prevent the investment company from acting as required in the best

[9] Payments of any kind which investment companies accept or which third parties grant in conjunction with the provision of investment services or related services for the customer.

[10] Directive 2006/73/EC of 10 August 2006, s. 26.

[11] Directive 2006/73/EC of 10 August 2006, s. 26, para. ii.

[12] Swiss Supreme Court, Civil Department 4C.32/2005, judgement of 22 March 2006.

interests of the customer."[11] These are the central elements of the statutory conditions. Many questions remain unanswered here. What, for example, the disclosure to the customer should included exactly, is heavily contested. The existing regulation leaves leeway for the status quo to be maintained as long as the question of quality is unmistakably clarified. Interesting in this context is a Supreme Court Judgement in Switzerland, which finds that asset managers must generally pass on commission they receive from banks to their customers.[12]

In the basic judgement, the question was what happened in relation to an asset management contract to the so-called retrocessions and similar benefits that the asset manager receives from banks. In Switzerland, a retrocession is when, on the basis of a corresponding agreement, a bank passes on part of the commission it earns to a third party, for example a broker in an asset management transaction.

Finder's fees as a one-off payment for acquiring new customers are also common. The judges ruled that the forwarding of retrocessions and finder's fees to the client could not be waived without the express waiver of account and delivery. The simple non-expression by the client may not be interpreted as such a waiver. In Austria, the relevant conditions are included in federal legislation regarding the regulation of investment services (WAG2007 – Austrian Securities Supervision Act) and in a recent circular that defines the regulations. In the event of conflicts of interest, WAG 2007 envisages a three-stage approach – identify, avoid, disclose: first of all potential conflicts of interest must be identified as a precaution, secondly they have to be avoided as much as possible and if a conflict of interest is still unavoidable despite these measures, this must then be disclosed to the customer. As these conditions obviously do not have a great effect (as they are too general), the FMA found it necessary to publish a definitive circular which explicitly addresses and explains grievances, such as how companies have to act when providing investment services in order to act honestly, candidly and professionally in the best interests of the customer and to maintain the compliance regulations.

[13] FMA circular on conflicts of interest in specific remuneration systems, 01.12.2009.

Up to half a fund's costs go in sales. This is a system failure in Private Banking and we have decided to solve it: Our advisor contract and the portfolio management contract therefore guarantee that we will pass on these kick-backs, retrocessions, trailers or even stock commission in full to our customers. Issue charges remain with the customer. This is our „Independence Guarantee". As a result, we are now only paid from one side – the customer. This ensures genuine independence in advice. Advice instead of sales.

The „FMA Circular on conflicts of interest in specific remuneration systems" in the sale of investment products is aimed at financial institutions, investment services companies, insurance companies and capital investment companies and refers to investment services, investment activities and investment-related services. The regulatory authority explains what has to be considered in sales incentive systems in order to manage possible conflicts of interest according to s. 34f Wertpapieraufsichtsgesetz 2007 [Securities Supervision Act], (WAG2007). It states that where there are remuneration systems (internal company remuneration, commission payment or other bonus systems), companies must develop procedures and take measures to avoid conflicts of interest. In practice, however, a corresponding arrangement and introduction of control mechanisms should be sufficient for the existing models to be maintained. As a careful reader, it is again surprising, especially the final sentence! The entire circular has the tone of a recommendation which de facto protects current practice rather than preventing it. As all these conditions and their practical implementation show, this alone cannot be enough to guarantee the absolute protection of the customer's interests.

There needs to be more than just a few well-meaning words and veiled pseudo-regulations. Banks, which want to fulfil more than just the minimal requirements of the law, but instead are also wondering how to combat conflicts of interest structurally and, therefore, conclusively, have to give the matter further consideration. Instead of half-heartedly fighting the symptoms, the finance industry should finally give increased consideration to sustained prevention. This applies even more to Private Banking, which sees itself as a high-quality and exclusive alternative to ordinary asset advice. So that the finance industry is not tempted to neglect its duties, a change or adjustment to the business model must be considered. Only in this way can the duty to the customer be fulfilled.

[14] The FMA defines a conflict of interest as: a potential conflict of interest arises if the interest of the legal entity on one side and their obligations towards the customers on the other compete with each other, whereby it is not sufficient that the legal entity can enjoy an advantage. At the same time, there must be or could be a potential disadvantage for the customer. Conflicts of interest increase the risk that those who act for the customer act to their disadvantage if their own interests are counter to those of the customer (cf. FMA circular on conflicts of interest in specific remuneration systems, 01.12.2009, p2).

The transparency paradox

An increase in transparency is seen as a solution to the system failures outlined above. This is a necessary but insufficient condition, as the following considerations will show. In the world of the homo oeconomicus human behaviour can be explained through the maximisation of self-interest. In view of this, the conflict of interest can be clearly defined: a homo oeconomicus acts selectively in order to improve his or her own situation. They act rationally by pursuing the goal of maximising their benefit.

As soon as an advisor receives income from third parties, therefore, they can be persuaded to consider their interests and thus to place their own interests above those of the customers. Or, to put is more generally, anyone who serves two masters sooner or later has a conflict of interests.[14] In the context of asset investment, the conflict of interest therefore merely depends on the questions as to whether the protagonists are aware of the counterparty‘s incentive structure. The dilemma of the conflict of interest is reduced therefore to a problem of information.

At this point, the regulator calls for an increase in transparency, with the aim of reducing the information asymmetry between the protagonists, as explained in the previous section. However, the ethical dimension is completely concealed here.

Perhaps you have already asked yourself: What is this subject doing in an annual report? We think that every reader of our Annual Report should know the reasons why the bank has made changes to its business model. If you take the time to read it, you will understand it. If you do not, no problem. For you will still receive fair, honest and professional advice. Even if you do not consciously realise, you will notice ...

[15] Cf. Dembinski Paul, 2009, p34.

The information asymmetry argument is based on the assumption that the customer (one of the protagonists) has the financial knowledge and all the time to verify the advice service received. Ultimately, this would result in a paradox: if the customer had this expert competence, they would not have to be informed so transparently or would not even need any advice (which would resolve the question of the conflict of interest). Confronting a customer with additional – partly highly technical – financial information could even be counterproductive and increase the „understanding asymmetry“. If we consider that the bank advisor frequently represents the only entry to the secret world of finance for the customer, like a lawyer or doctor for law or medicine, only by adhering to their duty towards the customer can the advisor protect the customer from suffering as a result of the advisor‘s superiority. In a relationship based on this, there is no room for conflicts of interest, as the advisor is paid directly for the decisions made in the customer‘s best interests. If banks want to restore their lost trust capital, they need a public and credible obligation for high ethical and professional standards.[15]

Homo reciprocans – the better human and banking picture

There are many experimental studies which clearly prove that home oeconomicus is far less universal than commonly assumed.

The majority of participants in these experiments behave reciprocally, i.e. they reward fair conduct and punish unfair conduct, even if this results in costs.

The proof of reciprocal conduct has far-reaching consequences for the economic solving of problems. This intrinsic sense of fairness must be considered by the banks when dealing with their customers, otherwise they undermine their own justification for existence over the long term. Banks which treat their customers like partners generate a large amount of good-will in this way.

Especially in Private Banking, these are the cornerstones of a successful and lengthy relationship to the customers. Unfair behaviour is perceived as such by the customers sooner or later and this prevents a bank-customer relationship being created which includes a high degree of loyalty.

[16] Cf. Falk Armin, 200, p4.

[17] Cf. Bernet B., Zwischen Rendite und Risiko – Lektion 4: Grenzen der Vernunft [Between returns and risk, – Lecture 4: Limits of reason] http://www.sbf.unisg.ch/org/sbf/web.nsf/bf9b5a227ab50613c1256a8d003f0349/b7ef527b530f3b03c12574f2004892cf/$FILE/Zwischen%20Rendite%20und%20Risiko%20Grenzen%20der%20Vernunft.pdf

We are convinced that with fairness and transparency over the long term we will be more successful. This includes the hope that in a few years we will no longer be the only ones with this attitude. For it is worth it. An independent initiative is even better than waiting for the law to finally correct the system failure.

From scientific experiments, we now know, for example, that fair and unfair conduct is rewarded or punished.

However, an action or an event is only considered to be fair or unfair if the acting person is actually responsible for it, i.e. if the respective person could have decided differently. This means that it is not just the consequences of actions and results that are relevant for a fairness judgement, but also intentions and procedures.[16] In this context, the finding from the research field of neuro-economics is extremely interesting, namely that the areas of the brain where mathematical-logical decisions are localised, are barely active in investment decisions and thus have as good as no influence on the decisions. Instead, the brain regions are stimulated, whose activity is connected with social skills. Human interaction therefore plays a not insignificant role in investment decisions.[17] If science already realises that human behaviour functions much more complex than controlling self-interest suggests, it would be time for the banking world to implement models that take these matters into account. These (reciprocal) principles of behaviour are the basis for the future bank models in Private Banking.

What is genuine quality?

Quality in Private Banking is defined by the claim to be able to offer really independent advice. A claim that the fewest providers can genuinely assert, as they do not have the corresponding business model. Consequently, quality is a question of the business model. Private Banking customers want a personal financial expert who acts exclusively in their interests.

Among incredibly wealthy families today, it is usual for finance experts to set up an office in the family. The industry must be oriented to this customer segment which sets the highest requirements. The fundamental questions here concern the organisation and business structure of a bank and its product and price strategies.

Many business structures contain a latent potential for conflicts of interest, which is increasingly considered with distrust by customers and regulatory authorities – as has been explained. However, any reconsideration of the business model must also address other questions that will enhance quality in the new age.

A contractually promised „independence guarantee“ can ensure fair advice. There is more to finding the right investment. To this end, we have created an internal certification process for investment products. Products that we recommend are checked from top to bottom by a central team. We cannot and will not wait for the state to prescribe a quality test like it does for medicines. Ultimately, however, the investment products are like medicines, the dose must be right. So ask your advisor about the effects and unwanted side-effects.

It is becoming ever more challenging to master the increasing complexity of the financial world (products and services). This trend will lead to an adjustment in the profession and places high requirements on the „learning organisations“. How can the bank ensure that its advisors are always at the cutting edge of knowledge? How can the advisor even provide added value for the customer in a world of information overload? How does the bank ensure that it has the skills to filter the relevant information from the information overload?

In addition, the customer advice model has to be developed further in view of this. A customer advisor alone will always find it difficult to be able cover all product areas competently. In future, quality in Private Banking will increasingly be measured on such questions. Actually a pleasing fact. Banks that reveal a genuine striving to improve their business model are now thinking about this. This should be rewarded by customers, but represents a declaration of respect towards them. At a time when, in particular, banks are being especially critically observed by the public, coherent behaviour as a corporate citizen corresponding to the zeitgeist and society's values is an enormous opportunity for a bank to give a sign, and thus to redefine the standard for the entire branch.

[18] Roth/Hoffmann, 2003; Bassen/Jastram/Meyer, 2005, p231-236; Habisch, 2008.

The traditional tension between legality and legitimacy is expressed here. For the acceptance of corporate action, it is not enough that it merely moves within the framework of legality: a company also requires the consent and thus the legitimacy of its employees, customers, shareholders, capital providers and all other groups affected by the company (stake-holders). Legitimacy is achieved through compliance with legal requirements and through the legal obligation of additional ethical corporate governance. Sustainable corporatism is recorded, for example, under the concept of corporate responsibility. A significant component of a responsible and sustainably value-oriented corporate management, therefore, is the current decision as to what should be done and what omitted within the framework of corporate responsibility – including beyond what is required by law.[18] This takes courage and persistence, for experience shows that the time customers take to adapt to an entirely new model can be longer than imagined. Despite this – or because of it – the following applies: Whoever identifies or even anticipates the sign of the times, whoever now seizes the opportunities, will survive this period of transition more strongly and will be accepted (acknowledged) as a responsible and reliable partner.

2009 brought with it the opportunity for change. In our environment, we believe that we have used this. But today we are still a long way from our destination. For it will certainly take a little time until every customer notices that something has changed. We will have patience, we hope you will too. For we are convinced it is worth it!

Conclusion

Private Banking models have a promising future, if the imminent system failures are successfully overcome. The customers‘ focus (and that of the regulatory authorities – MiFID was only the start) will lie in future on the real quality features of the Private Banking service. The ability to offer independent advice without any conflicts of interest will be the priority criterion here. The change process towards a new Private Banking 2.0, which upholds these independence features, leads on one hand to an adjustment to the business model (hard factors) and on the other to a cultural change in behaviour (soft factors).

