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SOUTHERN CONNECTICUT BANCORP INC
Form 10KSB
March 28, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

F O R M 10 - K S B

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934 For the Fiscal Year Ended December 31, 2004.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 333-59824

SOUTHERN CONNECTICUT BANCORP, INC.
(Name of Small Business Issuer in Its Charter)

Connecticut 06-1609692
(State or other jurisdiction of (I.R.S. Employer Identification Number)
incorporation or organization)

215 Church Street 06510
New Haven, Connecticut (Zip Code)
(Address of Principal Executive Offices)

Issuer's telephone number (203) 782-1100

Securities registered under Section 12(b) of the Exchange Act:

Common Stock, par value \$.01 per share
(Title of Class)

Securities registered under Section 12(g) of the Exchange Act:

None

Check whether the issuer: (1) filed all reports required to be filed by
Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such
shorter period that the registrant was required to file such reports), and (2)
has been subject to such filing requirements for the past 90 days.

Yes No

Check if disclosure of delinquent filers in response to Item 405 of
Regulation S-B is not contained in this form, and no disclosure will be
contained, to the best of registrant's knowledge, in definitive proxy or
information statements incorporated by reference in Part III of this Form 10-KSB
or any amendment to this Form 10-KSB.

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State issuer's revenue for its most recent fiscal year: \$4,895,086.

Aggregate market value of the voting stock held by nonaffiliates (assumes all directors, executive officers and 10% or greater holders are affiliates) of the registrant as of March 16, 2005: \$20,421,912.

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Number of shares of the registrant's Common Stock, par value \$.01 per share, outstanding as of March 14, 2005 2,797,711

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for 2005 Annual Meeting of Incorporated into Part Shareholders. (A definitive proxy statement III of this Form 10-KSB will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year covered by this Form 10-KSB.)

Transitional Small Business Disclosure Format (check one):

Yes ____; No X

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PART I

Item 1. Description of Business.

Background

Southern Connecticut Bancorp ("Bancorp") is a bank holding company headquartered in New Haven, Connecticut that was incorporated on November 8, 2000. Bancorp's strategic objective is to serve as a bank holding company for community-based commercial banks serving the greater New Haven and greater New London markets, as well as the approximately 45 miles of coastal towns and communities located between these two cities and extending to Rhode Island (the "Southern Connecticut Market").

Bancorp owns 100% of the capital stock of The Bank of Southern Connecticut, (the "Bank") a Connecticut-chartered bank with its headquarters in New Haven, Connecticut. The Bank commenced operations on October 1, 2001 after receiving its Final Certificate of Authority from the State of Connecticut and its deposit insurance from the FDIC. Bancorp has received a temporary certificate of authority from the State of Connecticut to charter a second, wholly-owned bank to be headquartered in New London, Connecticut and to be named The Bank of Southeastern Connecticut ("TBSEC"). The opening of TBSEC is subject to receipt of final approval from the Department of Banking, the approval of deposit insurance from the FDIC and the approval of the Federal Reserve Board. Bancorp has applied to the FDIC to insure the deposits of TBSEC. As of September 30, 2004, the application with the FDIC was extended to permit Bancorp to provide additional information regarding the infrastructure in place to support the two banks and to revise certain proposed policies of TBSEC. By letter dated March 2, 2005, the FDIC requested that Bancorp provide it with supplemental information pertaining to the initial areas of inquiry noted above. Bancorp will respond to the FDIC's information requests on or before the FDIC's requested April 2, 2005 response date. Bancorp will also be required to apply for approval

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from the Federal Reserve Bank after receipt of FDIC approval. At this time, renovations on TBSEC's headquarters at 15 Masonic Street, New London, are nearly complete and management anticipates that the premises will be ready for occupancy by early April 2005. Subject to receipt of regulatory approvals, TBSEC is expected to be open for business during the second half of 2005 and will be staffed, managed and operated in a comparable manner to the Bank. Bancorp will provide certain management and operations support and services to the two banks as well as certain infrastructure. Bancorp believes that providing such services will benefit TBSEC by lowering its operating costs in comparison to other de novo banks and in providing common frameworks of operating policy and business philosophy with its affiliate, the Bank.

The Bank focuses on serving the banking needs of small to medium-sized businesses in the greater New Haven market. The Bank's target commercial customer has between \$1.0 and \$25.0 million in revenues, 15 to 150 employees and borrowing needs of up to \$3.0 million. The primary focus on this commercial market makes the Bank uniquely qualified to move deftly in responding to the needs of its clients. The Bank has been successful in winning business by offering a combination of competitive pricing for its services, quick decision making processes and a high level of personalized customer service.

Bancorp's geographic market focus gives the Bank unique competitive advantages by having Bancorp's headquarters, senior executives and key decision makers all based in the local commercial communities that the Bank currently serves and which the Bank and TBSEC are targeting to serve. In addition, both subsidiary banks have or will have their own boards of directors comprised of members of the local business communities. Although Bancorp faces competition from much larger, better capitalized national or super-regional organizations, Bancorp's local market knowledge, relationships, customer service and presence has enabled it to successfully compete for and obtain new business and clients.

Bancorp has experienced significant growth in both assets and deposits. As of December 31, 2004 Bancorp has assets of \$81.7 million and deposits of \$58.7 million, representing a 44.9% and 24.1% increase from

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December 31, 2003, respectively. Total loans, net outstanding as of December 31, 2004 were \$49.8 million, a 21.9% increase from December 31, 2003. The growth has been achieved while maintaining excellent credit quality and margins, with non-performing loans at 0.02% of total loans as of December 31, 2004, and net interest margin of 4.62% for the twelve months ended December 31, 2004.

Southern Connecticut Market

Bancorp's market focus is to serve the Southern Connecticut Market, which is composed of the communities located in New Haven, Middlesex and New London Counties, and communities bordering or economically linked to these counties. The Southern Connecticut Market is located in the center of, and is a critical component of, the commercial activity of the northeast corridor in New England. The market focus resides in the busy transportation and commercial area between New York City to the south, Hartford to the north, Providence to the east, and Boston to the northeast. The diversified economic base of this market region includes pharmaceutical, advanced manufacturing, healthcare, defense, technology and energy companies, and Connecticut's leading port. The region is also one of New England's most popular tourist destinations, featuring popular

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shoreline and heritage sites. Additionally, New England's largest casinos, Foxwoods and the Mohegan Sun, are located in the region.

Growth and Operating Strategy

Bancorp's strategic focus is to own and operate independent, community-based commercial banks in southern Connecticut founded with the philosophy of local relationships and providing prompt personal service and quality banking products. Bancorp's target customers are small to medium-sized businesses and their owners and employees. The Bank emphasizes personal relationships with customers, community involvement by employees and the board of directors, and responsive lending decisions by an accessible and experienced local management team.

The key elements of the business strategy for Bancorp's current and proposed commercial banks subsidiaries are:

- o Provide individualized attention with local underwriting and credit decision-making authority. As the only commercial bank based in and wholly focused on the greater New Haven area, the Bank is better able to provide the individualized customer service, combined with prompt local underwriting and credit decision-making authority that management believes small to medium-sized businesses desire. Following formation of The Bank of Southeastern Connecticut, Bancorp plans to extend that strategy into the greater New London area as well.
- o Take market share from large, non-local competitors. As the only commercial bank headquartered in New Haven, the Bank competes with large, non-locally owned and headquartered financial institutions. TBSEC, when it commences operations, is expected to be the only commercial bank headquartered in New London, a market also dominated by large, non-locally owned and headquartered financial institutions. Bancorp believes that the Bank has and can continue to attract small to medium-sized businesses that prefer local decision-making authority and interaction with banking professionals who can provide prompt personalized and knowledgeable service.
- o Optimize net interest margin. Bancorp seeks to optimize net interest margin by funding commercial loans, when possible, with low cost money market and non-interest bearing demand deposits.

- o Leverage personal relationships and community involvement. The directors, officers and senior employees of Bancorp and the Bank have extensive personal contacts, business relationships and involvement in communities in which they live and work and which the Bank serves. By building on and leveraging these relationships and community involvement, Bancorp believes that it has and will continue to generate enthusiasm and interest from small to medium-sized businesses in the targeted market areas.
- o Employ qualified and experienced banking professionals. Bancorp seeks to continue to hire and retain highly experienced and qualified local commercial lenders and other banking professionals with successful track records and established relationships with small to medium-sized businesses in the targeted market areas.

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- o Maintain and enhance high credit quality. The success of Bancorp's business plan depends to a significant extent on the quality of the Bank's assets, particularly loans. The Bank has built a strong internal emphasis on credit quality and has established stringent underwriting standards and loan approval processes. The Bank actively manages past due and non-performing loans in an effort to minimize credit loss and related expenses and to ensure that the allowance for loan losses is adequate.

Lending, Depository and Other Products

Lending Products. The Bank offers a broad range of loans to businesses and individuals in its service area, including commercial and business loans, personal loans, mortgage loans, home equity loans, and automobile loans. The Bank has received lending approval status from the Small Business Administration ("SBA") to enable it to make SBA loans to both the greater New Haven business community and companies located throughout the State of Connecticut.

Loans are made on a variable or fixed rate basis, with fixed rate loans limited to five year terms. All loans are approved pursuant to lending policies and procedures authorized by the Bank's board of directors. At the present time, the Bank is not syndicating or securitizing loans. The Bank, at times, participates in multi-bank loans to companies in its market area. Commercial loans and commercial real estate loans may be written for maturities of up to twenty years. Loans to purchase or refinance commercial real estate are supported by personal guarantees of the principal owners and related parties and are collateralized by the subject real estate, which may in cases be supplemented by additional collateral in the form of liquid assets. Loans to local businesses are generally supported by the personal guarantees of the principal owners and are carefully underwritten to determine appropriate collateral and covenant requirements.

Depository Products. The Bank has attracted a base of core deposits, including checking accounts, money market accounts, savings accounts, sweep accounts, NOW accounts and a variety of certificates of deposits and IRA accounts. To continue to attract deposits, the Bank employs an aggressive marketing plan in its service area and features a broad product line and rates and services competitive with those offered in the greater New Haven market. The primary sources of deposits have been and are expected to continue to be residents of and businesses and their employees located in, greater New Haven. The Bank obtains these deposits through personal solicitation by its officers and directors, outside programs and advertisements published and/or broadcasted in the local media. The Bank also offers drive-in teller services, automated teller services, wire transfer, lock box and safe deposit services.

Other Services. The Bank provides a broad range of other services and products, including cashier's checks, money orders, travelers' checks, bank-by mail, direct deposit and U. S. Savings Bonds. The Bank is associated with a shared network of automated teller machines that its customers are able to use throughout Connecticut and other regions. The Bank does not expect to offer trust services directly in the near future, but

may offer trust services in the future through a joint venture with a larger institution. To directly offer trust services, the Bank would need the approval

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of the Connecticut Banking Commissioner and the FDIC.

Investment Services

On November 17, 2003, SCB Capital, Inc., a wholly-owned subsidiary, was incorporated and is intended to engage in a limited range of investment banking, advisory and financial brokerage services primarily to small to medium-sized business clients of Bancorp and others in the target market. SCB Capital is in the process of applying for approval of and membership with the National Association of Security Dealers ("NASD") as a broker-dealer. SCB Capital has received only minimal capital and has not yet commenced operations. The amount to be invested in SCB Capital will be determined by the Bancorp board of directors following completion of the NASD application process. SCB Capital, Inc. is expected to act solely as broker and advisor and is not intended to make equity investments in capital raises it completes or assists in. SCB Capital, Inc. may accept warrants, options or similar instruments in partial compensation for its services.

Investment Securities

Another significant activity for Bancorp and the Bank is maintaining an investment portfolio. Bancorp and the Bank's overall portfolio objective is to optimize the long-term total rate of return through active management of portfolio holdings taking into consideration estimated asset/liability and liquidity needs, tax equivalent yields and maturities. Permissible investments include debt securities such as U.S. Government securities, government sponsored agency securities, municipal bonds, domestic certificates of deposit that are insured by the FDIC, mortgage-backed securities and collateralized mortgage obligations. The Bank's current investment portfolio is limited to U.S. Government sponsored agency obligations and sponsored agency issued collateralized mortgage obligations, which have been classified as available for sale. Accordingly, the principal risk associated with the Bank's current investing activities is market risk (variations in value resulting from general changes in interest rates) rather than credit risk. Bancorp's current investment portfolio is limited to U.S. Government sponsored agency obligations. Bancorp also holds liquid investments, including funds allocated for investment in TBSEC, in money market mutual funds.

