

PORTFOLIO QUALITY AND MANAGEMENT

PORTFOLIO QUALITY FOR 31 DECEMBER 2005

The bank measures the loan quality based on an aged portfolio-at-risk. Loans classified depending on the number of days they are overdue. For each class of loans, the outstanding principal balance of such loans is divided by the outstanding principal balance of the gross loan portfolio (that is, before deducting the allowance for loan loss). Loans are considered as overdue if the principal of the loan has delinquency of more than 1 day or if the loan was rescheduled or refinanced. The number of days of lateness is based on the due date of the earliest loan installment that has not been fully paid.

| | Outstanding principal balance | |
|-------------------------|-------------------------------|---------------------|
| | Portfolio at risk | Amount |
| Current | 99.03% | 37,707,691.5 |
| 1–30 days late | 0.29% | 111,765.8 |
| 31–60 days late | 0.13% | 49,297.1 |
| 61–90 days late | 0.08% | 30,892.4 |
| 91–120 days late | 0.07% | 26,427.0 |
| 121- 180 days late | 0.13% | 48,869.4 |
| 181-270 | 0.13% | 47,248.5 |
| More than 271 days late | 0.13% | 50,292.7 |
| Rescheduled | 0.01% | 5,404.8 |
| Subtotal | 0.97% | 370,197.7 |
| Total | 100.00% | 38,077,889.2 |

The Bank reports the quality of loan portfolio to Central bank according Central Bank's loan classification procedure which instructs to classify loans by 90 days in 5 loan classes: current, past due, substandard, doubtful and bad. The provisioning percentages established on the Bank's portfolio are according Central bank loan loss provisioning policy as follows.

PROVISIONING POLICY FOR 31 DECEMBER 2005

| Loan Status | Loan by overdue days | Allowance percent |
|---------------------------|----------------------|-------------------|
| Current | - | 0% |
| Past Due | 1-90 days | 5% |
| Substandard/ Restructured | 91-180 days | 40% |
| Doubtful | 181-270 days | 75% |
| Bad | More than 271 days | 100% |

Restructured loans are provisioned like substandard loans with 40%.

The allowance for loan losses as 31 December 2005 is as follows.

ALLOWANCE FOR LOAN LOSS AS 31 DECEMBER 2005

| Loan Status | Outstanding Loan Portfolio | Share of total | Allowance for loan loss | |
|--------------|----------------------------|----------------|-------------------------|------------------|
| | | | Percent | Amount |
| Current | 37,707,691.5 | 99.1% | 0.0% | - |
| Past Due | 191,955.3 | 0.5% | 5.0% | 9,597.8 |
| Substandard | 75,296.4 | 0.2% | 40.0% | 30,118.5 |
| Doubtful | 47,248.5 | 0.1% | 75.0% | 35,436.3 |
| Bad | 50,292.7 | 0.1% | 100.0% | 50,292.7 |
| Restructured | 5,404.8 | 0.0% | 40.0% | 2,161.9 |
| Total | 38,077,889.2 | 100.0% | | 127,607.3 |

Historic trend shows that loan loss provisioning had enough coverage over the write offs.

| | 2002 | 2003 | 2004 | 2005 |
|-------------------------------|----------|-----------|-----------|-----------|
| A. Average reserve (000'MNT') | (49,759) | (120,784) | (220,165) | (198,084) |
| B. Write offs (000'MNT) | (2,162) | (13,109) | (167,134) | (10,485) |
| C. Coverage (A/B) | 23.0 | 9.2 | 1.3 | 18.9 |

Before writing of the loan work out actions are taken first by the respective branches where the loan was disbursed and second by the work out unit of the HQ. If all the attempts are failed the proposal to write off is presented to HQ. For loans with outstanding balance of less than US\$4,000, the decision to write of the loans made by Risk Management Committee of the Bank which is composed of all senior management team. The decision for loans above US\$ 4,000 is made Board of the Bank. By Central bank policy to write off loan it is required certain documentation evidencing that the loan is uncollectible.

Restructuring or renegotiating is done on case by case basis. A loan can be restructured only if a borrower faces temporary cash flow problem which would have reasonable evidence of future recovery. Proposal to restructure a loan is prepared by a credit officer and the final decision as made at HQ by Credit Committee comprised of Senior Managers. Restructured loans are reported to Board as well.

RELATED PARTY LOANS FOR 31 DECEMBER 2005

| Borrower | Principle balance outstanding /000 MNT/ | Loan term | Status |
|-----------------|--|------------------|--|
| General Manager | 126,376 | 21-60 months | Current |
| Board member | 189,779 | 11-60 months | Current |
| Staff loans | 768,000 | 1-120 months | 2 loan restructured 1 loan past due 1 loan Bad |
| Total | <u>1,084,155</u> | | |

Loans to related parties are disbursed within the limit pre-approved by the Board. Loans below 25.000 USD to the bank staff excluding CEO and President and every loan to CEO and President need to be approved by Board Credit Committee.

All insider loans are reported every month to the Central Bank and every quarter to the Board. Loan request review, disbursement and monitoring procedures are the same as to those applied to the borrowers.

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