The hard factors are the simpler part of the change process, whereby it is clear that many will fail here. The cultural change to a new professional ethics is the really challenging part. In addition, the mutual influence of the two levels must not be neglected either: Only whoever has a genuine desire to change will be in a position to change their business model. And only a suitable business model will be able to release the forces of a new corporate culture. Legislators are rightly demanding that banks should be candid when providing investment services for their customers. According to the lexicon, being candid means talking and acting without deceit and falsity, perfectly agreeing action and talking with ethos and without concealed ulterior motives and hidden intentions.[19]

19) Cf. http://www.textlog.de/38190.html, explanation of the terms „candid“ and „upright“, used here as synonyms.

Any action by the bank must be examined, as to whether it satisfies this maxim: Each banker should imagine what it would be like to be their own customer. This is the true litmus test for Private Banking 2.0.

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CAPITAL BANK – GRAWE GRUPPE AG

Performance and Figures

PERFORMANCE AND FIGURES
CAPITAL BANK – GRAWE GRUPPE AG

	31.12.2009 EUR K	31.12.2008 EUR K	31.12.2007 EUR K	31.12.2006 EUR K
Balance sheet total	653,309	731,082	735,829	563,684
Receivables due from customers	121,106	143,447	173,657	133,356
Liabilities due to customers	215,326	236,553	234,691	240,445
Operating profit	9,260	11,781	22,558	21,901
Profit on ordinary activities	5,451	175	17,663	16,840
Equity capital % of the assessment basis according to section 22 para. 1 BWG (Austrian Banking Act)	31.0 %	24.6 %	24.0 %	22.1 %
Volume of securities accounts	4,676,609	3,900,318	5,143,665	4,170,209
Employees (excluding subsidiaries)	161	187	171	141

Statutory Bodies of Capital Bank – GRAWE Gruppe AG in the Financial Year 2009

Board of Directors

Christian Jauk, MBA
Chief Executive Officer

Mag. Constantin Veyder-Malberg
Member of the Board

Supervisory Board

Mag. Dr. Othmar Ederer
Chief Executive Officer of Grazer Wechselseitige Versicherung AG
Chairman of the Supervisory Board

Dr. Siegfried Grigg
Deputy Chief Executive Officer of Grazer Wechselseitige Versicherung AG
Deputy Chairman of the Supervisory Board

DDIng. Mag. Dr. Günther Puchtler
Member of the Board of Directors of Grazer Wechselseitige Versicherung AG
Member of the Supervisory Board

Dr Franz Hörhager
Managing Director of Mezzanine Management GmbH
Member of the Supervisory Board
(from 10 July 2009)

Dr. Dolf Stockhausen
Industrialist
Member of the Supervisory Board
(to 09 July 2009)

Members Nominated by the Works Council

Rudolf Laudon

Harald Greimel
(from 28 November 2009)

Christina Zotter (nee Wolf)
(to 27 November 2009)

Representatives of the Regulatory Authorities

Mag. Peter Maerschalk
State Commissioner
(from 01 October 2009)
Deputy State Commissioner
(to 30 September 2009)

MR Mag. Andrea Mörtl
State Commissioner
(to 30 September 2009)

Management Report 2009 of Capital Bank – GRAWE Gruppe AG

For the global banking industry, 2009 was a year of rehabilitation and consolidation, and for some market members also a year of new directions.

In 2008, the industrial nations massively intervened in the financial markets, and later – on into 2009 – increasingly also in the real markets in a never-before-seen rescue campaign against the threatening systemic crisis. By spring 2009, according to estimates, at least US$ 6,600 billion – almost 13 % of global GDP – had been earmarked or already invested in financial market stabilisation and economic recovery programmes. More than two thirds of this flowed into the languishing financial system and provisionally ensured a considerable recovery. Never before has the market recovered so quickly from such a low, whereas the probability that actual corporate profits in the near future will be able to keep up with this pace is considered to be limited. The banking industry remained a worry, however. Although the systemic weaknesses of the banking system have generally been identified as the trigger and main cause of the crisis, the restructuring steps have been restricted to injections of cash and a considerable softening of the reporting regulations. Furthermore, focus has been on considering containing bonuses to bank managers and, especially in German-speaking countries, on measures to boost tax honesty in conjunction with investments outside the country of domicile (residence).

While many banks, also in the Austrian market, were mainly dealing with recovering from the structural deficits and risks revealed in 2009, Capital Bank – GRAWE Gruppe AG („Capital Bank“), an independent specialist bank with a focus on Private and Investment Banking, used the agility and innovation of its managers and employees to orient itself to the new general conditions in significant cornerstones. Consequently, we set the direction of travel for a new banking landscape early.

In this way, the Private Banking division, the bank‘s most important business field, started a new template in June with a portfolio management: Under the management of a newly appointed Chief Investment Officer and with support from all the specialists in the bank, work started in 2009 on devising investment strategies for centrally managed portfolios and fundamental recommendations for investments. At the same time, we offered our customers a selection from one of our new, transparent fee models, thereby linking our remuneration to the investment success of our customers. This new orientation bears the name „Private Banking New“ and we are pleased with the successful start of the new model. The aim will now be to convince more customers of the benefits of the new, fair model, and to acquire new customers, so that its growth is ensured effectively through the considerable expansion of managed assets in Private Banking.

Apart from this fundamental repositioning in the Private Banking division, other structural measures have been implemented. For example, in December the Salzburg branch moved into new premises that offer a representative and modern environment for customers and employees. In addition to the branch in Salzburg, Capital Bank maintains branches in Graz, Kitzbühel and Vienna, as well as a representation in Prague.

Capital Bank also continued its focus on the Austrian Private Banking market. The Family Office remained true to its core business of advising „Ultra High Net Worth Individuals“, family companies and private foundations. The customer custodial account volume managed in the Private Banking division remained stable despite the difficult situation in the first half of 2009. Income fell compared to the previous year as a result of the market situation.

Because of the structural changes and capacity reductions undertaken in 2008, the Investment Banking division continued to a reduced extent. In the leveraged finance department, open risk positions were further reduced, alongside the processing of existing commitments. The equity sales and equity trading departments were streamlined through an organisational merger, with concentration on traditional equity sales with institutional customers.

Capital Bank‘s third business division, the so-called „platform business“, where the bank assumes the role of a depositary for customers of independent investment service companies, developed extremely satisfactorily, in particular as a result of the recovery in the stock markets and the restart of the market in independent financial service providers in the second half of the year.

The staff and service departments, after a few resizing steps in 2008, were characterised by consolidation and the preparation for measures integrating the banking group of Hypo-Bank Burgenland, notably the creation of uniform consolidated departments. In 2009, this included, for example, the credit management department, which was completely reorganised, and the restructured legal and compliance department.

In terms of the media, the financial year 2009 was characterised by the turbulent events concerning the Hypo-Group Alpe Adria („HGAA"). Until the end of the year, our parent company, Hypo-Bank Burgenland („Bank Burgenland") held 20.48 % (indirectly) of Hypo Alpe-Adria-Bank International AG, the group parent of HGAA, and had to leave the group of shareholders of HGAA. Due to this development, it was necessary to write-down this investment in full. However, the balance sheet of the subgroup of the Capital Bank Group is not affected by these developments.

Capital Bank always tries to maintain its employees' standards of education at a very high level. In Private Banking, this striving was implemented through an academic university course „Technical and Social Competence in Private Banking", which started in autumn 2008. The subjects treated include international financial markets, portfolio management, tax and legal aspects in Private Banking. A particular emphasis is placed on social skills. Because of the high technical qualifications and motivation of our employees, as well as regular investment in their training and education, we see the future development of our bank as very secure, both for the coming year and over the long term. As at 31.12.2009, Capital Bank had 161 employees.

As part of society, Capital Bank is aware of its social responsibility. For example, numerous free presentations on economic topics have been given. With specialist presentations at academic institutions, the primary aim was also to give the students expert knowledge and to grant them a practical insight into the world of banking. In addition, Capital Bank supports numerous social and university-related institutions.

The General Economic Environment

The international financial and economic crisis, which began in the USA, dominated events on the global capital markets in 2009. According to the latest figures from the IMF, global economic output fell by 0.8 %, with the Euro zone being affected more greatly (-3.9 %) than the US economy (-2.5 %). Of the most important industrial countries, Japan suffered most from the economic crisis with a fall in GDP of 5.3 %. Even the economic powerhouse of China suffered a slight fall in GDP, but with economic growth of 8.7 % remained ahead of the rest of the world.

An analysis of international financial markets showed that there were also large falls in the 1st quarter of 2009. The recovery in the three subsequent quarters was considerable, however. The Dow Jones EUROSTOXX 50 Index, important for Europe, lost around -15.4 % in the first quarter, but finished with an annualised positive performance of +21.1 %. Similar developments were experienced by the Dow Jones Industrial Average (annual performance: +18.8 %) and the NIKKEI 225 (annual performance: +19.0 %). With regard to the Austrian stock index ATX, an extremely positive performance of +42.5 % was observed in 2009, following the heavy losses in 2008. Despite this positive development, however, falls and a continuing volatile situation on the stock markets is assumed for 2010.

In order to counter the recessive developments in the Euro zone, state economic and banking packages of billions of Euro were put together. After a large fall in economic output in the 1st quarter of 2009, the European economy stabilised considerably in the 2nd quarter of 2009 and actually grew by 0.4 % in the 3rd quarter, according to Eurostat estimates. According to reports from the OeNB, the state interventions described above were mainly responsible for the recovery, along with strong export growth. A detailed analysis of the GDP growth components is still awaited, according to the OeNB, the provisional indicators suggest the first causes of the impetus for the GDP developments.

For example, industrial output grew in September for the third time in a row (+0.3 %) and the advance and capital goods production recovered considerably in the last few months. While production and confidence indicators improved, the economic crisis had a delayed impact on the labour market. In December 2009 the seasonally adjusted unemployment rate in Austria totalled 5.4 %, a rise of 1.2 percentage points compared to the previous year. Overall, Austria is second in the European Union despite this slight increase in unemployment. Only Holland has a lower unemployment rate than Austria, at 4.0 %. By contrast, the EU27 reports unemployment of 9.6 %, the highest level since January 2000. According to estimates by Eurostat, there were around 23 million unemployed people in the EU27 in December 2009, with all EU states reporting a rise in their unemployment rates over the year. A calming in the labour market and a related fall in unemployment is not expected for 2010.

The European trade deficit fell in 2009. Thus, imports in December 2009 increased by 1.1 % compared to the previous month, while exports increased significantly more strongly at 5.5 % despite the appreciation of the Euro against the Dollar. Together with falling income flows, the improvement in the balance of trade led to a reduction in seasonally adjusted trade deficit to Euro 6.7 billion.

For 2009, Eurostat calculated an average annual inflation of 1.0 % compared to 3.7 % for 2008. A moderate rise in consumer prices is also expected for the coming years 2010 and 2011, according to Eurostat. The range of expectations for 2010 is between 0.8 % and 1.7 % and between 0.7 % and 2.0 % for 2011.

Sources:
OeNB, Konjunktur Aktuell, December 2009
EUROSTAT, European Economic Indicators 2009
OECD, World Economic Outlook No. 86
IMF, World Economic Outlook, October 2009
IMF, World Economic Outlook Update, January 2010

In order to counter the continuing tense economic situation, in 2009 the ECB reduced the key rate a total of four times to a historic low of 1.0 %. Important aims of these monetary policies measures are the revitalisation and stabilisation of the credit and financial markets.

Interbank rates, which had increased greatly in the EU and in the USA after the insolvency of the American investment bank Lehman Brothers, narrowed last year and fluctuated at a low level. Whether this stabilisation will be effective on the interbank markets and the related improved trust between banks, will only be seen over time.

CYCLE OF RISING INTEREST RATES

None

CYCLE OF FALLING INTEREST RATES

05.03.2009: 1.50 percent (-0.50 percentage points)
02.04.2009: 1.25 percent (-0.25 percentage points)
07.05.2009: 1.00 percent (-0.25 percentage points)

Balance Sheet

The balance sheet total of Capital Bank fell in the previous financial year by around 10.6 % from EUR 731 million to EUR 653 million. This can mainly be explained by the fall in receivables (liabilities) due from (to) customers and by the reduced issue activity by the bank. The receivables (liabilities) due from (to) customers fell by 15.6 % (8.97 %) compared to the previous year from EUR 143.5 million (EUR 236.6 million) in 2008 to EUR 121.1 million (EUR 215.3 million) in 2009. The volume of own issues, which exclusively comprises performance linked notes, fell due to the market by 22.5 % from 263.4 million in 2008 to 204 million in 2009.