Asset and Liability Management

Interest rate risk measures the impact that changing interest rates have on current and future earnings. The goal is to optimize long-term profitability while minimizing exposure to interest rate fluctuations. Interest rate risk exposure is monitored through the Bank's ALCO, consisting of senior management personnel and selected members of the Bank's board of directors. ALCO reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. ALCO reports to the board of directors on a quarterly basis regarding the status of ALCO activities within the Bank.

Regulatory Compliance

Bancorp operates in a heavily regulated industry and is subject to increasing regulatory review and scrutiny from the Federal Reserve Board, the Connecticut Banking Commissioner and the FDIC. Bancorp has invested and continues to invest significant time and resources to ensure compliance and conformity with applicable regulations (see "Regulation and Supervision"). In response to this regulatory environment, in March 2004 the board of directors of the Bank adopted resolutions designed to strengthen and enhance the Bank's Bank Secrecy Act and Gramm-Leach-Bliley Act compliance and the Bank's information technology controls, promoted a new Bank Secrecy Act Officer and amended its Bank Secrecy Act policies to strengthen compliance. In addition to responding to the Bank's regulatory compliance commitment, in connection with asset and staff

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increases, the Bank has hired a experienced loan administration officer to manage the Bank's loan administration functions and enhance loan portfolio administration practices and procedures. The Bank also engaged a full time network administrator for its internal computer network and systems. Further, the Bank

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has retained an experienced outside consultant to assist it in developing and implementing information technology controls. In addition, the board of directors of the Bank has formed an Oversight Committee in March of 2004 with responsibility to assist management, monitor systems and operations and hire and retain outside consultants to help ensure ongoing compliance and conformity with applicable regulations.

Competition

There are numerous banks and other financial institutions serving the Southern Connecticut Market posing significant competition to attract deposits and loans. The Bank competes for loans and deposits with other commercial banks, savings and loan associations, finance companies, money market funds, credit unions and other financial institutions, a number of which are much larger. To grow, the Bank, and TBSEC in the future, will have to win existing customers away from existing banks and financial institutions as well as successfully compete for new customers from growth in the target markets.

The greater New Haven market is currently served by approximately 80 offices of commercial banks, none of which is headquartered in New Haven. All of these banks are substantially larger than the Bank expects to be in the near future and are able to offer products and services which may be impracticable for the Bank to provide at this time. There are numerous banks and other financial institutions serving the communities surrounding New Haven, which also draw customers from New Haven, posing significant competition for the Bank to attract deposits and loans. The Bank also experiences competition from out-of-state financial institutions with little or no traditional bank branches in New Haven. Many of such banks and financial institutions are well established and better capitalized than the Bank, allowing them to provide a greater range of services.

Intense market demands, economic pressures and significant legislative and regulatory actions have eroded traditional banking industry classifications and have increased competition among banks and other financial institutions. Market dynamics as well as legislative and regulatory changes have resulted in a number of new competitors offering services historically offered only by commercial banks, non-bank corporations offering services traditionally offered only by banks, increased customer awareness of product and service differences among competitors and increased merger activity.

Over the past ten years, the Connecticut banking market has been characterized by significant consolidation among financial institutions. Since January 1994, there have been at least 60 completed acquisitions of Connecticut based banks and thrifts. Although the Bank's competitors are currently much larger than the Bank, the corporate service culture and operational infrastructure at large banks is believed to not provide the type of personalized service that many of the Bank's small to medium-sized business clients desire and that the Bank strives to provide.

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Employees

As of December 31, 2004, the Bank had 32 full-time and no part-time employees. It is Bancorp's intention to move approximately 11 of these 32 employees who focus on finance and operations to Bancorp in 2005. These employees will service the Bank, and once final approvals are received, TBSEC. Relationships with all employees are believed to be excellent.

Bancorp intends to recruit a majority of directors, executive management and employees of TBSEC from the greater New London area. Outside of staffing TBSEC and new branch locations, Bancorp currently intends to add an additional lending officer, a loan administration officer, an accountant and two additional operations employees in early 2005.

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REGULATION AND SUPERVISION

Banks and bank holding companies are extensively regulated under both federal and state law. Bancorp and the Bank have set forth below brief summaries of various aspects of supervision and regulation that they are subject to, and that TBSEC will be subject to upon commencement of its operations assuming that all necessary approvals are obtained. These summaries do not purport to be complete and which are qualified in their entirety by reference to applicable laws, rules and regulations.

Regulations to which Bancorp is Subject

General. As a bank holding company registered in accordance with the BHC Act, Bancorp is regulated by and subject to the supervision of the Federal Reserve Board and is required to file with the Federal Reserve Board an annual report and such other information as may be required. The Federal Reserve Board has the authority to conduct examinations of Bancorp as well. The Federal Reserve Board has the authority to issue orders to bank holding companies to cease and desist from unsound banking practices and violations of conditions imposed by, or violations of agreements with, the Federal Reserve Board. The Federal Reserve Board is also empowered to assess civil money penalties against companies or individuals who violate the BHC Act or orders or regulations there under, to order termination of non-banking activities of non-banking subsidiaries of bank holding companies, and to order termination of ownership and control of a non-banking subsidiary by a bank holding company.

The BHC Act--Acquisitions and Permissible Activities. The BHC Act requires the prior approval of the Federal Reserve Board for a bank holding company to acquire substantially all the assets of a bank or acquire direct or indirect ownership or control of more than 5% of any class of the voting shares of any bank, bank holding company or savings association, or increase any such non-majority ownership or control of any bank, bank holding company or savings association, or merge or consolidate with any bank holding company. Federal law generally authorizes bank holding companies to acquire banks located in any state, subject to certain state-imposed age and deposit concentration limits, and also generally authorizes interstate bank holding company and bank mergers and to a lesser extent, interstate branching.

Unless a bank holding company becomes a financial holding company under the Gramm-Leach-Bliley Act of 1999 ("GLBA") (as discussed below), the BHC Act prohibits a bank holding company from acquiring a direct or indirect interest in or control of more than 5% of any class of the voting shares of a company that

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is not a bank or a bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiary banks, except that it may engage in and may own shares of companies engaged in certain activities the Federal Reserve Board has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The GLBA, which was enacted on November 12, 1999, permits a qualifying bank holding company to become a "financial holding company" and thereby engage in a broader range of activities than is permissible for a traditional bank holding company. In order to qualify for this election, all of the depository institution subsidiaries of the bank holding company must be well capitalized and well managed, as defined under Federal Reserve Board regulations, and all such subsidiaries must have achieved a rating of "satisfactory" or better with respect to meeting community credit needs. Pursuant to the GLBA, financial holding companies are permitted to engage in activities that are "financial in nature" or incidental or complementary thereto, as determined by the Federal Reserve Board. The GLBA identifies several activities as "financial in nature," including, among others, insurance underwriting and agency activities, investment advisory services, merchant banking and underwriting, and dealing in or making a market in securities. At this time, Bancorp has not elected to become a financial holding company and has no immediate plans to do so.

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Capital Requirements. The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications submitted to it under the BHC Act. These capital adequacy guidelines generally require bank holding companies to maintain total capital equal to 8% of total risk-adjusted assets and off-balance sheet items (the "Total Risk-Based Capital Ratio"), with at least one-half of that amount consisting of Tier I or core capital and the remaining amount consisting of Tier II or supplementary capital. Tier I capital for bank holding companies generally consists of the sum of common shareholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stocks which may be included as Tier I capital), less goodwill and other non-qualifying intangible assets. Tier II capital generally consists of: hybrid capital instruments; perpetual preferred stock, which is not eligible to be included as Tier I capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage capital ratio of Tier I capital (defined by reference to the risk-based capital guidelines) to total average assets (the "Leverage Ratio") of 3.0%. Total average assets for this purpose do not include goodwill and any other intangible assets and investments that the Federal Reserve Board determines should be deducted from Tier I capital. The Federal Reserve Board has announced that the 3.0% Leverage Ratio requirement is the minimum for the top-rated bank holding companies without any supervisory, financial or operational weaknesses or deficiencies or those that are not experiencing or anticipating significant growth. For all other bank holding companies, the minimum leverage ratio is 4%, and bank holding companies with supervisory, financial, managerial or operational weaknesses or organizations expecting significant growth are expected to maintain capital ratios well above minimum levels.

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Bancorp is currently in compliance with the Total Risk-Based Capital Ratio, Tier I Capital and the Leverage Ratio requirements. As of December 31, 2004, Bancorp had a Tier I Risk-Based Capital Ratio and a Total Risk-Based Capital Ratio equal to 32.08% and 33.24%, respectively, and a Leverage Ratio equal to 24.66%. U.S. bank regulatory authorities and international bank supervisory organizations, principally the Basel Committee on Banking Supervision, currently are considering changes to the risk-based capital adequacy framework, including emphasis on credit, market and operational risk components, which ultimately could affect the appropriate capital guidelines.

Limitations on Acquisitions of Common Stock. The federal Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a depository institution or a depository institution holding company unless the appropriate federal banking agency has been given at least 60 days to review the proposal and public notice has been provided. "Control" is generally defined under this act as ownership of 25% or more of any class of voting stock. In addition, under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a depository institution or a depository institution holding company with a class of securities registered under Section 12 of the Exchange Act would, under the circumstances set forth in the presumption, constitute the acquisition of control. Furthermore, any company, as that term is broadly defined in the BHC Act, would be required to obtain the approval of the Federal Reserve Board under BHC Act before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of any class of voting securities of a depository institution or a depository institution holding company, or such lesser percentage as the Federal Reserve Board deems to constitute a "controlling influence."

Bank Holding Company Dividends. The Federal Reserve Board has authority to prohibit bank holding companies from paying dividends if such payment is deemed to be an unsafe or unsound practice. The Federal Reserve Board has indicated generally that it may be an unsafe or unsound practice for bank holding companies to pay dividends unless the bank holding companies net income over the preceding year is sufficient to fund the

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dividends and the expected rate of earnings retention is consistent with the organization's capital needs, asset quality and overall financial condition.

Bank Holding Company Support of Subsidiary Banks. Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial and managerial strength to each of its subsidiary banks and to commit resources to their support. This support may be required at times when the bank holding company may not have the resources to provide it. Similarly, under the cross-guarantee provisions of the Federal Deposit Insurance Act ("FDIA"), the FDIC can hold any FDIC-insured depository institution liable for any loss suffered or anticipated by the FDIC in connection with (1) the "default" of a commonly controlled FDIC-insured depository institution; or (2) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution "in danger of default."

The Sarbanes-Oxley Act. The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") implements a broad range of corporate governance and accounting measures for public companies (including publicly-held bank holding companies such as Bancorp) designed to promote honesty and transparency in corporate America.

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Sarbanes-Oxley's principal provisions, many of which have been interpreted through regulations released in 2003, provide for and include, among other things: (i) the creation of an independent accounting oversight board; (ii) auditor independence provisions that restrict non-audit services that accountants may provide to their audit clients; (iii) additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer of a public company certify financial statements; (iv) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; (v) an increase in the oversight of, and enhancement of certain requirements relating to, audit committees of public companies and how they interact with the company's independent auditors; (vi) requirements that audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer; (vii) requirements that companies disclose whether at least one member of the audit committee is a "financial expert" (as such term is defined by the SEC); (viii) expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods; (ix) a prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions on nonpreferential terms and in compliance with other bank regulatory requirements; (x) disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; and (xi) a range of enhanced penalties for fraud and other violations.