The eligible equity[1] capital according to Section 23 BWG (Austrian Banking Act) increased by 2.4 % from EUR 122.92 million in 2008 to EUR 125.9 million in 2009. The required equity capital according to Section 22 para 1 BWG fell as a result of the adjustment in Investment Banking to the general economic conditions by around 18.9 % from EUR 47.9

1) ROE = Profit on ordinary activities in relation to equity capital, without balance sheet profit and allocation to reserves
2) ROA = Profit on ordinary activities in relation to the average balance sheet total.
3) ROCE = Profit on ordinary activities in relation to the required equity capital.

million in 2008 to EUR 38.9 million in 2009. Consequently, the equity capital surplus totals around EUR 87 million and increased in the reporting period by 16.0 % compared to the previous year. Capital resources as a percentage of the basis for assessment remained at an above-average level of 31.0 % (2008: 24.6 %). Capital resources as a percentage of the required equity capital according to Section 21 para. 1 BWG increased from 256.4 % in 2008 to an above-average high of 323.7 % in 2009. The reported equity capital does not include any supplementary capital, participation capital or other lower-ranking capital components.

The return on equity (ROE: 2008: 0.2 %, 2009: 4.7 %) was increased by 4.5 percentage points compared to the previous year. The return on assets was also improved: this increased from 0.02 % in 2008 to 0.79 % in 2009. The return on capital employed was also improved considerably by 13.6 percentage points from 0.4 % in the financial year 2008 to 14.0 % in 2009 because of the significantly higher profit on ordinary activities.

As the focus of Capital Bank lies on commission business, the development of the balance sheet total and the comparison with the traditional retail banks is less important for Capital Bank. The long-term aim of Capital Bank is to earn risk-adequate returns in the owner's interest and thus to increase further the profitability of the company in future.

Volume of Securities Accounts

The bank's volume of securities accounts as at 31.12.2009 totals EUR 4.7 billion and was increased as a result of important strategic measures in combination with the improving general economic conditions by 19.9 % compared to 2008. Our subsidiary, Security KAG, was able to increase its volume of securities accounts from EUR 1.2 billion in 2008 to EUR 1.5 billion in 2009. This corresponds to an increase of 19.2 % compared to the previous year. The subgroup of Capital Bank – GRAWE Gruppe AG was therefore able to increase the total assets under management, including own issues, from EUR 5.6 billion in 2008 to EUR 6.5 billion in 2009 (+15.8 %).

[4] Cost Income Ratio = Operating expenses in relation to operating income

Profit and Loss Account

Both Private Banking and Investment Banking divisions of Capital Bank continued to battle the financial crisis in 2009. Nonetheless, the profit from ordinary activities of EUR 175 k in 2008 was increased greatly to EUR 5.5 million. Capital Bank's net interest income fell in 2009 by around 39.4 % from EUR 9.4 million in 2008 to EUR 5.7 million, but the significantly higher financial result more than compensated for this. The lower interest income can be explained primarily by the continuing low interest rates.

Operating income recorded a slight absolute fall of EUR 1.1 million compared to the financial year 2008. Operating expenses increased marginally from EUR 21.5 million in 2008 to EUR 22.9 million in 2009 (+6.7 %). Personnel costs of EUR 11 million were held roughly at the same level as the previous year of EUR 11.1 million. Material costs, by contrast, increased by around 15.6 % from EUR 9.4 million in 2008 to EUR 10.9 million in 2009. The reasons are higher IT costs and higher costs for the seamless settlement of transactions on the fund platform. In 2009, Capital Bank reported an operating profit of EUR 9.3 million. This corresponds to a decrease of around 21.4 % compared to the operating profit of EUR 11.8 million in 2008. The Cost Income Ratio[4] increased compared to the previous year from 64.6 % to 71.2 %. This is due to the reduced operating income and the higher operating expenses.

The precautionary principle has been applied insofar as only the profits realised as at the reporting date are reported, all identifiable risks and anticipated losses have been taken into account.

No particular or noteworthy events have occurred since the reporting date.

Proposed Dividend

In the financial year 2009, results from ordinary activities of EUR 5.5 million were achieved. After a successful motion at the General Meeting, Capital Bank shall pay out a dividend estimated to be EUR 4 million to its owner, Hypo Bank Burgenland AG.

Outlook

2010 will again bring many uncertainties for the global financial markets. Following the nadir of the global economic and financial crisis in March 2009, the unexpectedly positive stock markets, driven by high liquidity on the stock markets and by the state economic recovery programmes, is resulting in regular inflationary tendencies on the stock markets. For the ATX, this means a constant increase, interrupted only by slight falls, in the ATX to more than 2,600 points, after a low of around 1,400 points. Directly after the New Year, the bull market continued on due to the sustained positive economic climate, but by the end of January 2010 prices had fallen heavily again, caused by the new focus on structural problems such as Greece's high levels of debt. The further development of the markets and economy will depend, in particular, on the form in which the enormous amounts of money pumped by the central banks into the financial markets and which will also increase consumer prices. It is expected that in the medium term the central banks will raise interest rates considerably in order to dampen a resulting inflation.

For the divisions of Capital Bank, we see considerable market opportunities here as, in this scenario, there will be increased demand for quality investment advice and intensified diversification, such as for investments in raw materials and properties, which the bank can now offer more intensely.

The Private Banking division will be characterised in 2010 by the full integration of the new advice and fees model and, in particular, by the profits from new customers and new volumes. The structures developed to support our quality requirements oblige Capital Bank to grow. The Private Banking market in Austria, which is undergoing massive change, offers excellent opportunities. A subject that Capital Bank will also tackle intensively are the current developments that have the aim of promoting tax honesty in conjunction with investments outside Austria.

The Investment Banking division will be positioned defensively in 2010.

The financial year 2010 will be a milestone for the bank in terms of organisation. The final stage of the integration of the banks into the banking group of Grazer Wechselseitige Versicherung will start in the second quarter. The staff and service departments of Bank Burgenland, Capital Bank and Brüll Kallmus Bank will be merged uniformly into so-called corporate departments under a standardised management. As a result of this, we expect an optimised control of the banking group, the full exploitation of costs and business synergies and a further raising of the quality of our services.

Introduction

Risk management in Capital Bank – GRAWE Gruppe AG is seen as a work-sharing process of identification, measurement, monitoring and control of defined risks at Group level. An appropriate risk management is seen as a significant factor for the success of the effectively required development of the company.

In 2009, the expansion of Group Risk Management, in particular, and the associated complete bank control represented substantial tasks of the risk management. The aim was not to implement any large methodical changes in the calculations, but to refine and expand the scenarios already applied, and to define standardised evaluation and reporting methods in the HYPO Bank Burgenland AG Group. In addition, there were other significant challenges for risk management in 2009 as a result of the introduction of refined risk management activities in the Private Banking division of Capital Bank – GRAWE Gruppe AG the implementation, started in 2008, of the subsidiary Brüll Kallmus Bank AG as an investment bank.

Risk Management

The objective of risk management is to identify, quantify and actively steer all the risks of the banking business (credit, market, interest and liquidity risks and operational risks). According to the conditions of Section 30 para. 7 BWG, Hypo Bank Burgenland Aktiengesellschaft as the parent bank is required to comply with the ICAAP conditions at the consolidated level. The consolidation group of Hypo Bank Burgenland Aktiengesellschaft includes the Capital Bank – GRAWE Gruppe AG, Bank Burgenland Leasing and Sopron Bank as downstream bank in other EU countries.

Capital Bank – GRAWE Gruppe AG is a bank which specialises in Private Banking and Investment Banking, but which also offers services related to these areas. In addition, Capital Bank – GRAWE Gruppe AG offers a clearing platform for independent financial service providers. The aim is to maximise income for the given risk load. This is underlined by the principle that a return should be achieved for every transaction which is appropriate to the risk content. The optimisation of a balanced ratio between risk and income is the focus of Capital Bank – GRAWE Gruppe AG. The aim is identify the risks resulting from banking operations and to manage and restrict them actively through effective risk steering. The focus of these risk steering activities is on the most efficient use of the available capital as possible, taking into account medium and long-term strategic goals and growth prospects.

The further development of the instruments and processes of risk identification, quantification and steering in order to guarantee an adequate risk-opportunities ratio are considered to be effective strategic components. The assumption of risk to achieve results therefore represents a core function of the corporate activity of Capital Bank – GRAWE Gruppe AG.

The risk strategy in the HYPO Bank Burgenland AG Group, therefore, is to enter into usual banking risks within a defined framework and to use the resulting income potential. In this sense, a risk management has been established in the HYPO Bank Burgenland AG Group, which forms the basis of a risk and income-oriented overall bank steering and this supports selective growth. Risk management represents a central unity in Capital Bank – GRAWE Gruppe AG which takes into account the type, extent and complexity of the transactions specific to the Bank and the resulting risks for the Bank, in addition to the general regulatory conditions based on the Austrian Banking Act (BWG) and various directives and guidelines. The risk management of Capital Bank – GRAWE Gruppe AG is integrated into the risk management cycle of Hypo Bank Burgenland AG.

Capital Bank – GRAWE Gruppe AG interprets 'risk management' as the working processes of identification, measurement, monitoring and steering various risks. The individual phases of the risk management process include:

– Risk identification – This includes recording, measuring and analysing all risks relevant to the Bank.

– Risk steering – Risk steering is the entirety of all risks entered into consciously within the approved limits and the selective use of measures to deal with risks. The decision-making takes place in corresponding committees / departments irrespective of the market.

– Risk documentation – This includes written documentation of the internal risk management in the form of a risk manual.

– Risk communication – The risk situation is worked out in risk reporting in a form suitable for and understandable to the respective recipients, transparently and comprehensively, and is provided at regular intervals.

– Risk monitoring – Risk monitoring takes place through an internal control system which guarantees compliance with the limits and guidelines defined in the risk manual.

Principles of Risk Management

The risks to Capital Bank – GRAWE Gruppe AG are controlled and steered through a system of risk principles, risk measuring processes, limit structures and monitoring processes.

A significant principle within the framework of the risk management process is the risk policy. Risk policy is part of corporate strategy and defines the willingness and orientation for risk of the Bank and the marginal conditions within which the operative risk policy goals have to be implemented. The risk policy in Capital Bank – GRAWE Gruppe AG is determined by the Board of Directors, subject to the Group development. It includes the planned development of the entire business in several dimensions, setting limits for relevant risks and the restriction of lump-sum risks in the form of large investment limits.

Another component of the principles of risk management is represented by the risk-policy principles. At Capital Bank – GRAWE Gruppe AG, the following risk-policy principles are defined in accordance with the Group guidelines:

– The management and all employees are subject to the risk-policy principles and also make their decisions in accordance with these guidelines.

– In order to maintain a desired risk/return ratio, the individual business divisions are limited by risk and/or volume requirements taking into account the risk-capacity of the company.

– The methods of risk evaluation and measurement are arranged and implemented according to the respective extent, complexity and risk content of the transactions. In principle, not only risks of retail business are recorded, but also those which result from an overall Bank consideration. The flexibility in the method selection should facilitate sensible developments.

– In order to guarantee a consistent and coherent risk management process, uniform methods of risk assessment and limitation are used.

– Within the framework of risk steering, a suitable limit system has to be applied and constantly monitored. Limit systems have to be derived and defined from the overall Bank limits for the various sub-risks and also for the various subsidiaries. The defined risk limits are based on the risk coverage potential. The risk coverage potential is not used up for the measured risks, and a reserve is kept for extraordinary scenarios and unmeasured risks.

– Risk steering and controlling processes correspond to the current statutory requirements and are adjusted to the changing conditions. In addition, the risk steering factors are recorded in a system for total Bank steering.

– For the main risk types which threaten the existence, if applicable, a risk management is striven for at a level which corresponds to comparable institutions in terms of structure and size ("best practice").

– Risk management is performed at Group level. Additionally, each employee is required to identify risk potential and to take corresponding measures. The organisation of the risk management is subject to the principle of separation of functions between trading and backoffice and has to guarantee that conflicts of interest are avoided at all decision-making levels.

– For the current risk steering, the Board of Directors and the decision-making committee, both at Group and individual bank levels, have to report regularly on the risk situation of the Bank. The respective organisational units are responsible for risk documentation and reporting.

New Products, New Markets

Capital Bank – GRAWE Gruppe AG is committed in principle to those business fields where the company has long been active and where there is a corresponding monitoring or the possibility to assess specific risks.