Regulations to which the Bank is Subject

General. The Bank is organized under the Banking Law of the State of Connecticut. Its operations are subject to federal and state laws applicable to commercial banks and to extensive regulation, supervision and examination by the Connecticut Banking Commissioner, as well as by the FDIC, as its primary federal regulator and insurer of deposits. While the Bank is not a member of the Federal Reserve System, it is subject to certain regulations of the Federal Reserve Board. In addition to banking laws, regulations and regulatory agencies, the Bank is subject to various other laws, regulations and regulatory agencies, all of which directly or indirectly affect the Bank's operations. The Connecticut Banking Commissioner and the FDIC examine the affairs of the Bank for the purpose of determining its financial condition and compliance with laws and regulations. The Connecticut Banking Commissioner and the FDIC have the authority to limit the Bank's payment of dividends based on such factors as the maintenance of adequate capital, which could reduce the amount of dividends otherwise payable. Following the commencement of its operations, TBSEC will be subject to these same requirements.

The Connecticut Banking Commissioner and the FDIC have significant discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to

the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such policies, whether by the FDIC, Congress, the Connecticut Banking Commissioner or the Connecticut General Assembly, could have a material adverse impact on the Bank.

Activities and Investments of Insured State-Chartered Banks. Section 24 of the FDIA generally limits the activities as principal and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national

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banks. Bancorp does not expect such provisions to have a material adverse effect on Bancorp or the Bank.

Capital Requirements. The FDIC has issued regulations and adopted a statement of policy regarding the capital adequacy of state-chartered banks, such as the Bank. Under the regulations, a bank generally is deemed to be (i) "well-capitalized" if it has a Total Risk-Based Capital Ratio of 10.0% or more, a Tier I Risk-Based Capital Ratio of 6.0% or more, a Leverage Ratio of 5.0% or more and is not subject to any written capital order or directive; or (ii) "adequately capitalized" if it has a Total Risk-Based Capital Ratio of 8.0% or more, a Tier I Risk-Based Capital Ratio of 4.0% or more, and a Leverage Ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well-capitalized;" or (iii) "undercapitalized" if it has a Total Risk-Based Capital Ratio that is less than 8.0%, a Tier I Risk-Based Capital Ratio that is less than 4.0% or a Leverage Ratio that is less than 4.0% (3.0% under certain circumstances); or (iv) "significantly undercapitalized" if it has a Total Risk-Based Capital Ratio that is less than 6.0%, a Tier I Risk-Based Capital Ratio that is less than 3.0% or a Leverage Ratio that is less than 3.0%, and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. If an institution becomes undercapitalized, it would become subject to significant additional oversight and regulation, as mandated by the FDIA.

As of December 31, 2004, the Bank was deemed to be a well-capitalized institution for the above purposes. Pursuant to the FDIC's approval of the Bank's application for deposit insurance, the Bank is required to maintain a Leverage Ratio of 8.0% until October 1, 2004. Additionally, The Bank of Southeastern Connecticut will be required to maintain an 8% Leverage Ratio for its first three years of operations.

Prompt Corrective Action and Other Enforcement Mechanisms. Federal law requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. An institution that, based upon its capital levels, is classified as "well capitalized," "adequately capitalized" or "undercapitalized" may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat an institution as "critically undercapitalized" unless its capital ratio actually warrants such treatment.

In addition to restrictions and sanctions imposed under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease and desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

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Premiums for Deposit Insurance. The FDIC has implemented a risk-based assessment system, under which an institution's deposit insurance premium assessment is based on the probability that the deposit insurance fund will incur a loss with respect to the institution, the likely amount of any such loss, and the revenue needs of the deposit insurance fund.

Under this risk-based assessment system, banks are categorized into one of three capital categories (well capitalized, adequately capitalized, and undercapitalized) and one of three categories based on supervisory evaluations by its primary federal regulatory. The three supervisory categories are: financially sound with only a few minor weaknesses (Group A), demonstrates weaknesses that could result in significant deterioration (Group B), and poses a substantial probability of loss (Group C). The capital ratios used by the FDIC to define well capitalized, adequately capitalized and undercapitalized are the same in the FDIC's prompt corrective action regulations. As of March 31, 2004, the most recent notification from the FDIC and the State of Connecticut Department of Banking categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events that management believes have changed the Bank's category.

FDIC insurance of deposits may be terminated by the FDIC, after notice and hearing, upon finding by the FDIC that the insured institution has engaged in unsafe or unsound practices, or is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule or order of, or conditions imposed by, the FDIC.

Safety and Soundness Standards. Federal law requires each federal banking agency to prescribe for depository institutions under its jurisdiction standards relating to, among other things: internal controls; information systems and audit systems; loan documentation; credit underwriting; interest rate risk; asset growth; compensation; fees and benefits; and such other operational and managerial standards as the agency deems appropriate. The federal banking agencies have promulgated regulations and Interagency Guidelines Establishing Standards for Safety and Soundness (the "Guidelines") to implement these safety and soundness standards. The Guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The Guidelines address internal controls and information systems; internal audit system; credit underwriting; loan documentation; interest rate risk exposure; asset quality; earnings and compensation; fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standards prescribed by the Guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard set by the FDIA.

The federal banking agencies also have adopted regulations for real estate lending prescribing uniform guidelines for real estate lending. The regulations require insured depository institutions to adopt written policies establishing standards, consistent with such guidelines, for extensions of credit secured by real estate. The policies must address loan portfolio management, underwriting standards and loan to value limits that do not exceed the supervisory limits prescribed by the regulations.

Community Reinvestment Act. Under the Community Reinvestment Act ("CRA"), as implemented by FDIC regulations, the Bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not prescribe specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop

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the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC, in connection with its examination of a depository institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution. The FDIC is required to provide a written evaluation and make public disclosure of an institution's CRA performance utilizing a four-tiered descriptive rating system. Institutions are evaluated and rated by the FDIC as

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"Outstanding," "Satisfactory," "Needs to Improve," or "Substantial Non Compliance." Failure to receive at least a "Satisfactory" rating may inhibit an institution from undertaking certain activities, including acquisitions or other financial institutions, which require regulatory approval based, in part, on CRA compliance considerations. In its CRA evaluation, dated July 14, 2003, the Bank was rated as "Satisfactory."

Transactions with Affiliates. Sections 23A and 23B of the Federal Reserve Act restrict transactions between a bank and an affiliated company, including a parent bank holding company. The Bank is subject to certain restrictions on loans to affiliated companies, on investments in the stock or securities thereof, on the taking of such stock or securities as collateral for loans to any borrower, and on the issuance of a guarantee or letter of credit on their behalf. Among other things, these restrictions limit the amount of such transactions, require collateral in prescribed amounts for extensions of credit, prohibit the purchase of low quality assets and require that the terms of such transactions be substantially equivalent to terms of similar transactions with nonaffiliates. Generally, the Bank is limited in its extensions of credit to any affiliate to 10% of the Bank's capital and in its extensions of credit to all affiliates to 20% of the Bank's capital.

Customer Information Security. The FDIC and other bank regulatory agencies have adopted guidelines (the "Security Guidelines") for safeguarding confidential, personal customer information. The Security Guidelines require each financial institution, under the supervision and ongoing oversight of its board of directors or an appropriate committee thereof, to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the security or integrity of such information, and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

Privacy. Financial institutions are required to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to nonaffiliated third parties. In general, the statute requires explanations to consumers on policies and procedures regarding the disclosure of such nonpublic personal information, and, except as otherwise required by law, prohibits disclosing such information except as provided in the financial institution's policies and procedures.

USA PATRIOT Act. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "Patriot Act"), designed to deny terrorists and others the ability to obtain access to the United States financial system, has significant implications for depository institutions, brokers-dealers and other businesses involved in the transfer of money. The Patriot Act, as implemented by various federal regulatory agencies, requires financial institutions, including Bancorp and the Bank, to

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implement new policies and procedures or amend existing policies and procedures with respect to, among other matters, anti-money laundering, compliance, suspicious activity and currency transaction reporting, and due diligence on customers. The Patriot Act and its underlying regulations also permit information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, subject to certain conditions, and require the Federal Reserve Board (and other federal banking agencies) to evaluate the effectiveness of an applicant in combating money laundering activities when considering applications filed under the BHC Act or the Bank Merger Act.

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Item 2. Description of Property.

Bancorp executed a lease for a free-standing building located at 215 Church Street, New Haven, Connecticut, in the central business and financial district of New Haven. The lease was assigned to The Bank of Southern Connecticut, and the Bank assumed all obligations thereunder. The location is a former bank branch, which has been renovated for use as the headquarters of the Bank and Bancorp. The building has a drive-up teller, an automated teller machine, two vaults and a night deposit drop.

The lease is for an initial term of five years and three months, commencing April 11, 2001 with an option to extend the lease for up to three additional terms of five years. There was no base rent payable for the first three months of the initial term and monthly rent was \$4,117 until August 1, 2001. The annual base rent during the balance of the initial term will be \$107,400 for the first year and increases each year to \$125,500 for the fifth year. The base rent for the option periods is also fixed in the lease. The Bank is responsible for all costs to maintain the building, other than structural repairs, and for all real estate taxes. The Bank, as Bancorp's assignee, will have a right of first refusal to purchase the building.

To the extent that the building contains space not needed for operations, the Bank expects to sublease such excess to the extent practicable. The Bank of Southern Connecticut had subleased approximately 1,045 square feet to Laydon and Company, LLC, an entity owned by Elmer A. Laydon, the son of Elmer F. Laydon, one of Bancorp's directors.

The following table sets forth the location of the Bank's branch offices and other related information:

Office	Location
-----	-----
Main Office	215 Church Street, New Haven, Connecticut
Branford Office	445 West Main Street, Branford, Connecticut
Amity Office	1475 Whalley Avenue, New Haven, Connecticut

The Bank of Southern Connecticut entered into a lease agreement on

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August 7, 2002 to lease the facility at 445 West Main Street, Branford, Connecticut, the site of the Branford branch which opened for business on October 7, 2002.

The Branford branch lease is for an initial term of five years, with an option to extend the lease for up to three additional terms of five years. The base rent payable for the initial term and monthly rent is \$3,095 until September 30, 2007. The base rent for the option periods increases and is fixed in the lease. The Bank is responsible for all costs to maintain the building, other than structural repairs, and for all real estate taxes.

On August 15, 2002 the Bank also purchased an additional branch facility at 1475 Whalley Avenue, New Haven, Connecticut, the site of the Amity branch location which opened March 24, 2003.

On January 14, 2004 Bancorp entered into a lease agreement to lease the facility at 15 Masonic Street, New London, Connecticut, the site of the proposed TBSEC. Pending regulatory approval of TBSEC, the facility is in the process of being improved to accommodate the new bank, which is expected to be completed in early April of 2005. Improvements, furnishings and equipment are estimated to be \$363,000. TBSEC is expected to commence operations during the second half of 2005. The Lease is for an initial term of five years, with three successive five year option periods. Base rent is \$45,580 annually until January 14, 2009. The base rent for the option years is subject to increases. Bancorp is responsible for pro rata allocations for taxes, utilities, common facility charges and other customary tenant expenses of the premises. Upon the commencement of bank operations, it is Bancorp's intention to assign the lease to TBSEC.

On June 23, 2004, Bancorp, through a nominee, entered into an agreement to purchase an approximately one acre improved site with two buildings in Clinton, Connecticut for the primary purpose of establishing a

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branch office of the Bank. The net purchase price of the property is \$495,000. The entity under which title to the property will be ultimately held is to be determined. During 2004, the Bank filed applications to the Connecticut Department of Banking and the FDIC to establish bank operations at the Clinton location. Due to a delay in completing the acquisition of the Clinton property, the Bank's initial application to the FDIC to establish the Clinton branch was withdrawn pending completion of the acquisition of the property. Bancorp intends that Bancorp or the Bank will improve the facility to accommodate banking services. The costs of such improvements have not been fully determined at this time. Development of the property is expected to begin in the second half of 2005, at which time the Bank will reapply with the FDIC for permission to establish the Clinton branch.

Item 3. Legal Proceedings.

There are no legal proceedings currently pending or threatened against Bancorp, its subsidiaries or their property. Bancorp is not aware of any proceeding contemplated by a governmental entity involving Bancorp or a subsidiary.