The development of new business fields or new products requires an adequate analysis of the business-specific risks. A product authorisation process has been defined for this point in Capital Bank – GRAWE Gruppe AG. This product authorisation process defines the process-organisation regulations which determine the procedures for issues or investments in new products or the inclusion or entrance into new markets. Within the framework of the product authorisation process, certain information must be provided by the applicant of the new product, which is then examined by Internal Audit, the Legal Department and the compliance officer.

If it is necessary to involve other departments in the product authorisation process, these are informed by the Risk Management Department of the product authorisation process and are asked for an opinion. The main prerequisite for a positive opinion from risk management is the reproducibility of the products in the risk systems. A final report is only prepared after all opinions have been received, and is sent to the Board of Directors which then decides to accept or reject the product.

Organisation and Documentation of the Risk Management

The basis for the risk management of Capital Bank – GRAWE Gruppe AG is the strict separation between trading and backoffice. The risk management functions are merged in the member of the Board of Directors responsible for risk management. The activities of the risk management units are performed in accordance with the guidelines on risk policy which define the risk steering and the qualified and timely monitoring of risks in conjunction with the various company divisions and the independent risk function. In accordance with the principle of proportionality, the organisation of the risk management corresponds in terms of quality and quantity to the company‘s internal requirements, the business activities, the strategy and the risk situation. The responsibility for risk steering in Capital Bank – GRAWE Gruppe AG is distributed across several units. The market risk organisational unit is responsible for the Group-wide risk steering of all risks relating to market risk and for risk monitoring in the Private Banking business of Capital Bank – GRAWE Gruppe AG.

Risk Controlling is responsible for the risk management activities connected with the strategic credit risk and the operational risks, as well as the overall bank steering. The operating credit risk management is performed in the Credit Management department. Risk management at Group level is performed by the parent bank Hypo Bank Burgenland AG. The risk management of Capital Bank – GRAWE Gruppe AG and its subsidiaries continues to be performed by the Capital Bank – GRAWE Gruppe AG Risk Management. Within the framework of the implementation of the Group Risk Management, there is close cooperation between the Bank Burgenland AG risk management and Capital Bank – GRAWE Gruppe AG.

The Risk Management units are supported in their tasks by the following committees:

– Overall Banking Risk Committee
Risk steering in the HYPO Burgenland AG Group takes place in the overall banking risk committee under the leadership of the Board of Directors and with the involvement of the boards of the subsidiaries and with representatives from the risk management units, the treasury and internal audit. The Overall Banking Risk Committee deals with risk policy, strategic and structural matters of principle and risk at the superordinate level, the company-wide risk policy and strategic tasks of overall bank steering. The monitoring and steering of the risk capacity and the setting of risk limits also take place the overall bank level in the Overall Banking Risk Committee.

– Risk Management Committee (RIMCO)
The RIMCO represents an occasional committee in the Capital Bank Group, where specific risk topics of Capital Bank – GRAWE Gruppe AG and its subsidiaries are reported. Decisions in the RIMCO are always made in consideration of the overall banking risk situation and the decisions of the overall banking risk committee. It should be noted that the RIMCO is responsible for the overall Capital Bank Group – i.e. Capital Bank – GRAWE Gruppe AG, Brüll Kallmus Bank AG and Security KAG.

– Investment Committee (IC)
In the Capital Bank Group, the IC assumes the position of an investment committee whose main task is to make decisions on the bank's own investments in securities, which extend beyond the activities of the Treasury and which are not regulated by the limit system.

In order to ensure a coordinated and comprehensive risk steering

- an overall bank risk strategy is defined,
- an overall bank risk manual and instructions are used as the basis for documentation, and
- risk limits are set.

The overall bank risk strategy defines, on one hand, the general principles of risk management (principles, risk steering process, organisation, etc.) and on the other hand the risk strategies for each risk category. The objective of the Risk Manual is to take into account the statutory and commercial requirements of risk management. It supports the risk management in systematically dealing with risks and allows the employees and management to systematically deal with the various components of risk management. The objective of instructions, like the Risk Manual, is to bring specific risk topics and their control closer to the employees. In contrast to the Risk Manual, they have a high degree of detail and are mostly restricted to specific, individual subjects. The risk limits are defined at least once a year on the basis of the risk capacity calculation. Compliance with the risk limits is constantly monitored and regularly reported to the management. When the early warning stage is reached or a limit is exceeded, measures to restrict the risk are taken in cooperation with the Board of Directors and the respective departmental director corresponding to the respective risk.

The central instrument of the overall banking risk steering of the Capital Bank Group is the risk capacity calculation. The risk figures from the various risk types are aggregated here into a total loss potential from risk assumptions and are compared in a process to the collateral (earning power, reserves and equity capital) available to cover these potential losses. The aim of this comparison is to determine to what extent the bank is able to cope with potential, unanticipated losses (risk capacity calculation). According to the risk capacity calculation, the aim is to guarantee the continued existence of the bank.

The Board of Directors decides the overall risk strategy, which contains the allocation of the collateral coverage potential to the individual risk categories. This determines the amount to which risks can be entered into in the individual divisions. The calculation of the risk capacity therefore acts as a limit for all risk activities in the Group. The risk capacity is calculated quarterly for the Capital Bank Group and for the banks Capital Bank – GRAWE Gruppe AG, incl. Security KAG and for Brüll Kallmus Bank AG. In addition, the risk positions are constantly monitored in order to be able to take ad hoc risk-minimising steps if deviations occur. The calculations by the Capital Bank Group also flow into the Group risk capacity calculation of HYPO Bank Burgenland AG.

The risk capacity analysis compares the economically required capital for unexpected losses against the collateral. The difference represents the equity reserve. The risk capacity is calculated using two methods: The economic method, which focuses on the protecting the creditors, and the going-concern method, which defines the seamless continuation of the banking business as risk capacity. The difference between these two methods lies in the offsetting of the collateral and in the evaluation of the risks. The capital provided by the Group for risks is equity which comprises TIER I and TIER II capital. In addition, part of the hidden reserves and the expected profit from the current financial year are taken into account when calculating the risk collateral.

The method for calculating the risks differs depending on the risk category. The following risk categories are taken into account in the risk capacity calculation:

- Credit risk
- Risks of the large trading portfolio
- Market risks of the banking book (interest rate and foreign currency risk)
- Capital guarantees
- Operational risk
- Investment risk
- Other risks

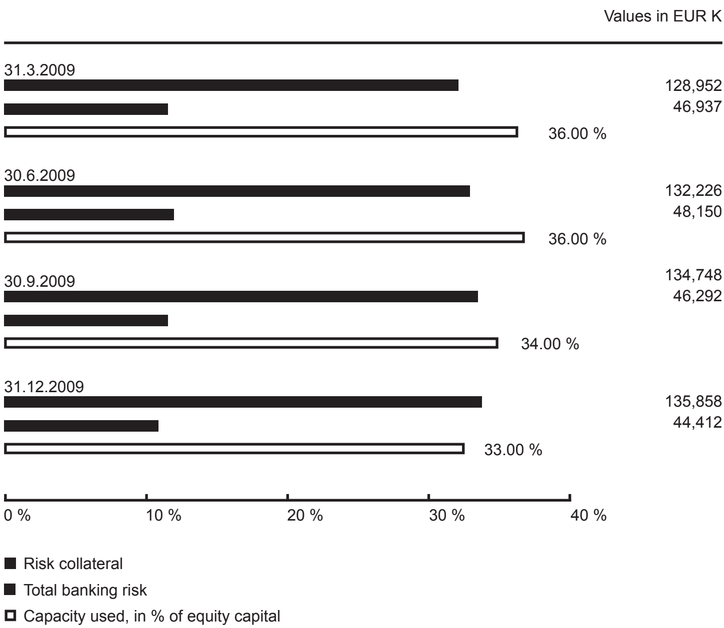
The Capital Bank Group applies the standard method to calculate the risks in the economic method in the credit and market risk of the large trading portfolio and for the banking book, as well as for the capital guarantees. The values from the standard method are adapted for a consideration of these risks in the going-concern method by correcting the values statistically to a confidence interval of 95 %. The operational risk is measured according to the basic indicator approach, in compliance with regulations, which is also applied to the economic method. For the consideration of the operational risks for the going-concern method, the average absolute loss of the last three years from the loss database is referenced with a multiplier.

In addition, a general buffer is added for other risk types which cannot be explicitly quantified. The proportions of the individual risk types in the economic capital of the Capital Bank Group as at 31.12.2009 are contained in the chart.

RISK CATEGORIES

To calculate the total risk, the individual risk types are aggregated irrespective of correlation effects. The amount of the total risk capacity used, in % of the risk collateral, in the Capital Bank Group at the end of the year was 33 % using the economic method. By comparison, using the economic method as at 31.12.2008 it was 38 %.

Risk Capacity 2009



The required reconciliation process between the quantified risk potential on one hand and the bank's risk collateral potential on the other was therefore constantly taken into account during the 2009 financial year. In order to be able to estimate the risks of extreme market developments, additional stress scenarios are applied to specific risk categories.

Risk Management of Specific Risk Types

Within the framework of the overall banking risk steering, a distinction is drawn in the Capital Bank Group between the following risk categories:

– Market risk
– Operational risk
– Credit risk
– Liquidity risk
– Other risks

Because of its specialisation in the areas of private and Investment Banking, the main risks arise, above all, in the area of market and operational risks, which are significant within the framework of the monitoring and steering process.

Market Risk

Market risks arise through possible changes to market price indicators such as interest rates, exchange rates and share prices, as well as from the change to credit spreads. These risky positions arise either through customer transactions or through the deliberate assumption of positions. Capital Bank – GRAWE Gruppe AG defines interest rate changes, foreign currency and credit spread risks as risk subtypes.

The identification, measuring, monitoring and steering of market risks in the trading and banking book are performed by the Market Risk organisational unit. Apart from the daily monitoring of the market risk and counterparty risk limits, the further development of the risk measurement system and the risk steering aspects represent the main tasks in market risk department. A central element of the market risk steering in Capital Bank – GRAWE Gruppe AG is the limit system. The overall limit and individual limits are set by the Board, taking into account the risk capacity and the Group limits. A desired degree of diversification in the portfolios, and the trading strategy, are important factors for developing the limit structure. Apart from volume and positions limits, sensitivity limits and country limits are taken into account when setting limits. In its risk strategy, the Capital Bank Group has defined the foundation for dealing with market risks. The limit provided for entering into market risks restricts the extent of the market risks entered into to a contractual and desirable extent for the Group, and leads to a risk mix which has been optimised from a risk/return perspective.

As specified in the Austrian Banking Act, Capital Bank – GRAWE Gruppe AG keeps a 'large trading portfolio'. The market risk of the Capital Bank – GRAWE Gruppe AG large trading portfolio is mainly characterised by the share price risk and the interest rate change risk. Capital Bank – GRAWE Gruppe AG applies the standard method according to Section 220 para. 2 BWG to calculate the required equity capital for the trading portfolio.

At present, a value-at-risk calculation is not performed for positions from the bank's own holdings on the basis of the business strategy and the risk positions currently held. As part of the restructuring of Capital Bank – GRAWE Gruppe AG's proprietary trading activities, the plan for 2010 is for the Capital Bank Group's own positions to be included in the value-at-risk calculations of the parent Hypo Bank Burgenland. This will be another step towards the application of standardised methods of risk assessment in the Group.

A particular focus within the framework of the market risk for Capital Bank – GRAWE Gruppe AG is represented by the guarantees issued in conjunction with the securities transactions. Capital Bank – GRAWE Gruppe AG has issued capital guarantees for some products designed and marketed by Capital Bank – GRAWE Gruppe AG itself and for products marketed by insurance companies. Under the terms of these guarantees, where the product loses value, the bank stands liable for the difference between the current market value and the amount invested by the customer. This amount therefore represents a risk for the bank. Within the framework of risk management, therefore, the management and performance of the capital guarantees are monitored and necessary steps to limit risks are arranged. One of the measures required under the risk management system involves monthly inspection of the sum guaranteed (cash value) against the market value and an examination of the plausibility of the data. The markets are kept under constant observation in risk management in order to be able to take measures at any time if risks arise.

With reference to the capital guarantees, particular importance is attached to the ‘Prämienbegünstigte Zukunftsvorsorge’ or PZV (state-aided pension provision), as Capital Bank – GRAWE Gruppe AG has furnished capital guarantees in accordance with the statutory regulations (Article 108 Paragraph 1 (3) EStG – Austrian Income Tax Act). Under the terms of this capital guarantee, the bank guarantees that the amounts paid-up plus the State subsidy will be paid out to the customer as a minimum. The PZV risk is therefore closely monitored by the risk management. Before furnishing the capital guarantee, therefore, an approval process was held, where the product operation was explained in more detail and problems arising were discussed and resolved both in-house (Risk Management, Accounting Department, Legal Department) and with third parties (KPMG, FMA). Within the framework of the capital guarantee management of Capital Bank – GRAWE Gruppe AG, there is monthly monitoring of the development of the guarantees of the performance of the underlying fund, as well as regular PZV meetings where significant changes to the PZV and the fund are discussed with Security KAG and Grazer Wechselseitige Versicherung AG.

As at the balance sheet date, the outstanding guarantees totalled roughly EUR 243 million. This is a change compared to the previous year of +19 %. These guarantees are matched against corresponding balance sheet items with intrinsic value.

Capital Bank – GRAWE Gruppe AG defines the interest rate risk as the risk of price fluctuations of interest-bearing securities that result from changes in capital market interest rates. To measure the interest rate risk, the regulatory authorities demand quarterly interest risk statistics which are calculated on the basis of balance sheet and off-balance sheet positions and the allocation of term bands corresponding to the statutory conditions and which assumes a 200 basis points interest shift.

The interest rate risk as at 31/12/2008 calculated in this way in the Capital Bank Group is 2 % of the available equity.

Interest rate risk 2009 – 200 BP shift in EUR K

	Previous year 31.12.2008	Max.	Average	Year's end
Interest rate risk	656	3,161	2,748	2,499
In % of equity capital	0.62 %	2.65 %	2.37 %	2.16 %

Interest rate risk 2008 – 200 BP shift in EUR K

	Previous year 31.12.2007	Max.	Average	Year's end
Interest rate risk	4,161	4,629	3,070	656
In % of equity capital	4.22 %	4.11 %	2.58 %	0.62 %

The table shows that the limit of 20 % of equity capital as defined by the regulatory authorities has been complied with and that there is sufficient buffer, and that the overall banking risk is less compared to the previous year. In addition, it shows that the interest rate risk of Capital Bank Group is a very small proportion of the overall banking risk.

Operational Risk

In the Capital Bank Group, the operational risk is defined analogously to the statutory banking provisions as the “Risk of unanticipated losses which arise as a result of the inappropriateness or failure of internal procedures, people and systems or of external events, including legal risk”. For example, failures in IT systems, material damage, incorrect processing, fraud, natural or other catastrophes and changes in the external environment should be subject to a more precise and, above all, consolidated risk assessment and steering in the future.

In order to identify operational risks, since 2006 Capital Bank – GRAWE Gruppe AG has used a loss case database, in which loss events are recorded in a structured form according to business process, event type and business field. The objective is to provide the risk management and the management with all relevant information related to operational risks and to facilitate a more precise quantification of the operational risk and a better steering and weaknesses analysis of defective processes.

Management is informed within the framework of the quarterly ICAAP report on the development of the operational losses. If groups of loss cases are identified, a process is started, taking into account organisational responsibilities, in order to reduce risks as they occur. In the event of serious claims, the Board of Directors is advised immediately on an ad hoc basis of the extent and the underlying cause of this loss case.

In order to minimise the operational risk, the Capital Bank Group also uses internal control systems, including Internal Audit, clear and documented internal guidelines ("Work Procedures"), the separation of functions ("four-eyes principle"), allocation and limitation of decision competences and a constant qualification assurance and enhancement for employees through training and development ("staff development"). These control and steering measures, which are integrated into the business processes, should ensure an appropriate and accepted risk level in the company.

In order to secure a Group-wide uniform procedure, all steering and monitoring measures for these risks are coordinated through the risk controlling department. The central committee for steering operational risks is the RIMCO.

Capital Bank – GRAWE Gruppe AG uses the basis indicator method for capital securitisation for the operational risk according to BASEL II. The equity capital requirement for the operational risk for Capital Bank – GRAWE Gruppe AG and its subsidiaries totalled EUR 7.239 million in the 2009 reporting year.

Credit Risk

At Capital Bank – GRAWE Gruppe AG, the credit risk is defined as default risks against third parties arising from non-securitised receivables and securitised receivables (securities). The risk lies in the fact that these receivables due to Capital Bank – GRAWE Gruppe AG may not be fulfilled in full or on time. This can result both from developments among individual contractual partners and from general developments which affect a large number of contractual partners. Credit risks can also result from specific forms of product arrangements or the business field. The responsibility for the competent management of all credit risks lies with credit management and risk controlling. The strategic credit risk management is the responsibility of the Risk Controlling department and concentrates on identifying, measuring, summarising, planning and steering, as well as monitoring, the credit risk.

The operative credit risk management supports the active bank operations through the compliant risk and credit rating audit of all applications for financing and their accuracy, the evaluation of the compliance with the assessment guidelines and the identification of early warning indicators. The total credit exposure (customer receivables incl. securities) and the distribution of the risk categories and countries is reported to the Board of Directors regularly. In addition, stress scenarios are also defined for Lombard credits in order to highlight changes in market prices in the securities provided as collateral and to represent their effect on the collateral. In addition, there is a constant comparison of other risks and the credit risk data of Capital Bank – GRAWE Gruppe AG are included in the Group credit risk consideration and analysis.

The credit volume (before individual write-downs and Section 57 reserve deduction) fell in the 2009 financial year by around 9 % compared to 2008 to EUR 143 million.

Risk management with regard to lending in the Capital Bank Group is performed according to the principles laid down in the 'Lending Guidelines' and the principles approved by the Board of Directors. These guidelines comply with the minimum lending requirements and guidelines issued by the Austrian Financial Market Authority and are adapted to changes in the business field or legal field. To steer country risks, country limits are defined both at Group and individual bank levels. To minimise counterparty risks, guidelines on counterparty approval are applied in the Capital Bank Group. The acceptance of new trading partners is therefore subject to risk management, which audits and approves the trading partner according to internal criteria.

One of the lending principles at Capital Bank Group is a clear credit and related risk policy. The keystone of this policy is that loans should be granted first and foremost in exchange for sufficient collateral. The main form of collateral used are corresponding securities whose loan-to-value ratios are differentiated according to various criteria. Apart from considering the security situation, the economic situation of the borrower is closely examined and included in the lending decision. To assign the customers to various risk categories and classes, Capital Bank Group applies a 10 or 4-step system.

Liquidity Risk

The short-term liquidity risk represents the danger that the bank will not be able to fulfil its due payment obligations on time or in full. The refinancing risk represents the danger that additional refinancing funds will only be able to be procured at higher market interest rates.

Since 2009, liquidity has been steered by Group Treasury.

According to regulatory requirements, the liquidity of a bank is secured if the weighted funds cover the callable weighted payment obligations for a period. In 2009, Capital Bank – GRAWE Gruppe AG was above the figures required by the regulatory authorities at all times. The provisions for an unforeseeable, increased liquidity requirement of a short-term liquidity procurement are guaranteed through the following options: Apart from using open refinancing lines from other banks, any additional liquidity requirement can be obtained at (relatively) short notice from the sale of securities on the books, which are not pledged. A statement of the current use of credit lines and of the sellable securities currently on the books is presented to the Board of Directors regularly. Within the framework of the treasury limits, a portfolio with free ECB-capable securities is held in the event of an unexpected liquidity outflow, which can be used to procure liquidity at short notice.

In order to restrict the liquidity risk, liquidity limits are also set for certain business divisions.

In 2009, Capital Bank – GRAWE Gruppe AG was in a situation of surplus liquidity despite the difficult market conditions resulting from the financial crisis.

Summary

In the Capital Bank Group, measures have been taken to limit and minimise all significant risks. A bank-wide summary of the measurable risks has been performed within the framework of the of the risk capacity analysis. In addition, measures have been taken to limit risks through an adequate limit system and by calculating various risk factors. The risk capacity calculation shows that the risk capacity of the Capital Bank Group is only partly used by risks and that there is sufficient buffer to the available risk collateral.

The Capital Bank Group will continue its business this year in accordance with its selected risk strategy. One of the focuses of the work of risk management will be the harmonisation of the risk methods, risk systems and risk steering with those of the parent bank HYPO Bank Burgenland AG. In addition, new challenges in risk management are arising from the business activities of Brüll Kallmus Bank AG. Risk monitoring in the Private Banking division will also be in focus in 2010. This will primarily involve devising new evaluations both for the management and for the individual Private Banking managers. The aim here is to guarantee a better representation of the risks resulting from the Private Banking business. A continuous improvement in the credit risk reporting should also be achieved. Alongside these projects, the current ICAAP process, the modification of the reporting and the constant improvement in existing risk management activities represent other tasks of the risk management for the coming year. The expansion of steering instruments, training for the employees and the continuous improvement in internal risk quantification methods also form the focus for 2010.

Graz, 10 March 2010

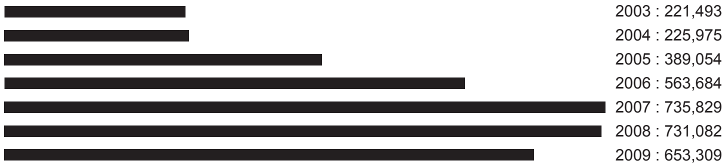
The Board of Directors

Vst.-Dir.
Christian Jauk, MBA e.h.

Vst.-Dir. Mag.
Constantin Veyder-Malberg e.h.

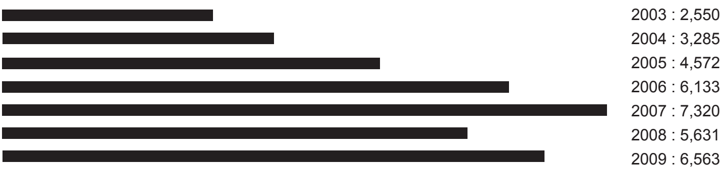
01. PROFIT FROM ORDINARY ACTIVITIES IN EUR K

02. BALANCE SHEET TOTAL IN EUR K



03. OPERATING PROFIT IN EUR K

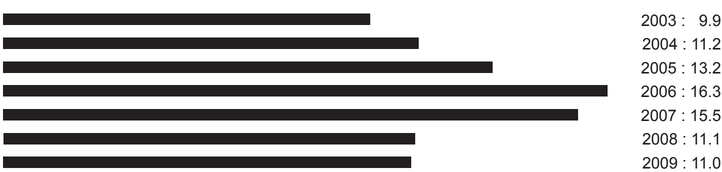
04. ASSETS UNDER MANAGEMENT (INCL. SECURITY KAG) IN EUR M



05. OPERATING INCOME IN EUR M

06. NET INTEREST REVENUE IN EUR K

07. PAYROLL COSTS IN EUR M



Report by the Supervisory Board

In four ordinary meetings of the Supervisory Board in 2009, the Supervisory Board monitored reports and documents submitted by the Board of Directors, as well as through repeated contact with the management and approved their measures.

The 2009 Annual Accounts and Management Report, insofar as it refers to the Annual Accounts, have been audited by KPMG Wirtschaftsprüfungs- und Steuerberatungs GmbH, 1090 Vienna. This audit did not give rise to any objections, and consequently an unqualified audit certificate was issued.

The Supervisory Board has acknowledged the report and the proposed profit distribution submitted by the Board of Directors and has audited and approved the Annual Accounts as at 31 December 2009, which is thereby approved according to Section 96 para. 4 Austrian Companies Act.

The Supervisory Board thanks all the customers for their confidence in Capital Bank – GRAWE Gruppe AG and the Board of Directors and all employees for their work in 2009.