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Item 4. Submission of Matters to a Vote of Security Holders.

No matter was submitted to a vote of shareholders of Bancorp during the fourth quarter of the fiscal year covered by this Form 10-KSB.

PART II

Item 5. Market for Common Equity, Related Stockholder Matters and Small

Business Issuer Purchases Of Equity Securities.

Bancorp's Common Stock has been quoted on the American Stock Exchange under the symbol "SSE" since June 17, 2004. Prior to that date, Bancorp's Common Stock was quoted on the OTC Bulletin Board under the symbol "SCNO".

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The following table sets forth the high and low sales price* per share of Bancorp's Common Stock, as reported on Bloomberg Market Data System (TM) for the last two years:

(The prices listed may not reflect actual transactions.)

Quarter Ended	High	Low
March 31, 2004	\$11.70	\$ 7.95
June 30, 2004	\$ 9.80	\$ 7.95
September 30, 2004	\$ 8.75	\$ 7.55
December 31, 2004	\$ 8.53	\$ 8.16
March 31, 2003	\$ 7.50	\$ 7.09
June 30, 2003	\$ 9.77	\$ 7.00
September 30, 2003	\$ 9.36	\$ 7.86
December 31, 2003	\$ 9.09	\$ 7.86

*2003 share prices have been adjusted to reflect the 10% stock dividend declared January 13, 2004.

Holders

There were approximately 114 registered shareholders of record of Bancorp's Common Stock as of March 14, 2005.

Dividends

No cash dividends have been declared to date by Bancorp. Management expects that earnings, if any, will be retained and that no cash dividends will be paid in the near future. Bancorp may, however, declare stock dividends at the discretion of its Board of Directors. Bancorp declared a 10% stock dividend on January 13, 2004 to shareholders of record as January 30, 2004. Bancorp issued

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96,653 shares in connection with the stock dividend.

Bancorp's sole operating subsidiary is the Bank. Bancorp is dependent upon the ability of the Bank to declare and pay dividends to Bancorp. The Bank's ability to declare dividends is dependent upon the Bank's ability to earn profits and to maintain acceptable capital ratios, as well as meet regulatory requirements and remain compliant with banking law.

The policy of the Connecticut Banking Commissioner is to not permit payment of any cash dividends prior to recapture of organization and pre-operating expenses from operating profits. In addition, the Bank is prohibited by Connecticut law from declaring a cash dividend on its Common Stock without prior approval of the Connecticut Banking Commissioner except from its net profits for that year and any retained net profits of the preceding two years. "Net profits" is defined as the remainder of all earnings from current operations. In some instances, further restrictions on dividends may be imposed by the FDIC. However, during 2002, the Bank requested, and was granted, permission from the State of Connecticut Department of Banking, to pay a special cash dividend to Bancorp in the amount of \$200,000. At December 31, 2004 and 2003, no cash dividends may be declared by the Bank without regulatory approval.

The payment of dividends by the Bank may also be affected by other factors, such as the requirement to maintain capital in accordance with regulatory guidelines. If, in the opinion of the Connecticut Banking Commissioner, the Bank were engaged in or was about to engage in an unsafe or unsound practice, the

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Commissioner could require, after notice and a hearing, the Bank to cease and desist from the practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvements Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal banking agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

Equity Compensation Plan Information

The following schedule provides information with respect to the compensation plans (including individual compensation arrangements) under which equity securities of Bancorp are authorized for issuance as of December 31, 2004:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)
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Equity Compensation Plan approved by security holders	346,507	\$8.43
Equity Compensation Plan not approved by security holders (1)	73,509	\$10.91
Total	420,016	\$8.86

Bancorp adopted a 2001 Warrant Plan and 2001 Supplemental Warrant Plan (collectively, the "Warrant Plans") on April 11, 2001 and October 16, 2001. The Warrant Plans were not approved by security holders. Under the Warrant Plans, each director of Bancorp, other than Mr. Joseph V. Ciaburri, and each director of the Bank who is not a director of Bancorp, as of the initial public offering of Bancorp in July 2001, received a warrant to purchase one share of Bancorp common stock for each four shares purchased in the offering by such director or members of such director's immediate family. Under the 2001 Supplemental Warrant Plan, certain organizers of Bancorp who are not directors, officers or employees of Bancorp or the Bank but who made contributions to Bancorp's enterprise received a warrant to purchase one share of Bancorp common stock for each five shares purchased in the offering by such person or member of such person's immediate family. The warrants have a term of ten years. The exercise price of the warrants is \$10.91, the price at which Bancorp's common stock was sold in the initial public offering, as adjusted for the January 2004 10% stock dividend. They became exercisable as to 40%, 30% and 40% of the shares covered thereby on the first, second and third anniversary of the closing of the initial public offering of Bancorp, respectively. In the event of a change in control, the warrants will become exercisable in full.

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Recent Sales of Unregistered Securities

Bancorp has not sold unregistered securities.

Repurchase of Securities

Bancorp has not repurchased any of its securities.

Item 6. Management's Discussion and Analysis or Plan of Operation.

The following discussion is intended to assist you in understanding the financial condition and results of operations of Bancorp and the Bank, and should be read in conjunction with the consolidated financial statements and related notes beginning on page F-3.

Overview

Southern Connecticut Bancorp is a bank holding company headquartered in

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New Haven, Connecticut that was incorporated on November 8, 2000. Bancorp's strategic objective is to serve as a bank holding company for community based commercial banks serving the greater New Haven and greater New London markets, as well as the approximately 45 miles of coastal towns and communities located between these two cities and extending to Rhode Island.

Bancorp owns 100% of the capital stock of The Bank of Southern Connecticut, a Connecticut-chartered bank with its headquarters in New Haven, Connecticut, which commenced operations on October 1, 2001 after receiving its Final Certificate of Authority from the State of Connecticut and its deposit insurance from the FDIC. Bancorp has received a temporary certificate of authority from the State of Connecticut to charter a second, wholly-owned bank to be headquartered in New London, Connecticut. The establishment of TBSEC is subject to receipt of final approval from the Department of Banking, the approval of deposit insurance from the FDIC and the approval of the Federal Reserve Board; as further described in "Description of Business - Background" on page 4. Subject to these approvals, the New London based bank, to be named The Bank of Southeastern Connecticut, is expected to be open for business during the second half of 2005 and will be staffed, managed and operated in a comparable manner to the Bank.

Bancorp's net loss for fiscal year 2004 was \$98,000, a decrease of \$500,000 from the net loss of \$598,000 in fiscal year 2003. The decrease in the net loss from 2003 to 2004 reflects increased net interest income and non-interest income (from fees and other income, including referral fees and gains on sale of loan participations related to SBA guaranteed loans) during 2004 due to increased average earning assets in 2004 in comparison to 2003, and a larger average volume of customer accounts and higher transaction volume in 2004 as well. Increases in non-interest expense in 2004 in comparison to 2003 were due to increased asset and deposit volumes as well as to the development of infrastructure to support expanded operations, increased provision to the allowance for loan losses, and the cost of developing the proposed TBSEC, partially offset the increased revenue from net interest income and fee and other income.

The Bank offers a wide range of services to businesses, professionals and individuals. The Bank focuses on serving the banking needs of small to medium-sized businesses in its geographic areas. The Bank makes commercial loans, real estate and construction loans, consumer loans and accepts savings, time and demand deposits and provides a broad range of other services to its customers, either directly or through third parties.

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The Bank derives revenues principally from interest earned on loans and fees from other banking-related services. The operations of the Bank are influenced significantly by general economic conditions and by policies of financial institution regulatory agencies, primarily the Connecticut Banking Commissioner and the FDIC. Bancorp's cost of funds is influenced by interest rates on competing investments and general market interest rates. Lending activities are affected by the demand for financing of real estate and other types of loans, which in turn is affected by the interest rates at which such financings may be offered.

Year Ended December 31, 2004 Compared to December 31, 2003
Financial Condition

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Operating Data	2004	2003
Interest income	\$3,949,111	\$2,512,086
Interest expense	792,767	574,795
Net interest income	3,156,344	1,937,291
Provision for loan losses	341,108	213,100
Noninterest income	945,975	496,332
Noninterest expenses	3,859,495	2,818,450
Net loss	(98,284)	(597,927)
Basic and diluted loss per share	(0.05)	(0.56)
Balance sheet data		
Cash and due from banks	\$1,986,193	\$1,147,883
Federal funds sold	5,385,000	966,000
Short-term investments	8,372,689	454,115
Investment securities	11,371,894	8,478,068
Loans, net	49,763,952	40,818,718
Total assets	81,694,743	56,386,040
Total Deposits	58,700,377	47,273,875
Repurchase agreements	827,031	339,752
Total shareholders equity	20,697,727	7,314,302

Assets

Bancorp's total assets were \$81.7 million as of December 31, 2004, an increase of \$25.3 million over December 31, 2003. Earning assets comprise \$75.8 million of the total asset volume, and consist of Federal funds sold, short-term investments, securities and loans, a \$24.6 million increase from 2003. Bancorp has maintained liquidity by maintaining balances in overnight Federal funds sold and in short-term investments, primarily money market mutual funds, to provide funding for higher yielding loans as they are approved. As of December 31, 2004, Federal funds sold balances were \$5.4 million and short-term investments balances were \$8.4 million. Bank investment securities classified as available for sale were \$11.4 million and \$8.5 million as of December 31, 2004 and 2003, respectively. The gross loan portfolio was \$50.5 million and \$41.2 million as of December 31, 2004 and 2003 respectively, a net increase of \$9.3 million.

The earning asset increase in 2004 has been partially funded by deposit growth within the Bank's market area. Deposits were \$58.7 million and \$47.3 million as of December 31, 2004 and 2003 respectively, a net increase of \$11.4 million. The mix of deposits as of December 31, 2004 includes non-interest bearing checking accounts of \$17.3 million, interest-bearing checking deposits of \$8.7 million, savings deposits of \$3.3 million, money market deposits of \$20.6 million, as well as time certificates of deposit of \$8.8 million. The deposit mix

between 2004 and 2003 has not substantially changed, other than the reduction in the time deposit component due to a marketing de-emphasis of this product. The Bank has not accepted brokered deposits.

Investments

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The following table presents the maturity distribution of investment securities at December 31, 2004 and the weighted average yield of such securities. The weighted average yields were calculated based on the amortized cost and effective yields to maturity of each security.

Available for sale	One Year or Less	One Year Through Five Years	After Five but Within Ten Years	Over Ten Years	M
U. S. Government sponsored agency obligations	\$ 998,097	\$ 6,494,857	\$3,199,640	\$500,000	
Mortgage-backed securities	-	-	-	-	
Total	\$ 998,097	\$ 6,494,857	\$3,199,640	\$500,000	

The following table presents a summary of investments for any issuer that exceeds 10% of shareholders' equity at December 31, 2004.

	Amortized Cost	Fair Value
Federal National Mortgage Association	\$3,997,326	\$3,932,190
Federal Home Loan Bank	3,797,171	3,730,910
Federal Home Loan Mortgage Corporation	3,728,373	3,644,740

Loans

The Bank's net loan portfolio was \$49.8 million at December 31, 2004. Loan demand has been significant throughout the year. The net loan to deposit ratio as of December 31, 2004 was 84.9%. In comparison, the net loan to deposit ratio as of December 31, 2003 was 86.3%. Bancorp's current target for this ratio is 80% to 85%, and attributes the year end 2004 ratio to the success of the Bank's loan business development program to small to medium businesses, as well as an improving economy, in generating loan demand. Management believes that the ratio will generally remain within this band over time as the Bank's branch system deposit base grows and additional lending capacity is developed. The deployment of new deposit funds into the loan portfolio has produced a positive impact on net interest spread. See the table depicting the Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential on Page 26 of this Form 10-KSB. There are no significant loan concentrations in the loan portfolio.

The following table presents the maturities of loans in Bancorp's portfolio at December 31, 2004 by type of loan, and the sensitivities of loans to changes in interest rates:

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(Thousands of dollars)	Due in one year or less	Due after one year through five years	Due after five years	Total
Commercial loans secured by real estate	\$ 5,763,400	\$14,904,778	\$1,794,185	\$22,462,363
Commercial loans	17,897,241	6,263,476	257,741	24,418,458
Construction loans	2,232,461	44,357	-	2,276,818
Consumer home equity	421,399	432,459	-	853,858
Consumer installment	238,660	386,670	-	625,330
Total	\$26,553,161	\$22,031,740	\$2,051,926	\$50,636,827
Fixed rate loans	\$ 1,490,673	\$ 2,622,407	\$2,051,926	\$ 6,165,006
Variable rate loans	25,062,488	19,409,333	-	44,471,821
Total	\$26,553,161	\$22,031,740	\$2,051,926	\$50,636,827

Critical Accounting Policy

In the ordinary course of business, Bancorp has made a number of estimates and assumptions relating to reporting the results of operations and financial condition in preparing its financial statements in conformity with accounting principals generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. Bancorp believes the following discussion addresses Bancorp's only critical accounting policy, which is the policy that is most important to the portrayal of Bancorp's financial condition and results and requires management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Bancorp has reviewed this critical accounting policy and estimates with its audit committee. Refer to the discussion below under "Allowance for Loan Losses" and Note 1 to the consolidated financial statements for a detailed description of our estimation process and methodology related to the allowance for loan losses.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loans are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by

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management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses.

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The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Based upon this evaluation, management believes the allowance for loan losses of \$752,000 or 1.49% of gross loans at December 31, 2004 is adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2003, the allowance for loan loss was \$421,000 or 1.02% of gross loans outstanding. The increase in the allowance is attributable to management's assessment of the relevant factors impacting the quality of the loan portfolio, particularly the increase in the Bank's non-performing loans to approximately \$227,000 in the fourth quarter of 2004, including one impaired loan requiring a specific allowance of \$107,000.

The accrual of interest income on loans is discontinued whenever reasonable doubt exists as to its collectibility and generally is discontinued when loans are past due 90 days as to either principal or interest, or are otherwise considered impaired. When the accrual of interest income is discontinued, all previously accrued and uncollected interest is reversed against interest income. The accrual of interest on loans past due 90 days or more may be continued if the loan is well secured, and it is believed all principal and accrued interest income due on the loan will be realized, and the loan is in the process of collection. A non-accrual loan is restored to an accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt.

Management considers all non-accrual loans, other loans past due 90 days or more, based on contractual terms, and restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days and the related loans are not considered to be impaired. Bancorp considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

As of December 31,

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	2004	2003
Balance at beginning of period	\$ 421,144	\$ 2
Charge-offs	(28,976)	(
Recoveries	19,118	2
Provision charged to operations	341,108	2
Balance at end of period	\$ 752,394	\$ 4
Net charge-offs to average loans	.02%	

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	2004	2003
	Percent of Loans in Each Category to Total Loans	Balance
Commercial loans secured by real estate	44.36%	\$165,986
Commercial loans	48.22%	192,075
Construction loans	4.50%	35,589
Residential mortgages	0.00%	4,833
Consumer home equity loans	1.69%	1,300
Consumer installment loans	1.23%	21,361
Unallocated	0.00%	-
	100.00%	\$421,144

Non-Accrual, Past Due and Restructured Loans

Non-accrual loans at December 31, 2004 and 2003 totaled \$227,358 and \$94,063 respectively. In 2004 and 2003, there were no loans considered "troubled debt restructurings" and no loans greater than 90 days past due and still accruing interest.

Potential Problem Loans

Other than loans identified as non-accrual at December 31, 2004, the Bank had no material loans as to which management has significant doubts as to the ability of the borrower to comply with the present repayment terms.

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Deposits

Total deposits were \$58.7 million at December 31, 2004, an increase of \$11.4 million in comparison to total deposits as of December 31, 2003 of \$47.3 million. The deposit total at December 31, 2004 consists of non-interest bearing checking of \$17.3 million (29.5%), interest bearing checking and money market deposits of \$29.3 million (50.0%), savings deposits of \$3.3 million (5.6%) and certificates of deposit of \$8.8 million (14.9%). In 2004 the Bank emphasized growth in core non-interest checking accounts and related interest bearing checking, money market deposit, and savings accounts and was less aggressive in attracting higher cost time deposits. The Bank has not accepted any brokered deposits and has no present plans to review this policy.

The Bank continues to offer competitive interest rates in the very competitive New Haven County marketplace in order to fund expected loan growth.

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As of December 31, 2004 the Bank's maturities of time deposits were:

	\$100,000 or greater -----	Less than \$100,000 -----	Totals -----
(Thousands of dollars)			
Three months or less	\$ 2,230	\$ 858	\$ 3,088
Over three months to one year	2,616	1,413	4,029
Over one year	665	971	1,636
	-----	-----	-----
	\$ 5,511	\$ 3,242	\$ 8,753
	=====	=====	=====

Other

The increase in cash and due from banks is due to end of day settlement activity between the Bank and other financial institutions as of the close of business on December 31, 2004, and primarily represents checks deposited subject to customary Federal Reserve System inter-bank collection, typically of one business day duration.

The increase in loans held for sale is due to The Bank of Southern Connecticut's program of selling participations in SBA guaranteed loans. At December 31, 2004, \$99,000 of SBA guaranteed portion of loans were originated and held for sale by the Bank. At December 31, 2003, the Bank held no loans for sale.

The increase in Premises and equipment, net, is primarily due to the ongoing remodeling of the New London site for TBSEC. At December 31, 2004, \$141,000 of improvements had been completed in that facility. In addition, \$11,353 of equipment for TBSEC had been purchased and Bancorp has deposited \$25,000 with the seller of the proposed Clinton branch office property of the Bank.

In September, 2002, the Bank began offering repurchase agreements to customers, which are classified as secured borrowings, and generally mature

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within one to three days from the transaction date. Repurchase agreements are recorded at the amount of cash received in connection with the transaction. The Bank may be required to provide additional collateral based on the changes in fair value of the underlying securities. At December 31, 2004, repurchase agreement liabilities totaled \$827,000 in comparison to \$340,000 as of December 31, 2003.

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest bearing liabilities for the years ended December 31, 2004 and 2003.

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Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest differential

(Dollars in thousands)	2004			2003			Fluctuat in inter Income/Ex Total
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	
Interest earning assets							
Loans (1)	\$ 47,680	\$ 3,542	7.43%	\$ 29,091	\$ 2,224	7.64%	\$ 1,3
Short-term investments	3,895	55	1.41%	993	7	0.70%	
Investments	10,687	269	2.52%	8,747	256	2.93%	
Federal funds sold	6,064	83	1.37%	2,379	25	1.05%	
Total interest earning assets	68,326	3,949	5.78%	41,210	2,512	6.10%	1,4
Cash and due from banks	992			1,396			
Premises and equipment, net	3,403			3,381			
Allowance for loan losses	(483)			(303)			
Other	1,256			1,068			
Total assets	\$ 73,494			\$ 46,752			
Interest bearing liabilities							
Time certificates	\$ 11,441	245	2.14%	\$ 6,534	166	2.54%	
Savings deposits	3,097	38	1.23%	1,984	21	1.06%	
Money market / checking deposits	26,170	330	1.26%	18,381	211	1.15%	1
Capital lease obligations	1,190	171	14.37%	1,191	169	14.19%	
Repurchase agreements	1,336	9	0.67%	914	8	0.88%	
Total interest bearing liabilities	43,234	793	1.83%	29,004	575	1.98%	2

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Non-interest bearing deposits	15,453	9,645
Accrued expenses and other liabilities	423	357
Shareholder's equity	14,384	7,746
	-----	-----
Total liabilities and equity	\$ 73,494	\$ 46,752
	=====	=====

Net interest income	\$ 3,156	\$ 1,937	\$ 1,2
	=====	=====	=====
Interest spread	3.95%	4.12%	
	=====	=====	
Interest margin	4.62%	4.70%	
	=====	=====	

(1) Includes nonaccruing loans.

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RATE VOLUME VARIANCE ANALYSIS

The following table summarizes the variance in interest income and expense for 2004 and 2003 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest income and expense attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis.

(Dollars in thousands)	2004 vs 2003		
	Volume	Rate	Total

	Variance due to:		

Interest earning assets			
Loans	\$1,381	\$ (63)	\$ 1,318
Short-term investments	4	44	48
Investments	52	(39)	13
Federal funds sold	30	28	58
	-----	-----	-----
Total interest earning assets	1,467	(30)	1,437
	-----	-----	-----
Interest bearing liabilities			
Time certificates	108	(29)	79
Savings deposits	10	7	17
Money market / checking deposits	83	36	119
Capital lease obligations	-	2	2
Repurchase agreements	3	(2)	1
	-----	-----	-----
Total interest bearing liabilities	204	14	218
	-----	-----	-----

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Net interest income	\$1,263	\$ (44)	\$ 1,219
	=====	=====	=====

The improvements realized in net interest income during 2004 primarily reflect substantial increased earning asset volume over 2003, as the average earning assets in 2004 of \$68.3 million were 66% greater than average earning assets in 2003, and increases of 125 basis points in the level of short term interest rates occurring since midyear 2004. The increase in short term interest rates, such as the federal funds rate and the prime lending rate and other short term lending indices charged by banks, including the Bank, increased due to actions taken by the Federal Reserve on five occasions beginning in June 2004. Overall, interest income attributed to volume considerations considerably outweighed rate considerations (increase of \$1.5 million versus a decrease of \$30,000). Due to the decrease in the volume of the higher rate, longer term fixed interest rate portion of the loan portfolio, and a shortening of the duration of the investment portfolio during 2004, the impact of rising short term rates on the average yield in these portfolios was mitigated and the loan and investment average portfolio yields realized declined in 2004 in comparison to 2003. Variances in the 2004 cost of interest bearing liabilities in comparison to 2003 were due to increased volume considerations of \$204,000 and increased rate considerations of \$14,000.

The increase in the net loan portfolio and increases in investments in short term investments, investments, and federal funds sold have been the primary factor in improving net interest income. The net loan portfolio increase of \$8.9 million and net increase in investments, short-term investments and federal funds sold of \$15.2 million in 2004 was accompanied by a \$1.2 million increase in net interest income of Bancorp. Bancorp intends for the Bank, and TBSEC in the future, to continue to emphasize lending to small to medium businesses in its market area as its strategy to increase assets under management and to improve earnings. The Bank will seek opportunities to increase its deposit base, with a primary objective of attracting core non-interest checking and related money market deposit accounts, in order to support its earning assets through marketing, and by considering additional branch locations and new product and service offerings.

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The following are measurements of Bancorp's earnings (loss) in relation to assets and equity, and average equity to average assets for the year ended December 31, 2004 and 2003.

	2004	2003
	-----	-----
Return (Loss) on average assets	(.13%)	(1.28%)
Return (Loss) on average equity	(.68%)	(7.72%)
Average equity to average assets	19.57%	16.56%

Results of Operations

Bancorp's net loss for fiscal year 2004 was \$98,000, a decrease of

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\$500,000 from the net loss of \$598,000 in fiscal year 2003. The decrease in the 2004 loss was primarily due to increases in net interest income of \$1.2 million and non-interest income of \$450,000, partly offset by increases in non-interest expenses of \$1.0 million and in the provision for loan losses of \$128,000. The increase in non-interest expense was due to increases in staffing due to increased loan and deposit activity and other expenses relating to the development of the Bank's infrastructure. Also during 2004, Bancorp continued to incur expenses relating to the development of TBSEC.

Net Interest Income

The principal source of our revenues is net interest income. Bancorp's net interest income is dependent primarily upon the difference or spread between the average yield earned on loans receivable and securities and the average rate paid on deposits and borrowings, as well as the relative amounts of such assets and liabilities. Bancorp, like other banking institutions, is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different times, or on a different basis, than its interest-earning assets.

For the year December 30, 2004, net interest income was \$3.2 million versus \$1.9 million for the year ended December 31, 2003, a \$1.3 million or 62.9% increase. The 2004 increase was primarily the result of a \$27.1 million increase in average interest earning assets. The increase in average interest earning assets was comprised of increases in average loans of \$18.6 million, investments of \$1.9 million, short term investments of \$2.9 million and federal funds sold of \$3.7 million.