Graz, March 2010

Mag. Dr. Othmar Ederer
Chairman of the Supervisory Board

08. BALANCE SHEET OF CAPITAL BANK – GRAWE GRUPPE AG AS AT 31.12.2009

ASSETS		31.12.2009 EUR	31.12.2008 EUR K
1. Cash and balances at central banks		8,351,408.73	7,084
2. Public authority debt instruments, authorised for refinancing at the central bank			
Public authority debt instruments and similar securities		5,328,620.38	4,777
3. Receivables from banks		210,628,681.98	236,260
a) Daily	128,444,246.46		114,065
b) Other receivables	82,184,435.52		122,194
4. Receivables from non-bank customers		121,105,595.03	143,447
5. Loan stock and other fixed interest securities		51,294,701.77	25,736
6. Shares and other non-fixed interest securities		99,618,248.51	119,010
7. Investments		9,318.42	9
In banks	8,575.38		9
8. Shares in affiliated companies		23,972,255.30	23,972
In banks	22,900,925.13		22,901
9. Intangible fixed assets		105,678.70	250
10. Material assets		2,435,204.45	2,603
11. Other assets		129,829,953.34	167,158
12. Accruals		629,499.07	776
TOTAL ASSETS		653,309,165.68	731,082
Positions under the balance sheet			
1. Foreign assets		289,099,150.53	312,967
2. Managed capital investment fund plan		1,458,028,060.86	1,230,383

EQUITY AND LIABILITIES		31.12.2009 EUR	31.12.2008 EUR K
1. Liabilities to banks		63,345,802.82	80,951
a) Due daily	17,260,263.71		39,813
b) With agreed term or notice period	46,085,539.11		41,138
2. Liabilities to non-bank customers		215,326,120.10	236,553
a) Savings deposits	2,519,644.42		3,214
aa) Due daily	1,896,038.67		2,705
ab) With agreed term or notice period	623,605.75		509
b) Other liabilities	212,806,475.68		233,339
ba) Due daily	202,096,030.16		183,288
bb) With agreed term or notice period	10,710,445.52		50,051
3. Securitised liabilities		203,996,271.72	263,366
Other securitised liabilities	203,996,271.72		263,366
4. Other liabilities		30,951,798.89	18,699
5. Deferrals		225,163.55	0
6. Provisions		18,720,894.93	14,391
a) Provisions for severance payments	2,718,129.87		2,227
b) Provisions for pensions	343,455.92		444
c) Tax provisions	212,751.56		213
d) Other	15,446,557.58		11,507
7. Subscribed capital		10,000,000.00	10,000
Nominal amount	10,000,000.00		10,000
8. Capital reserves		55,915,661.65	55,916
a) Tied	35,082,987.22		35,083
b) Non-tied	20,832,674.43		20,833
9. Retained profit		41,896,218.77	41,896
a) Statutory reserves	1,504,504.45		1,505
b) Other reserves	40,391,714.32		40,392
10. Liability reserves according to Section 23 para. 6 BWG		8,827,000.00	8,827
11. Net profit		4,104,233.26	484
a) Profit brought forward	484,059.50		274
b) Annual profit	3,620,173.76		210
TOTAL LIABILITIES		653,309,165.68	731,082
Positions under the balance sheet			
1. Contingent liabilities			
Liabilities from bank sureties and liability from providing security		275,464,432.10	281,740
2. Credit risks		24,257,000.00	21,060
incl. liabilities from pension transactions	0.00		
3. Liabilities from trusts		18,742,191.00	21,556
4. Eligible equity according to Section 23 para. 14 BWG		125,884,978.69	122,918
5. Required equity capital according to Section 22 para. 1 BWG		38,885,960.40	47,932
incl. required equity capital according to Section 22 para. 1 nos. 1 and 4 BWG	38,492,960.40		46,488
6. Foreign liabilities		85,789,898.26	53,194

09. PROFIT AND LOSS ACCOUNT OF CAPITAL BANK – GRAWE GRUPPE AG FOR THE 2009 FINANCIAL YEAR

		31.12.2009 EUR	31.12.2008 EUR K
1. Interest and similar income		9,868,242.06	21,097
incl. from fixed interest securities	1,109,026.01		2,292
2. Interest and similar costs		-4,158,183.47	-11,671
I. NET INTEREST INCOME		5,710,058.59	9,426
3. Income from securities and investments		2,226,603.18	6,976
a) Income from shares, other equity interests and non-fixed interest securities	555,551.95		4,963
b) Income from investments	1,051.23		2
c) Income from shareholdings in affiliated companies	1,670,000.00		2,012
4. Commission income		34,709,630.12	47,680
5. Commission costs		-19,098,543.00	-28,344
6. Revenue/expenses from financial transactions		5,683,490.59	-4,285
7. Other operating income		2,932,731.46	1,784
II. OPERATING INCOME		32,163,970.94	33,238
8. General administrative expenses		-21,872,177.59	-20,510
a) Payroll costs	-10,987,157.67		-11,092
aa) Wages and salaries	-8,220,958.50		-7,734
ab) Expenses for statutory social charges and for income-based charges and compulsory contributions	-1,794,017.65		-1,983
ac) Other social security expenses	-139,069.51		-164
ad) Expenses for retirement benefits and support	-187,703.46		-265
ae) Allocation to the pensions reserve	100,571.08		234
af) Expenses for severance payments and payments to operational company pension funds	-745,979.63		-1,180
b) Other administrative expenses (operating expenses)	-10,885,019.92		-9,418
9. Value adjustments on the assets listed under asset items 9 and 10		-890,202.42	-937
10. Other operating expenses		-141,701.01	-11
III. OPERATING COSTS		-22,904,081.02	-21,457

		31.12.2009 EUR	31.12.2008 EUR K
IV. OPERATING PROFIT		9,259,889.92	11,781
11. Value adjustments on receivables and allocation to reserves for contingent liabilities and credit risks		-5,280,072.63	-31,786
12. Revenue from the reversal of value adjustments on receivables and from reserves for contingent liabilities and credit risks		1,777,606.40	14,784
13. Value adjustments on securities evaluated as financial assets and on shareholdings in affiliated companies		-306,306.77	-469
14. Revenue from the sale of securities evaluated as financial assets and on shareholdings in affiliated companies		0.00	5,865
V. PROFIT FROM ORDINARY ACTIVITIES		5,451,116.92	175
15. Tax on income		-1,766,246.14	430
16. Other tax, if not to be entered under item 15		-64,697.02	-68
VI. ANNUAL NET PROFIT / LOSS		3,620,173.76	537
17. Development of reserves		0.00	-327
incl. allocation to liability reserve	0.00		-327
VII. ANNUAL PROFIT		3,620,173.76	210
18. Profit brought forward		484,059.50	274
VIII. NET PROFIT		4,104,233.26	484

10. EQUITY AND EQUITY REQUIREMENTS IN EUR K

	Capital Bank – GRAWE Gruppe AG		
	2009	**2008**	**2007**
Core capital (Tier 1)	116,533	116,389	88,815
Paid-up capital	10,000	10,000	10,000
Capital reserve	55,916	55,916	39,916
Retained income	41,896	41,896	30,760
Liability reserve	8,827	8,827	8,400
Consolidation according to Section 24 para. 2 BWG	0	0	0
Intangible fixed assets	-106	-250	-261
Non-core elements (Tier 2)	9,352	6,529	24,506
Reserve as specified in Section 57 para. 1 BWG	7,540	6,058	24,000
and revaluation reserve	1,812	471	506
Deductions	0	0	0
Eligible equity capital	125,885	122,918	113,321
Assessment basis (non-trading portfolio)	404,250	494,288	461,620
Core capital ratio (non-trading portfolio)	28.83 %	23.55 %	19.24 %
Aggregated capital ratio (non-trading portfolio)	31.14 %	24.87 %	24.55 %
Equity requirements (non-trading portfolio)	32,340	39,543	36,930
Equity requirements (trading portfolio)	393	1,444	2,647
Equity requirement operational risk	6,153	6,946	-
Equity surplus	86,999	74,985	73,744

11. SCHEDULE OF ASSETS OF CAPITAL BANK – GRAWE GRUPPE AG AS AT 31.12.2009

in EUR	Procurement and manufacturing costs		
	As at 01.01.2009	Additions	Disposals
Public authority bonds	1,649,042.74	586,432.34	0.00
Receivables from banks (securities)	0.00	0.00	0.00
Receivables from customers (securities)	0.00	0.00	0.00
Bonds and other fixed income securities	7,071,072.00	34,073,069.63	0.00
Shares and other non-fixed income securities	16,706,923.19	0.00	0.00
Investments	9,334.89	0.00	0.00
Shares in affiliated companies	23,972,255.30	0.00	0.00
Intangible assets	688,046.45	13,742.40	11,500.24
Material assets	7,301,705.61	612,571.59	1,491,162.65
Low-value assets	0.00	39,760.47	39,760.47
TOTAL ASSETS	57,398,380.18	35,325,576.43	1,542,423.36

	Depreciation	Book value	Book value	Depreciation
As at 31.12.2009	cumulative	31.12.2009	31.12.2008	2009
2,235,475.08	54,450.00	2,181,025.08	1,607,217.74	12,625.00
0.00	0.00	0.00	0.00	0.00
0.00	0.00	0.00	0.00	0.00
41,144,141.63	161,734.67	40,982,406.96	7,068,784.00	159,446.67
16,706,923.19	1,783,521.41	14,923,401.78	15,041,536.39	118,134.61
9,334.89	16.47	9,318.42	9,318.42	0.00
23,972,255.30	0.00	23,972,255.30	23,972,255.30	0.00
690,288.61	584,609.91	105,678.70	249,626.11	157,689.81
6,423,114.55	3,987,910.10	2,435,204.45	2,603,216.85	692,752.14
0.00	0.00	0.00	0.00	39,760.47
91,181,533.25	6,572,242.56	84,609,290.69	50,551,954.81	1,180,408.70

Extract from the Notes on Capital Bank – GRAWE Gruppe AG Annual Accounts as at 31.12.2009

A. GENERAL INFORMATION

Capital Bank – GRAWE Gruppe Aktiengesellschaft (hereinafter referred to as „Capital Bank“) is the partner for all participators in the capital market: from the private, monthly saver through the medium-sized company to the institutional investor. The offer includes both asset investment and capital procurement.

Capital Bank is a subsidiary of Bank Burgenland, which acts as the superordinate bank. The main subsidiaries of Capital Bank are the holdings in Brüll Kallmus Bank AG, which was formed from Capital Bank International AG, and Security Kapitalanlage Aktiengesellschaft.

The parent company, which prepares the consolidated Annual Accounts for the largest group of companies, is Grazer Wechselseitige Versicherung AG, Graz. The consolidated Annual Accounts are published at the parent company's place of domicile. The parent company, which prepares the consolidated Annual Accounts for the banking group of companies, is HYPO-BANK BURGENLAND Aktiengesellschaft, Eisenstadt. The consolidated Annual Accounts of HYPO-BANK BURGENLAND Aktiengesellschaft are lodged with the Eisenstadt Provincial Court.

The comparison figures stated come from the 2008 Annual Accounts and are in brackets. The Annual Accounts of Capital Bank has been prepared in accordance with the provisions of the Austrian Banking Act in the current version and also – insofar as is applicable – the provisions of company law. The balance sheet and profit and loss account are laid out corresponding to the forms contained in Annex 2 to Section 43 BWG.

B. Accounting principles

The Annual Accounts of Capital Bank and its subsidiaries have been prepared according to the principles of proper accounting in compliance with the general standard in order to provide as true an image of the asset, financial and income situation as possible. The principle of completeness was observed when preparing the Annual Accounts. The principle of individual valuation is applied to the assets and debts. All identifiable risks and anticipated losses, which occurred in the 2009 financial year or earlier, have been taken into account. The valuation method previous applied has been adhered to.

The precautionary principle has been duly observed through displaying only the profits realised on the balance sheet date and taking into account all recognisable risks and anticipated losses.

For foreign currency receivables and liabilities, the ECB's reference exchange rates (average exchange rates) published on 31 December 2009 are applied.

Securities are assessed at procurement costs or lower market value or, for fixed interest securities, at the lower redemption sum (strict lower-of-cost-or-market principle), irrespective of whether they are classified as fixed assets or current assets. The securities of the trading portfolio are assessed at market values. The criterion for belonging to fixed assets is the sustained attainment of income or the existence of restrictions of disposal. Short stocks of securities are reported under Other liabilities.

Receivables from banks and non-bank customers have generally been assessed at nominal values. All risks identifiable in the credit business are taken into account through the application of appropriate individual write-downs. In addition, customer receivables are hedged with derivatives and thus form a valuation unit with them. Counter transactions have been concluded by the Bank with partner banks for these hedging transactions, which together form a valuation unit.

Investments and shareholdings in affiliated companies are assessed at procurement costs or, where there was sustained value reduction, at the reduced value as at the balance sheet date.

Extract from the Notes on Capital Bank – GRAWE Gruppe AG Annual Accounts as at 31.12.2009

Buildings and equipment are assessed at procurement costs, less the scheduled depreciation. The scheduled depreciation was applied on a straight-line basis. Low-value items were fully written off in the year of purchase.

The depreciation rates were 2.5 % to 10 % p. a. for immovables and 10 % to 33.3 % p.a. for movables. The full annual depreciation was offset against the receipts in the first half of the financial year, whilst half the annual depreciation was offset against the receipts in the second half of the financial year.