The yield on average interest earning assets for the twelve months ended December 31, 2004 was 5.78% versus 6.10% for same period in 2003, a decrease of 32 basis points. The decrease in the yield on assets reflects the increased level of average investments, short term investments, and federal funds sold during 2004 in comparison to 2003, which yield less than loan assets, as well as the lower yield on average loans due to a shortening of the average life to repricing of loans that occurred during 2004. Decreases in the yield on average earning assets in 2004 due to the mix of assets and due to the shortening of the loan portfolio average life were partially offset by the increases in market interest rates that occurred after midyear 2004, particularly in the prime lending rate and the Bank's base lending rate.

The cost of average interest bearing liabilities was 1.83% for the twelve months ended December 31, 2004 versus 1.98% for the same period in 2003, a favorable decrease of 15 basis points. The decrease in the cost of interest bearing liabilities was due to the \$7.8 million increase in the average outstanding balances of low rate money market and interest bearing checking deposits in comparison to the total increase in interest bearing liabilities of \$14.2 million. The average rate of interest paid on money market and interest bearing checking deposits increased 11 basis points in 2004 in comparison to 2003, significantly less than the general increase in the level of market rates during the year. Also, the Bank's average cost of funds for time deposits decreased 40 basis points in 2004 in comparison to 2003.

Due to the change in the mix of assets and the resulting decrease in the average yield on earning assets in 2004, partially offset by the favorable decrease in the cost of interest bearing liabilities, the interest spread decreased to 3.95% for fiscal year 2004, a decrease of 17 basis points from the interest spread realized in 2003. Net interest margin decreased to 4.62% in 2004 from 4.70% in 2003, a change of 8 basis points which largely reflects the change in the mix of assets in

the second half of 2004 to a higher percentage of investments, short term investments and federal funds sold in comparison to 2003.

Noninterest Income

The \$450,000 increase in non-interest income for the twelve months ended December 31, 2004 versus 2003 is comprised of an increase of \$221,000 in referral fee income and gains on sales of loan participations related to SBA guaranteed loans, increased deposit account service charges and fees of \$204,000 and an increase in other noninterest fee income of \$65,000, offset by a decrease in gains on the sales of investment securities of \$41,000. The Bank intends to continue to originate SBA guaranteed loans in the future and expects to continue to realize gains and earn fee income from SBA loan participation sales and referrals. It is anticipated that TBSEC will also originate and sell participations in the guaranteed portion of such loans. The increase in other noninterest fee income is attributable to volume growth in the loan and deposit portfolios, as well as increases in prepayment penalties on loans of \$18,000, and investment banking fees of \$25,000.

Noninterest Expenses

Total noninterest expenses were \$3.9 million for the year ended December 31, 2004 versus \$2.8 million for 2003, an increase of \$1,041,000 or 37%. The increase in expenses is due to the increases in Bancorp's loan and deposit volume, additional staffing in the lending, loan review and operations areas of the Bank, and other operating expenses. As a result, salaries and benefits increased \$501,000 to \$2.0 million in fiscal year 2004 in comparison to fiscal year 2003, and occupancy and equipment expenses increased by \$148,000 in fiscal year 2004 to \$518,000.

Bancorp and the Bank engaged various legal and other professional advisors and consultants during 2004 for the purposes of advising on matters relating to the public offering completed during 2004, the New London bank franchise initiative, and to develop the infrastructure of the Bank. Professional services for the year ended December 31, 2004 increased \$171,000 over the year ended December 31, 2003. Other operating expenses for 2004 totaled \$438,000, an increase of \$110,000 over the total for 2003. The increase in other operating expense is primarily attributable to higher insurance costs of \$50,000, and an increase in filing fees, largely attributable to SEC and stock exchange requirements, of \$22,000. Data processing expense increased \$87,000 during 2004 in comparison to 2003, to total \$284,000. The increase is attributable to increased processing costs at the Bank primarily relating to volume, increased services and expanded infrastructure.

Off-Balance-Sheet Arrangements

See Note 12 to the accompanying consolidated Financial Statements for required disclosure regarding off-balance-sheet arrangements.

Liquidity

Bancorp's liquidity position as of December 31, 2004 and December 31, 2003 consisted of liquid assets totaling \$27.2 million and \$11.1 million,

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respectively. This represents 33.2% and 19.6% of total assets at December 31, 2004 and 2003, respectively. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets as described in the accompanying balance sheet are considered liquid assets: Cash and due from banks, federal funds sold, short-term investments and securities available for sale. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposits and increases in its loan portfolio. The liquidity ratio as of December 31, 2004 is substantially higher than that at year end 2003 primarily due to the public offering in June 2004 pursuant to which \$13.3 million in net capital was raised, of which \$6 million has been invested by Bancorp in short term investments in anticipation of funding the capital of TBSEC during 2005.

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Management believes Bancorp's short-term assets provide sufficient liquidity to cover potential fluctuations in deposit accounts and loan demand and to meet other anticipated operating cash and investment requirements, such as the capitalization of TBSEC and the establishment of the proposed Clinton branch office of the Bank. Other than these uses of Bancorp and the Bank's short-term liquid assets, there are no current plans involving the significant purchase or sale of property or equipment.

Capital

	Bancorp	
	December 31, 2004	December 31, 2003
Tier 1 (Leverage) Capital Ratio to Average assets	24.66%	14.18%
Tier 1 Capital to Risk Weighted Assets	32.08%	16.36%
Total Capital to Risk Weighted Assets	33.24%	17.27%

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Based on the above ratios, the Bank is considered to be "well capitalized" under applicable regulations. To be considered "well capitalized" an institution must generally have a leverage capital ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%.

Bancorp's required ratios are not substantially different from those shown above.

Subject to final regulatory approval, Bancorp intends to establish The Bank of Southeastern Connecticut in the second half of 2005. Bancorp also anticipates commencing the operations of SCB Capital, Inc. in late 2005.

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Currently, the Bank has limited authority to conduct investment banking activity under Regulation B of the Federal Reserve Act, which authority, unless extended, expires March 31, 2006. Provided the new bank subsidiary and SCB Capital Inc. receive regulatory approval, Bancorp will capitalize these entities in 2005. The application for TBSEC specifies that the initial capitalization of TBSEC will be approximately \$6 million. The National Association of Security Dealers rules and regulations require a minimum capitalization for SCB Capital, Inc. to be not less than \$25,000.

Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of the Company's business, market risk is primarily limited to interest rate risk, which is defined as the impact of changing interest rates on current and future earnings.

Bancorp's goal is to maximize long-term profitability, while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread, while reducing the net effect of changes in interest rates. In order to reach an acceptable interest rate spread, Bancorp must generate loans and seek acceptable long-term investments to replace the lower yielding balances in Federal Funds sold and short-term investments. The focus also must be on

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maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable loans for the portfolio to offset the short-term re-pricing of the liabilities. In fact, a number of the interest bearing deposit products have no contractual maturity. Customers may withdraw funds from their accounts at any time and deposits balances may therefore run off unexpectedly due to changing market conditions.

The exposure to interest rate risk is monitored by the Asset and Liability Management Committee ("ALCO") consisting of senior management personnel and selected members of the Board of Directors. ALCO reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. ALCO reports to the Board of Directors on a quarterly basis regarding the status of ALCO activities within Bancorp.

Impact of Inflation and Changing Prices

Bancorp's financial statements have been prepared in terms of historical dollars, without considering changes in relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effect of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Notwithstanding this fact, inflation can directly affect the value of loan collateral, in particular,

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real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

Factors Affecting Future Results

Some of the statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere in this Annual Report on Form 10-KSB may include forward-looking statements which reflect our current views with respect to future events and financial performance. Statements which include the words "expect," "intend," "plan," "believe," "project," "anticipate" and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements or that could adversely affect the holders of our common stock. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its bearing liabilities, (2) the timing of re-pricing of Bancorp's interest earning assets and interest bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the effect of changes in regulations applicable to Bancorp and the conduct of its business, (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks and the impact of recently enacted federal legislation, (6) the ability of competitors which are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide, (7) the volatility of quarterly earnings, due in part to the variation in the number, dollar volume and profit realized from SBA guaranteed loan participation sales in different quarters, (8) the effect of a loss of any executive officer, key personnel, or directors, (9) the effect of Bancorp's opening of branches and organization of a new bank and the receipt of regulatory approval to complete both actions, (10) concentration of Bancorp's business in Southern Connecticut, (11) the concentration of Bancorp's loan portfolio in commercial loans to small-to-medium sized businesses, which may be impacted more severely than larger businesses during periods of economic weakness, (12) lack of seasoning in Bancorp's loan portfolio, which may increase the risk of future credit defaults, and (13) the effect of any decision by Bancorp to engage in any business not historically permitted to it. Other such factors may be described in other filings made by Bancorp with the SEC.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

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Item 7. Financial Statements

The consolidated balance sheets of Bancorp as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended, together with the report thereon of McGladrey & Pullen, LLP dated March 5, 2004 are included as part of this Form 10-KSB in the "Financial Report" following page 39 hereof.

Item 8. Changes in and Disagreements with Accountants on Accounting and

Financial Disclosure

Not applicable.

Item 8A. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

Based upon an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with participation of Bancorp's Chief Executive Officer, Chief Operating Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer, Chief Operating Officer and Chief Financial Officer concluded that Bancorp's disclosure controls have been effective in ensuring that material information relating to Bancorp, including its consolidated subsidiary, is made known to the certifying officers by others within Bancorp and the Bank during the period covered by this report.

As used herein, "disclosure controls and procedures" mean controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls

There have not been any significant changes in Bancorp's internal controls or in other factors that occurred during Bancorp's fiscal year ended December 31, 2004 that could significantly affect these controls subsequent to the evaluation referenced in paragraph (a) above.

Item 8B. Other Information

Not Applicable.

PART III

Item 9. Directors and Executive Officers of the Registrant

The information required by this Item 9 is incorporated into this Form 10-KSB by reference from Bancorp's definitive proxy statement for its 2005 Annual Meeting of Shareholders (the "Definitive Proxy Statement").

Item 10. Executive Compensation

The information required by this Item 10 is incorporated into this Fo organized;

- + the risk that dividends may be withheld at the source;
- + dependency on exports and the corresponding importance of international trade;
- + the difference in, or lack of, disclosure, auditing and financial reporting standards, which may result in unavailability of material information about issuers in many Central European countries;
- + the risk that the tax systems of Central European countries may not be reformed to prevent inconsistent, retroactive and/or exorbitant taxation;

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RISK FACTORS AND SPECIAL CONSIDERATIONS

- + the fact that statistical information regarding the economy of Central European countries may be inaccurate or not comparable to statistical information regarding the United States or other economies;
- + less extensive regulation of the securities markets than in more developed countries;
- + markets that may be substantially influenced by insider trading and other market practices not accepted in developed markets;
- + the risks associated with the difficulties that may occur in pricing our portfolio securities;
- + possible difficulty in identifying a purchaser of securities held by us due to the underdeveloped nature of the securities markets in Central Europe; and
- + the risk of lawsuits arising from restrictive regulations and practices with respect to foreign investment in particular industries.

RISKS FACTORS RELATING TO INVESTMENT IN RUSSIA

Investing in Russia subjects us to many of the same risks associated with investing in Central European countries that are described above. However, there

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are significant risks inherent in Russian securities that are not typically associated with securities of companies in more developed countries. The value of Russian securities may be affected by various uncertainties, such as economic, political and social instability, investment and regulatory risk, including crime and corruption in government and business, and inconsistency and underdevelopment of Russia's tax and legal systems. As is the case with issuers in most emerging markets, Russian securities are subject to a higher degree of volatility than the securities of Western companies. Although investment in Central European countries shares some of these risks, as described above, investments in Russia should be considered to have greater risks.

Since the break-up of the USSR at the end of 1991, Russia has undergone substantial and, at times, turbulent economic disruption and political and social upheaval. Russia continues to make the transition from a centrally controlled command system to a market-oriented, democratic model of government, but its continued development, and the pace with which it continues to make the transition, remains uncertain. Since 1991, Russia has been affected by declines in gross domestic product (GDP), hyperinflation, an unstable currency and high government indebtedness relative to GDP. The Russian economy also suffers from the lack of an effective banking system and a significant proportion of commercial transactions are settled in kind or by the use of promissory notes. The Russian economy is also plagued by a deteriorating infrastructure due to poor funding and maintenance, and potential inflationary pressures and currency devaluation as a result of insufficient funding on its debts. Russia's role and its reintegration into the global political economy are also unsettled. Moreover, internal regional conflicts continue to exist, which highlight the political tension between the central government in Moscow and certain regions within the Russian Federation. At times, the Russian government also engages in expropriation, nationalism and confiscation of assets.

Russia's lower house of parliament, the Duma, held elections on December 9th, 2003. The elections have resulted in a firmer shift of power towards parties professing loyalty to President Vladimir Putin, who with their support now has a simple majority that would allow him to pass legislation without having to compromise with other parties. There is also the possibility that an alliance of the parties loyal to President Putin could effect changes in Russia's constitution, including extending the term for which the President is allowed to serve. The election also led to the defeat of liberal and free-market political parties, which failed to attain the necessary 5% of the votes to gain seats in the Duma. At the same time one ultra-nationalistic party was able to double its representation in parliament. The election was criticized almost unanimously by independent observers, and allegations of election tampering remain unresolved. President Putin himself has been criticized for using state-run media

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RISK FACTORS AND SPECIAL CONSIDERATIONS

outlets, which control major segments of Russia's media landscape, for election purposes, as well as for failing to enforce a Russian law that would have mandated similar coverage for other political parties. Russia's transition towards a well-functioning democracy remains uncertain and much will depend on President Putin in the future, particularly on his relationship to the parties now loyal to him. President Putin will run for reelection in March of 2004.

The Russian economy relies heavily on the production and export of oil. Oil and gas companies can be significantly affected by the supply of and demand for energy fuels generally as well as the supply of and demand for oil and gas in particular, the general condition of industries that serve oil and gas companies, price fluctuations in energy and oil and gas prices, exploration and

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production spending, energy conservation, the success of exploration projects, government regulation, including taxation, world events, events involving nature, other events involving international politics, increased competition, social views, environmental concerns and economic conditions. Natural gas companies, moreover, are subject to changes in price and supply of both conventional and alternative energy sources. Russia also has substantial trading links with Iraq. Because Russia is highly sensitive to changes in the world oil price and because of recent United States military action against Iraq, it is even more difficult to predict future oil price movements with any certainty and fluctuations in pricing may increase substantially.

In addition, Russia's largest oil company, Yukos, is undergoing significant difficulties. An investigation over several billion U.S. dollars worth of allegedly back taxes has been launched, and the company's former chief executive has been arrested and charged with tax evasion and fraud. In early 2003 Yukos and Sibneft, another major Russian oil company, began merger talks which would have resulted in the world's fourth largest oil company. Sibneft has since announced it is terminating the merger, and the company is currently in the process of repurchasing the majority of its shares from Yukos. Yukos' difficulties have led to uncertainty in the Russian markets in general, and allegations of political motivations behind the company's investigation have added further uncertainty.

There is still no centralized public market for trading Russian securities, despite the number of stock exchanges in Russia, and trading occurs mostly over-the-counter. The Russian securities market is still developing and is regulated by several different authorities that are often in competition with each other, resulting in contradictory regulations, at times. Corporate governance standards for Russian companies have also proven to be poor, and minority stockholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer-pricing practices. Stockholders of Russian securities also lack many of the protections available to stockholders of Western issuers. In addition, businesses and parts of the Russian economic system also continue to suffer from very high crime levels, including extortion and fraud. Moreover, accounting, financial and auditing reporting by Russian companies is also generally of less quality and less reliable compared with Western companies.

Laws and regulations involving foreign investment in Russian enterprises, title to securities and transfer of title are also relatively new and can change quickly and unpredictably in a manner far more volatile than in developed market economies. We may also experience difficulty transferring income received in investments in Russian issuers, such as profits, dividends and interest payments, abroad. See "--Exchange Rate Fluctuations and Foreign Currency Considerations" below on page 34.

Russia's taxation system is frequently subject to change, and enforcement is inconsistent at federal, regional and local levels. Decision-making and enforcement under Russia's legal system also lack any consistency as a result of the volume of new legislation and political instability.

DILUTION OF NET ASSET VALUE

A dilution of the aggregate net asset value on a share of our common stock may be experienced as a result of this rights offering because the subscription price may be less than our then current net asset

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value per share. In addition, as a result of the terms of this rights offering, stockholders who do not fully exercise their rights should expect that they will, at the completion of this rights offering, own a smaller proportional interest in us than would otherwise be the case. Although it is not possible to state precisely the amount of such a decrease in value, because it is not known at this time what proportion of the shares will be subscribed for as a result of this rights offering, what the subscription price will be or what the net asset value per share will be on the expiration date, the dilution could be substantial. For example, assuming that all rights are exercised and that the subscription price of \$ is approximately % below our net asset value of \$ per share on , 2004 our net asset value per share (after payment of the financial advisory and soliciting fees and estimated offering expenses) would be reduced by approximately \$ per share. The distribution to stockholders of transferable rights which themselves may have intrinsic value will also afford non-participating stockholders the potential of receiving a cash payment upon sale of their rights, receipt of which may be viewed as partial compensation for the dilution of their interest in us. No assurance can be given that a market for the rights will develop or as to the value, if any, that rights will have.

NET ASSET VALUE DISCOUNT

As with any stock, the price of our shares of common stock will fluctuate with market conditions and other factors. Shares of closed-end investment companies frequently trade at a discount from net asset value. This is a risk separate and distinct from the risk that our net asset value will decrease. We cannot predict whether our common stock will trade at, above or below net asset value. The risk of purchasing shares of a closed-end fund which might trade at a discount is more pronounced for investors who wish to sell their shares in a relatively short period of time after the purchase because, for those investors, realization of gain or loss on their investment is likely to be more dependent upon the existence of a premium or discount than upon portfolio performance. Our shares of common stock are not entitled to redemption. Investors desiring liquidity may, subject to applicable securities laws, trade their shares on the NYSE. Stockholders wishing to sell their shares of common stock during this rights offering should be aware that there is greater risk that the discount to net asset value, which may increase during this rights offering, will adversely affect them. This increased risk is because, among other things, the market price per share may reflect anticipated dilution that will result from this rights offering. There can be no assurance that, after the completion of this rights offering, our shares will trade at the same level as our current discount to net asset value. For information about our common stock and its current and historical performance, see "Market and Net Asset Value Information" on page 13 of this prospectus and "Description of Common Stock" on page 40 of this prospectus.

EXCHANGE RATE FLUCTUATIONS AND FOREIGN CURRENCY CONSIDERATIONS

Substantially all of our assets are invested in Central Europe and Russia, and substantially all of the income we receive from these investments will be in euros or other foreign currencies. We anticipate that in general the foreign currencies received by us with respect to most of our investments will be freely convertible into U.S. dollars on foreign exchange markets and that in most cases the U.S. dollars received will be fully repatriable out of the various foreign countries in which we invest. However, our investments in Russia will be in securities denominated in Russian Roubles, which are not externally convertible into other currencies outside of Russia. There can be no assurance that the foreign countries in which we invest will not impose restrictions in the future movement of U.S. dollars or foreign currencies across local borders or on the convertibility of the foreign currencies into U.S. dollars.

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The value of our assets and income will be measured in U.S. dollars. Assets and liabilities denominated in euros or other foreign currency amounts are translated into U.S. dollars at 10:00 a.m. mid-point of

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the buying and selling spot rates quoted by the Federal Reserve Bank of New York. We will compute and distribute income in U.S. dollars, and the computation of income will be made on the day we earn the income. Therefore, if the value of foreign securities in which we receive income falls relative to the U.S. dollar between the earning of the income and the time at which we convert the foreign currencies to U.S. dollars, we may be required to liquidate securities in order to make distributions if we have insufficient cash in U.S. dollars to meet distribution requirements. The liquidation of investments, if required, may have an adverse impact on our performance.

Since we will invest in securities denominated or quoted in currencies other than the U.S. dollar, changes in foreign currency exchange rates will affect the value of our securities in our portfolio and the unrealized appreciation or depreciation of our investments. Further, we may incur costs in connection with conversions between various currencies.

We do not currently engage in foreign exchange transactions as an investment strategy. However, at such future time as our investment manager and investment advisor believe that one or more currencies in which our securities are denominated might suffer a substantial decline against the U.S. dollar, we may, in order to hedge the value of our portfolio, enter into forward currency contracts. For more information on our investment policies with respect to currency transactions, see "Investment Objective and Policies--Currency Transactions" on page B-5 of the SAI.

INTEREST EXPENSE

We may, subject to limitations described under "Investment Restrictions" in the SAI, borrow money for temporary or emergency purposes for the clearance of transactions. Borrowing money will subject us to interest expenses, and we may incur other transactions costs.

CERTAIN PROVISIONS OF OUR ARTICLES OF INCORPORATION AND BYLAWS

We have provisions in our articles of incorporation and bylaws that could have the effect of delaying, deferring, preventing or otherwise limiting the ability of other entities or persons to acquire control of us, to cause us to engage in certain transactions or to modify our structure. For a discussion of these provisions, see "Description of Common Stock--Provisions of Our Articles of Incorporation and Bylaws Affecting Change of Control and Extraordinary Transactions" on page 40 of this prospectus.

FOREIGN CUSTODY

Investors Bank and Trust Company ("IBT") acts as our custodian. IBT has agreements with a global network of sub-custodians, which, together with IBT, maintain custody of our portfolio securities and cash. Thus, our foreign securities and cash are generally held in foreign banks and securities depositories. There may be limited or no regulatory oversight over their operations. Also, the laws of certain countries may put limits on our ability to recover our assets if a foreign bank, depository or issuer of a security, or any of their agents, goes bankrupt. In addition, it is often more expensive for us

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to buy, sell and hold securities in certain foreign markets than in the United States. The increased expense of investing in foreign markets reduces the amount we can earn on our investments and typically results in a higher operating expense ratio for us than for investment companies invested only in the United States.

MARKET DISRUPTION

As a result of terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001, some of the U.S. securities markets were closed for a four-day period. These terrorist attacks and related events have led to increased short-term market volatility. U.S. military and related action in Iraq and Afghanistan and events in the Middle East could have significant adverse effects on U.S. and

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world economies and markets. We do not know how long the securities markets will continue to be affected by these events and cannot predict the effects of the military action or similar events in the future on the U.S. economy and securities markets. A similar disruption of the U.S. or world financial markets could impact interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to our common stock.

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Our management

INFORMATION REGARDING DIRECTORS AND OFFICERS

Our business and affairs are managed under the direction of our board of directors. The directors approve all significant agreements between us and persons or companies furnishing services to us, including our agreement with our investment manager, investment adviser, custodian and transfer agent. The management of our day-to-day operations is delegated to our officers and to our investment manager and investment adviser, subject always to our investment objective and policies and to the general supervision of our board of directors. We have nine directors, three of whom are "interested persons" (as defined in the Investment Company Act) and six of whom are not "interested persons." An "interested person" is a director who is not independent under the specific requirements of the Investment Company Act. The names and business addresses of our directors and officers and their principal occupations and other affiliations during the past five years are set forth on page B-8 under "Management" in the SAI.

INVESTMENT MANAGER

Deutsche Bank Securities Inc. ("DBSI"), with principal offices located at 60 Wall Street, New York, New York, is our investment manager and administrator. Subject to the supervision of our board of directors and pursuant to recommendations made by our investment adviser, DBSI also determines which securities are suitable for our investment. We pay DBSI an annual management fee equal to 0.65% of our average weekly net assets up to \$100 million, and 0.55% for those assets in excess of \$100 million.