Intangible assets of the fixed assets exclusively include purchased software. Straight-line depreciation is applied with rates of 25 % and 33.3 % p.a.

Securitised liabilities contain items for which the redemption sum is dependent on the market value of set basic investments and which are consequently assessed at the current market value of these items. These securitised liabilities constitute a valuation unit with the assets entered under various items. The securitised liabilities are furnished in part with a capital guarantee.

The remaining liabilities have been reported at the repayment amount.

When assessing the provisions, all identifiable risks and anticipated losses, as well as the amount of the liabilities not yet determined, have been taken into account corresponding to the statutory requirements.

Provisions for severance payments are calculated according to recognised actuarial principles (in the previous year according to financial principles based on an interest rate of 4 %) using AVÖ 2008 – Pagler-Pagler P-Basis for calculating pension insurance. Claims are valued according to the Projected Unit Credit Method. Moreover, for the calculations a pension age of 65 has been assumed for men and 60 for women. A long-term capital market interest rate of 5.5 % (previous year: 4.5 %) has been assumed.

Extract from the Notes on Capital Bank – GRAWE Gruppe AG Annual Accounts as at 31.12.2009

Provisions for pensions are also calculated according to recognised actuarial principles using the AVÖ 2008 – Pagler- Pagler P-calculation basis for pension insurance. Claims are valued according to the Projected Unit Credit Method. The group of beneficiaries exclusively includes pension recipients. A long-term capital market interest rate of 5.5 % (previous year: 4.5 %) has been assumed.

The option in Section 57 para. 1 BWG has been exercised in the 2009 Annual Accounts, as in the previous year.

C. Notes on the Annual Accounts

Fixed Assets

The break down of the fixed assets and their development are shown in the Schedule of Assets (cf. Annex 1 to the Notes). As in the previous year, the Bank did not have any developed or undeveloped properties as at the reporting date.

Securities

The total level of the securities portfolio (incl. prorata interest) as at the end of the year totalled EUR 281.5 million (EUR 308.8 m). Of this, a volume of EUR 202.0 million acts as the basic investment for securitised liabilities and total return swaps, with which valuation units have been formed. Of the bonds and other fixed income securities, nominals of EUR 26.8 million (EUR 10.5 million) become due on the reporting date in the following year.

The difference between the procurement costs and the higher market value on the reporting date of securities authorised for trade on the stock exchange, which are not financial assets, totals EUR 1.3 m (EUR 0.3 m).

The bank's fixed assets as at 31 December 2009 includes securities with a book value of EUR 58.1 million (EUR 23.7 million). The difference between procurement costs and higher market value totals EUR 2.7 million (EUR 0.6 million).

Securities of the fixed assets include the following positions:

– A2 public authority bonds EUR 2.2 million (EUR 1.6 million);
– A5 bonds and other fixed income securities EUR 41.0 million (EUR 7.1 million)
– A6 shares and other non-fixed income securities EUR 15.0 million (EUR 15.0 million).

We also refer to the enclosed Schedule of Assets, Annex 1.

The company maintains a trading book according to Section 22n BWG. Positions of the trading book are valued at market prices. As at 31 December 2009, this totalled EUR 4.1 million (EUR 27.1 million).

The securities devoted to the trading stock are listed in the following positions:

– in A4 receivables due to non-banking customer EUR 1.6 million (EUR 1.3 million);
– in A5 bonds and other fixed income securities EUR 2.5 million (EUR 6.7 million)
– in A6 share and other non-fixed income securities only in the previous year EUR 19.1 million.

The securities authorised for trading comprise the following:

In EUR K	Listed	Not listed	in fixed assets	in current assets
2008				
Bonds and other fixed		3,242		
income securities	30,514		8,676	17,097
Shares and other non-fixed		100,095		
income securities	18,915		15,042	84,821
2009				
Bonds and other fixed		1,942		
income securities	56,623		43,163	11,330
Shares and other non-fixed		87,149		
income securities	12,469		14,923	64,542

Bonds include lower-ranking assets totalling EUR 7.4 million (previous year: EUR 7.1 million).

Extract from the Notes on Capital Bank – GRAWE Gruppe AG Annual Accounts as at 31.12.2009

Investments

Investments and shareholdings in affiliated companies are not authorised for stock exchange trading.

As at 31 December 2008, the bank held at least a 20 % stake in the following companies[1)]

Holding	Company, cap. in EUR K	Own share	direct / indirect	Equity capital k in EUR K[2)]	Annual results in EUR K[3)]	Accounts
Brüll Kallmus Bank AG	6,000	**100 %**	**d**	**13,194**	**770**	**2009**
Security KAG	4,362	**100 %**	**d**	**17,499**	**1,031**	**2009**
Corporate Finance – Grawe Gruppe GmbH	1,000	**100 %**	**i**	**10,887**	**-12**	**2008**
CENTEC.AT Softwareentwicklungs und Dienstleistungs GmbH	35	**67 %**	**i**	**50**	**-11**	**2008**
CB Family Office Service GmbH	35	**100 %**	**i**	**108**	**73**	**2008**

V=Full consolidation; N = Not included according to Section 249 para. 2 or Section 263 UGB (Austrian Business Code) in conjunction with Section 59 para. 6 BWG;
d=direct, i=indirect stake;
1) Section 241 para. 2 UGB applied;
2) The equity capital is calculated according to Section 229 UGB and includes the taxed reserves; incl. balance sheet profit.
3) The annual profit / loss has been applied before transactions involving reserves according to Section 231 para. 2 no. 22 UGB.

Receivables due from banks and non-bank customers

Receivables due from banks include EUR 0.4 million (EUR 0.6 million) securitised receivables not authorised for stock exchange trading.
Receivables from non-bank customers include EUR 1.6 million (EUR 2.7 million) securitised receivables not authorised for stock exchange trading.

Representation of the maturities

Receivables / liabilities not due daily Total banks and non-bank customers (in EUR K)	Receivables		Liabilities	
	31.12.2008	31.12.2009	31.12.2008	31.12.2009
Up to 3 months	114,128	80,592	39,948	15,249
Between 3 months and 1 year	89,761	34,392	59,885	37,708
Between 1 and 5 years	44,038	46,106	491	429
More than 5 years	20,945	8,343	2,238	1,844
Total	268,872	169,434	102,652	55,229

There is sales tax affiliation between CORPORATE FINANCE – GRAWE GRUPPE GmbH and CENTEC.AT SOFTWAREENTWICKLUNGS UND DIENSTLEISTUNGS GmbH.

Capital Bank is part of a group of companies according to Section 9 KStG, Group leader is Bank Burgenland.

Publication according to Section 26 BWG is through the superordinate bank HYPO-BANK BURGENLAND AG.

Receivables and liabilities among affiliated companies and companies linked by virtue of participating interests

In EUR K	31.12.2009	31.12.2008
Receivables from banks		
Incl. from affiliated companies	207,110	219,139
Incl. from companies linked by virtue of participating interests	8	8
Receivables from customers		
Incl. from affiliated companies	1,082	13,168
Liabilities to banks		
Incl. to affiliated companies	55,695	61,501
Incl. to companies linked by virtue of participating interests	32	794
Liabilities to customers		
Incl. to affiliated companies	11,669	22,521

As at 31 December 2009, there were insignificant guilt-edged savings deposits.

Other assets

Positions above EUR 1 million (all figures in EUR K):

In EUR K	Residual term	31.12.2009	31.12.2008
Other shares in companies		122,253	155,503
Write-down according to s. 57 BWG		-4,435	-6,058
BW Other shares in companies	> 1 year	117,818	149,445
Tax Office clearing account	< 1 year	1,652	1,625
Deferred interest, securities	> 1 year	1,085	412
Receivables due from affiliated companies	< 1 year	1,612	1,996
Life insurance policies underwritten		0	5,423
Clearing balances on settlement accounts	< 1 year	5,243	5,622
Various outgoing invoices	< 1 year	1,520	1,470

Other liabilities

This item contains Tax Office liabilities of EUR 2,163 K (previous year: EUR 2,058 K) and liabilities from securities clearing of EUR 1,692 K (previous year: EUR 1,692 K), as well as liabilities from investment services for Total Return Swaps of EUR 20,141 EUR K (previous year: zero). Expenditure only recorded against results after the reporting date mainly refer to personnel costs of EUR 43 K (previous year: EUR 1,074 K) and various material costs. The other liabilities include liabilities of 20,141 EUR K with a residual term of 1 – 5 years. The remaining liabilities are due within one year. The other liabilities include liabilities due to affiliated companies of EUR 1,242 K.

Securitised liabilities

Securitised liabilities of EUR 8.1 million (previous year: EUR 17.2 million) will become due in the next financial year.

Other provisions

The other provisions mainly include provisions for loss cases totalling EUR 5,321 K (EUR 3,449 K), for holidays not taken totalling EUR 408 K (EUR 435 K), for other personnel costs totalling EUR 3,869 K (EUR 2,732 K), and for commission payments totalling EUR 1,591 K (EUR 1,704 K).

Share capital

The company's share capital remains at € 10.0 million and is divided into 1,376,030 ordinary shares. Of these, 729,030 are bearer shares and 647,000 are registered shares with restricted transferability.

D. Notes on the Profit and Loss Account

A breakdown of revenue by geographic market according to Section 64 (1) Z9 BWG is omitted, as the geographic markets, considered from the perspective of the organisation, do not differ significantly.

Income from securities and investments includes payouts from affiliated companies of EUR 1,670 K (previous year: EUR 2,012 K).

Income / costs from financial transactions includes profits on sales of securities of EUR 9,403 K (previous year: EUR 43,089 K) which are offset by losses from this area of EUR 4,411 K (previous year: EUR 48,312 K).

Other operating income mainly includes income from the Service Level Agreements of EUR 2,814 K (previous year: EUR 310 K).

The expenditure for severance payments includes costs to employees‘ provident funds of EUR 63 K.

The deferred tax which was possible to capitalise according to Section 198 para. 10 UGB (Austrian Business Code) as at the reporting date totals EUR 2.8 million (previous year: EUR 2.0 million). The capitalisation option has not been applied.

The write-downs on receivables and allocations to reserves for contingent liabilities and credit risks were adjusted within the framework of the conditions of Section 57 para. 2 BWG.

OBLIGATIONS FROM THE USE OF MATERIAL ASSETS (WITHOUT INDEXING) NOT REPORTED IN THE BALANCE SHEET:

	EUR K	EUR K
Obligations 2010 (2009)	880	(940)
Obligations 2010-2014 (2009-2013)	4,890	(5,160)

The appreciations to securities, omitted for tax reasons, total EUR 1,169 K (previous year: 343 K). This may result in tax charges in subsequent years of up to EUR 292 K.

The tax result according to Section 237 No. 6 lit. b UGB relates in full to the current financial year.

The information regarding the expenditure incurred for the financial year for auditors has been omitted, as this is carried by Bank Burgenland at Group level.

Extract from the Notes on Capital Bank – GRAWE Gruppe AG Annual Accounts as at 31.12.2009

E. Additional information

The assets on the balance sheet, which are in foreign currencies, total EUR 137.4 million as at the reporting date (previous year: EUR 140.1 million), the liabilities on the balance sheet which are in foreign currencies total EUR 32.3 million (previous year: EUR 40.3 million).

THE FOLLOWING FORWARD CONTRACTS NOT YET SETTLED ARE OPEN AS AT THE REPORTING DATE:

In EUR K	Nominal value		Market value positive	
	31.12.2009	31.12.2008	31.12.2009	31.12.2008
1. Interest rate agreements				
OTC products				
Forward rate agreements	-	-	-	-
Interest swaps	2,100	(36,247)	-	-
Interest options	137,099	-	169	-
Other similar agreements	-	-	-	-
Traded products	-	-	-	-
2. Exchange rate agreements				
OTC products				
Forward exchange agreements	171,203	(182,149)	1,511	(9,027)
Currency options	-	-	-	-
Currency swaps	-	-	-	-
Other similar agreements	14,855	(15,377)	557	(751)
Traded products	-	-	-	-
3. Securities-related agreements				
OTC products				
Share options bought	2,100	(18,840)	-	(1,477)
Share options sold	-	(11,900)	-	-
Security swaps	50,141	(30,000)	1,659	(2,625)
Other similar agreements	-	-	-	-
Traded products				
Purchased share options	-	(4,852)	-	(2,412)
Sold share options	-	(9,582)	-	-
TOTAL	**377,498**	**(308,946)**	**3,896**	**(16,293)**

Market value negative 31.12.2009	Market value negative 31.12.2008	Book value Active	Book value Passive
-	-	-	-
13	(147)	-	13
169	-	-	-
-	-	-	-
-	-	-	-
3,999	(987)	113	2,700
-	-	-	-
-	-	-	-
557	(751)	-	-
-	-	-	-
-	-	-	-
-	(527)	-	-
-	-	-	-
-	-	-	-
-	-	-	-
-	(31)	-	-
4,738	**(2,443)**	**113**	**2,713**

Currency forwards and currency swaps are valued at the ECB's valuation rate on the respective reporting date taking into account the interest rates of the currency involved and the residual terms. External valuations are applied to other derivatives.

Positive market values are only applied if derivatives are allocated to the trading stock or are in a valuation unit with own issues.

Negative market values from interest swaps totalling EUR 60 K are not accrued, as they are in a valuation unit with securities swaps.

Contingent liabilities

The contingent liabilities as at 31 December 2009 include capital guarantees for state-aided pension provision of EUR 155.3 million (EUR 115.2 million) and other capital guarantees of EUR 99.1 million (EUR 154.7 million). As at the reporting date, there were no pension transactions (previous year: EUR 18.4 million).

The credit risks reported below the balance sheet are credits not yet claimed of EUR 24.3 million (EUR 21.1 million).

There is also an obligation resulting from the membership, mandatory according to Section 93 BWG, of the Banken & Bankiers Gesellschaft mbH deposits guarantee scheme. If this deposit guarantee scheme is used, according to Section 93a para. 1 BWG this totals a maximum of 1.5 % of the assessment basis for the individual bank plus 12.5 times the equity capital requirement for positions of the trading book as at the last reporting date. Thus the upper limit is calculated to be EUR 6.0 million (EUR 4.8 million).

Securities with a book value of EUR 5.0 million (EUR 4.9 million) have been lodged as an arrangement deposit. There are also cash deposits of EUR 50 K (EUR 50 K). There is also collateral of EUR 269 K (EUR 269 K) for pension provisions.

F. Other information

During the 2009 financial year, the average number of employees totalled 141 (159) plus 11 (6) blue-collar workers.

Receivables due from non-bank customers as at 31 December 2009 include loans to members of the Board of Directors totalling EUR 2 K (EUR 3 K) and to members of the Supervisory Board totalling EUR 1 K (previous year: EUR 2 K). Interest rates and other conditions (term and security) are customary for this line of business.

Costs of severance payments and pensions, including allocations to provisions, total EUR 104 K (EUR 105 K) for senior employees and EUR 458 K (EUR 1,141 K) for other employees.

Costs of pensions to former members of the Board of Directors total EUR 45 K (EUR 115 K).

Directors’ emoluments:
The provisions laid down under Article 241 (4) UGB were applied. The Members of the Supervisory Board were not remunerated for their work over the course of the financial year.

Audit Certification

The unabridged Financial Accounts for Capital Bank – GRAWE Gruppe AG as at 31.12.2009 were issued with the following unqualified audit certificate by the chosen auditor:

We have performed an audit, incorporating the company accounts, for the Annual Accounts for Capital Bank – GRAWE Gruppe AG, Graz, for the financial year from 1 January 2009 to 31 December 2009. This Annual Report includes the balance sheet as at 31 December 2009, the Profit and Loss Account for the financial year to 31 December 2009 and the Notes.

Responsibility of the statutory representatives for the Annual Report and the accounts

The statutory representatives of the company are responsible for the accounts and for preparing an Annual Report that gives a true and fair view of the net assets, financial position and results of operations of the company in accordance with the provisions of Austrian company and banking law. This responsibility includes: arranging, implementing and maintaining an internal control system, insofar as this is important for the preparation of the Annual Report and the presentation of a true and fair view of the net assets, financial position and results of operations of the company, so that this is free of major inconsistencies, whether due to intended or inadvertent mistakes; the selection and application of appropriate accounting principles; making estimates that appear appropriate given the general conditions.

Responsibility of the auditor and description of the type and extent of the statutory audit

It is our responsibility to issue an audit finding for these Annual Accounts on the basis of our audit. We have performed our audit taking into account the statutory regulations and standard commercial principles applicable in Austria. These principles require the audit to be planned and performed in such a way that a sufficiently secure finding can be drawn from the audit, declaring whether the Annual Accounts are free of major inconsistencies.

An audit includes the implementation of audit procedures to obtain documentary evidence in respect of the amounts and other information in the Annual Accounts.

The audit procedures are selected at the auditor‘s mandatory discretion, taking into account their assessment of the risk of major inconsistencies, whether due to intended or inadvertent mistakes.

When assessing this risk, the bank auditor takes into account the internal control system, insofar as this is important for the preparation of the Annual Report and the presentation of a true and fair view of the net assets, financial position and results of operations of the company, in order to determine the appropriate audit procedures in consideration of the general conditions, but not in order to submit an audit finding regarding the effectiveness of the company‘s internal controls.

The audit also includes an evaluation of the accounting principles and of significant estimates performed by the statutory representatives and an appraisal of the Annual Accounts as a whole.

We are of the view that our audit constitutes a sufficiently secure basis for our audit finding, so that our audit represents a sufficiently secure basis for our audit finding.

Audit Finding

Our audit did not lead to any objections. On the basis of the findings drawn from the audit we have performed, we feel that the Annual Accounts comply with the statutory regulations and provide a true and fair view of the net assets, financial position and results of operations of the company as at 31 December 2009 and of the income situation of the company for the financial year from 01 January 2009 to 31 December 2009 in accordance with the Austrian principles of proper accounting.

Statement on the Management Report

The Management Report has to be audited on the basis of the statutory provisions as to whether it corresponds to the Annual Accounts and that the other information in the Management Report does not generate a false impression of the situation of the company. The auditor's certificate must also include information as to whether the Management Report corresponds to the Annual Accounts.

In our view, the Management Report corresponds to the Annual Accounts.

Vienna, 10 March 2010,

KPMG
Wirtschaftsprüfungs- und
Steuerberatungs GmbH

Mag. Bernhard Gruber
Auditor

Mag. Thomas Smrekar
Auditor

Publication or circulation of the Annual Accounts bearing our audit certificate may only be performed using the version we have audited. Compliance with the regulations of Article 281 Paragraph 2 UGB is required for any alternative versions (e.g. abbreviated versions or translated versions). The Annual Accounts are lodged with the Commercial Register of the Graz Provincial Court for Matters under Civil Law under FN 112471z and is published in the Official Gazette of the 'Wiener Zeitung' newspaper.

SUBGROUP OF CAPITAL BANK – GRAWE GRUPPE AG

The following subgroup accounts according to UGB/BWG of Capital Bank – GRAWE Gruppe AG serves as orientation for the reader regarding the economic development of Capital Bank and its subsidiaries. The subgroup report according to UGB/BWG has been audited by the auditor within the framework of the Group audit of HYPO Bank Burgenland AG.

12. SUBGROUP OF CAPITAL BANK – GRAWE GRUPPE
CONSOLIDATED BALANCE SHEET AS OF 31 DECEMBER 2009

ASSETS		31.12.2009 EUR		31.12.2008 EUR K
1. Cash and balances at central banks		8,431,408.73		7,144
2. Public authority debt instruments, authorised for refinancing at the central bank				
Public authority debt instruments and similar securities		5,328,620.38		4,777
3. Receivables from banks		210,505,865.01		237,676
4. Receivables from non-bank customers		121,251,541.39		143,594
5. Loan stock and other fixed interest securities		53,330,506.90		25,736
6. Shares and other non-fixed interest securities		115,001,933.49		133,143
7. Investments		9,418.42		9
in banks	8,575.38			
8. Shares in affiliated companies		1,191,330.17	9	1,156
9. Intangible fixed assets		115,002.70		261
10. Material assets		5,742,892.23		6,048
11. Other assets		130,516,494.09		169,413
12. Accruals		747,365.55		857
TOTAL ASSETS		652,172,379.06		729,813
Positions under the balance sheet				
1. Foreign assets		290,285,008.65		313,150
2. Managed capital investment fund plan		1,458,028,060.86		1,230,383

LIABILITIES		31.12.2009 EUR		31.12.2008 EUR K
1. Liabilities to banks		45,876,904.15		68,195
2. Liabilities to non-bank customers		218,120,489.86		236,884
a) Savings deposits	2,519,644.42			
b) Other liabilities	215,600,845.44			
3. Securitised liabilities		203,996,271.72	3,797	263,366
Other securitised liabilities	203,996,271.72		233,086	
4. Other liabilities		34,050,693.71		21,391
5. Deferrals		225,163.55	263,366	0
6. Provisions		22,968,155.79		17,464
a) Provisions for severance payments	2,990,387.38			
b) Provisions for pensions	343,455.92			
c) Tax provisions	212,751.56		2,496	
d) Other	19,421,560.93		444	
7. Subscribed capital		65,915,661.65	1,013	65,916
8. Generated capital		61,019,038.64	13,511	56,598
9. Minority interests		0.00		0
TOTAL LIABILITIES		652,172,379.06		729,813
Positions under the balance sheet				
1. Contingent liabilities				
Liabilities from bank sureties and liability from providing security		275,464,432.10		281,740
2. Credit risks		24,532,000.00		21,779
incl. liabilities from pension transactions	0.00			
3. Liabilities from trusts		18,742,191.00	9,200	21,556
4. Eligible capital according to Section 23 para. 14 BWG (Austrian Banking Act)		131,372,613.99		127,804
5. Required equity capital according to Section 22 para. 1 BWG		38,912,960.40		47,831
incl. required equity capital according to Section 22 para. 1 nos. 1 and 4 BWG	38,519,960.40			
6. Foreign liabilities		88,668,132.37	46,387	36,684

13. SUB-GROUP OF CAPITAL BANK – GRAWE GRUPPE
CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE 2009 FINANCIAL YEAR

		31.12.2009 EUR		31.12.2008 EUR K
1. Interest and similar income		9,909,874.38		21,204
incl. from fixed interest securities	1,131,993.31		2,318	
2. Interest and similar costs		-4,099,434.70		-11,158
I. NET INTEREST INCOME		5,810,439.68		10,047
3. Revenue from securities and investments		1,342,170.06		5,817
a) Income from shares, other equity interests and non-fixed interest securities	1,122,118.83		5,559	
b) Income from investments	150,051.23		2	
c) Income from shareholdings in affiliated companies	70,000.00		257	
4. Commission income		49,714,078.69		59,077
5. Commission costs		-26,196,704.86		-34,817
6. Revenue/expenses from financial transactions		5,683,579.73		-4,285
7. Other operating income		3,011,573.31		1,884
II. OPERATING INCOME		39,365,136.61		37,723
8. General administrative expenses		-27,332,362.43		-23,715
a) Payroll costs	-14,948,664.75		-13,689	
aa) Wages and salaries	-11,648,255.82		-9,734	
ab) Expenses for statutory social charges and for income-based charges and compulsory contributions	-2,271,178.40		-2,350	
ac) Other social security expenses	-175,531.17		-204	
ad) Expenses for retirement benefits and support	-190,457.93		-309	
ae) Allocation to the pensions reserve	100,571.08		234	
af) Expenses for severance payments and payments to operational company pension funds	-763,812.51		-1,326	
b) Other administrative expenses (operating expenses)	-12,383,697.68		-10,026	
9. Value adjustments on the assets listed under asset items 9 and 10		-1,055,584.26		-1,112
10. Other operating expenses		-146,701.01		-11
III. OPERATING COSTS		-28,534,647.70		-24,838

	31.12.2009 EUR	31.12.2008 EUR K
IV. OPERATING PROFIT	10,830,488.91	12,885
11. Value adjustments on receivables and allocation to reserves for contingent liabilities and credit risks	-5,280,072.63	-31,786
12. Revenue from the reversal of value adjustments on receivables and from reserves for contingent liabilities and credit risks	1,780,403.43	14,828
13. Value adjustments on securities evaluated as financial assets and on shareholdings in affiliated companies	-307,806.77	-728
14. Revenue from the sale of securities evaluated as financial assets and on shareholdings in affiliated companies	18,351.20	5,871
V. PROFIT FROM ORDINARY ACTIVITIES	7,041,364.14	1,071
15. Tax on income	-2,539,776.44	-238
16. Other tax, if not to be entered under item 15	-80,345.74	-85
VI. CONSOLIDATED ANNUAL NET PROFIT/LOSS (before minority interests)	4,421,241.96	748
17. Minority interests‘ share of the annual profit	0.00	0
VII. CONSOLIDATED NET PROFIT	4,421,241.96	748

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