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DBSI is an indirect wholly-owned subsidiary of Deutsche Bank AG. DBSI is engaged in the securities underwriting, investment advisory and securities brokerage business, and it is a member of the NYSE and other principal United States stock exchanges. DBSI also serves as investment manager for The Germany Fund, Inc. and The New Germany Fund, Inc., which are closed-end registered investment companies.

With total assets of approximately \$1,826.7 billion, Deutsche Bank AG is the largest commercial and investment bank in Germany and a leading European financial institution, and is ranked among the world's largest banks in terms of total assets as of September 30, 2003. Its principal corporate offices are located at Taunusanlage 12, 60325 Frankfurt am Main, Germany. Deutsche Bank AG and certain of its affiliates are engaged in the management of client funds as well as investment advisory activities. The total amount of funds under management by Deutsche Bank AG and its affiliates was approximately \$ billion as of , 2003.

For additional information about our investment manager, see "Investment Advisory and Other Services" on page B-17 of the SAI.

INVESTMENT ADVISER

Deutsche Asset Management International GmbH ("DeAMI"), with principal offices located at Mainzer Landstrasse 178-190, 60327 Frankfurt am Main, Germany, is our investment adviser. In accordance with our investment objective, policies and restrictions, DeAMI makes recommendations to our investment manager with respect to our investments and, upon instructions given by our investment manager as to which securities are suitable for investment, transmits purchase and sale orders and selects brokers and dealers to execute portfolio transactions on our behalf. We pay DeAMI an annual investment advisory fee equal to 0.35% of our average weekly net assets up to \$100 million, and 0.25% for those assets in excess of \$100 million.

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OUR MANAGEMENT

DeAMI is a subsidiary of Deutsche Bank AG. DeAMI provides international portfolio management services to institutional investors worldwide. As of December 31, 2003, funds worth \$8.7 billion were managed by DeAMI for institutional accounts in more than ten countries, including the United States. DeAMI also serves as investment adviser for The Germany Fund, Inc. and The New Germany Fund, Inc., which are closed-end registered investment companies.

For additional information about our investment adviser, see "Investment Advisory and Other Services" on page B-17 of the SAI.

PORTFOLIO MANAGEMENT

The names of the persons primarily responsible for the day-to-day management of our investment portfolio and their business experience during at least the past five years are set forth in the table below.

NAME	TITLE	LENGTH OF TIME SERVED	BUSINESS EXPERIENCE D
----	-----	-----	-----
Hanspeter Ackermann	Chief Investment Officer	Year to year since 1996.	President of Deutsche

			Management Inc. Manag Bank Securities Inc. Senior International Manager, Bankers Trus Fund, Inc. and The Ne President and Managin Management (1993-1996 and CIO, SBC Brinson, Portfolio Management (institutional invest (1983-1993). Funds manager for Eme Equities at DWS/DeAM
Steffen Gruschka	Head of Emerging European Equities, Director	Year to year since 2001.	
Robert Kalin	Senior Fund Manager Equities	Year to year since 2002.	Senior Portfolio Mana Markets at DWS/DeAM s Senior Portfolio Mana (2001-2002), responsi Europe; Advisor to Zu Mittelosteuropa Fund
Sylwia Szczepek	Senior Fund Manager Equities	Year to year since 2001.	Funds manager for Eme Equities at DWS/DeAM Deutsche Bank, Corpor

AFFILIATED BROKERAGE

We pay brokerage commissions to Deutsche Bank AG, and its affiliates. Deutsche Bank AG is the German parent of our investment manager and investment adviser. For our fiscal year ended October 31, 2003, Deutsche Bank AG and its affiliates received \$5,665 in brokerage commissions as a result of executing agency transactions in portfolio securities on our behalf. For information about brokerage practices and commissions, see "Brokerage Allocation and Other Practices" on page B-18 of the SAI.

OUR EXPENSES

In addition to the management fee and advisory fee of our investment manager and investment adviser, respectively, we are responsible for the following expenses if incurred:

- + the fees and expenses of directors who are not affiliated with our investment manager or investment adviser;

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OUR MANAGEMENT

- + interest expenses;
- + all taxes and corporate fees payable by us to governmental agencies;
- + broker's commissions and other expenses in connection with our securities transactions;
- + the cost of stock certificates representing our shares;
- + expenses of registering our shares with federal, state and foreign securities authorities;

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- + the charges and expenses of our legal counsel and independent accountants;
- + the fees and certain expenses of our custodian and transfer and dividend disbursing agents, including those in respect of the accounting and record-keeping services;
- + expenses related to stock exchange listings of our shares;
- + expenses of our stockholders meetings and of preparing and distributing proxies and reports to our stockholders; and
- + litigation and indemnification expenses and other extraordinary expenses not incurred in the ordinary course of our business.

NON-RESIDENT DIRECTORS AND INVESTMENT ADVISER

Five of our directors reside outside of the United States and all or a significant portion of the assets of these directors are located outside of the United States. In addition, our investments adviser's principal offices are based outside the United States and all or a significant portion of our investment adviser's assets are located outside of the United States. Our non-resident directors have no authorized agents in the United States to receive service of process. As a result, it may not be possible for investors to effect service of process within the United States upon these directors or to enforce against them in United States courts judgments predicated upon the civil liability provisions of United States securities laws.

Central European and Russian markets

[To be added by amendment]

Economies of Central Europe and Russia

[To be added by amendment]

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Description of common stock

GENERAL

All shares of common stock are equal as to earnings, assets, dividends, liquidation and voting privileges and, when issued, will be fully paid and nonassessable. There are no conversion, pre-emptive or other subscription rights. In the event of liquidation, each share of common stock is entitled to its proportion of our assets after debts and expenses. Stockholders are entitled to one vote per share and do not have cumulative voting rights. Our outstanding common stock is listed on the NYSE under the symbol "CEE," as will be the shares offered for subscription in this rights offering. Our common stock is also listed on the Regulated Market Segment (Geregelter Markt) of the Frankfurt Stock Exchange. The rights are transferable and application will be made to list them on the NYSE under the symbol " ."

Set forth below is information with respect to our common stock as of January 2, 2004:

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TITLE OF CLASS -----	AMOUNT AUTHORIZED -----	AMOUNT HELD BY US OR FOR OUR ACCOUNT -----	AMOUNT OUTSTANDING (EXCLUSIVE OF HOLDINGS) -----
Common Stock \$.001 par value.....	80,000,000	5,859,145	7,646,830

We have no present intention of offering additional shares, other than pursuant to this rights offering, except that additional shares may be issued under our dividend reinvestment plan. For information about our dividend reinvestment plan, see "Voluntary Cash Purchase Program and Dividend Reinvestment Plan" in this prospectus. Additional offerings of our common stock, if made, will require approval of our board of directors and will be subject to the requirements of the Investment Company Act that common stock may not be sold at a price below the then current net asset value (exclusive of underwriting discounts and commissions) except in connection with an offering to existing stockholders or with the consent of a majority of our outstanding stockholders.

PROVISIONS OF OUR ARTICLES OF INCORPORATION AND BYLAWS
AFFECTING CHANGE OF CONTROL AND EXTRAORDINARY TRANSACTIONS

We have provisions in our articles of incorporation and bylaws that could have the effect of delaying, deferring, preventing or otherwise limiting the ability of other entities or persons to acquire control of us, to cause us to engage in certain transactions or to modify our structure. Our board of directors is divided into three classes each having a term of three years. Each year, the term of one class expires and the successor or successors elected to that class will serve for a three-year term. This provision could delay for up to two years the replacement of a majority of our board of directors by our stockholders. A director may be removed from office only by the affirmative vote of at least two-thirds of all the votes entitled to be cast by our stockholders generally in the election of directors. Except as otherwise required by law, any vacancy created on our board of directors can be filled only by the affirmative vote of the remaining directors in office. Our bylaws generally require that advance notice be given to us in the event a stockholder desires to nominate a person for election to the board of directors or to transact any other business at a meeting of stockholders.

In addition, the affirmative vote of the holders of two-thirds of our outstanding shares is required to authorize our dissolution or any of the following transactions:

- + the merger or consolidation of us with or into any open-end investment company;
- + the sale of all or substantially all of our assets; or

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DESCRIPTION OF COMMON STOCK

- + any amendment to our articles of incorporation which makes the common stock a redeemable security or reduces the two-thirds vote required to authorize the actions listed in clauses (1) through (3).

The full text of these provisions can be found in our articles of incorporation and bylaws, on file with the SEC, as described under "Available Information" in this prospectus. These provisions could have the effect of depriving stockholders of an opportunity to sell their shares at a premium over prevailing

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market prices by discouraging a third party from seeking to obtain control of us in a tender offer or similar transaction. Our board of directors believes that the provisions of our articles of incorporation and bylaws described above provide the advantage of greater assurance of continuity of board and management composition and policies. The supermajority voting requirements are generally greater than the minimum voting requirements imposed on us by the Investment Company Act and Maryland law. Our board of directors has determined that the foregoing provisions are in the best interests of stockholders generally.

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Dividends and distributions

We distribute to stockholders, at least annually, substantially all of our net investment income and net realized capital gains. Distributions are made in cash or in common stock with the option to receive cash. Stockholders entitled to a distribution to be made in common stock with the option to receive cash may elect to receive cash by timely returning a completed option card to Investors Bank & Trust Company, our dividend-paying agent.

The following table shows the history of dividends and distributions we distributed to stockholders:

RECORD DATE	ORDINARY INCOME	LONG-TERM CAPITAL GAINS	TOTAL
12/22/ 2003.....	\$0.22		\$0.22
11/19/2001.....	\$0.23		\$0.23
11/16/1998.....	\$0.14		\$0.14
9/01/1998.....	\$0.01	\$0.01	\$0.02
11/17/1997.....	\$1.54	\$5.01	\$6.55
9/03/1997.....		\$0.02	\$0.02
12/19/1996.....	\$0.11	\$1.79	\$1.90
12/27/1995.....	\$0.16	\$0.22	\$0.38
12/29/1994.....	\$0.20		\$0.20
12/28/1993.....	\$0.08		\$0.08
12/28/1992.....	\$0.17	\$0.13	\$0.30
9/05/1991.....		\$0.02	\$0.02
12/04/1990.....	\$0.22	\$0.04	\$0.26

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Voluntary cash purchase program and dividend reinvestment plan

GENERAL

We offer stockholders a Voluntary Cash Purchase Program and Dividend Reinvestment Plan which provides for optional cash purchases and for the automatic reinvestment of dividends and distributions payable by us in additional shares of our common stock. A more complete description of the plan

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is provided in the plan brochure available from Investors Bank & Trust Company, the plan agent, Shareholder Services, P.O. Box 642, OPS 22, Boston, Massachusetts 02117-0642 (telephone 1-800-437-6269).

Under the Plan, participating stockholders appoint the plan agent to receive or invest our distributions. In addition, participating stockholders may make optional cash purchases of our shares through the plan agent as often as once a month. There is no charge to participating stockholders for participating in the plan, although when shares are purchased under the plan by the plan agent on the NYSE or otherwise on the open market, each participating stockholder will pay a pro rata share of brokerage commissions incurred in connection with these purchases.

REINVESTMENT OF FUND SHARES

Whenever we declare a capital gains distribution, an income dividend or a return of capital distribution payable, at the election of stockholders, either in cash or in our shares of common stock, the plan agent will automatically elect to receive our shares for the account of each participating stockholder.

Whenever we declare a capital gains distribution, an income dividend or a return of capital distribution payable only in cash and the net asset value per share of our common stock equals or is less than the market price per share on the valuation date (the market parity or premium), the plan agent will apply the amount of that dividend or distribution payable to a participating stockholder to the purchase from us of our shares for a participating stockholder's account, except that if we do not offer shares for this purpose because we conclude Securities Act registration would be required and such registration cannot be timely effected or is not otherwise a cost-effective alternative for us, then the plan agent will follow the procedure described in the next paragraph. The number of additional shares to be credited to a participating stockholder's account will be determined by dividing the dollar amount of the distribution payable to a participating stockholder by the net asset value per share of our common stock on the valuation date, or if the net asset value per share is less than 95% of the market price per share on such date, then by 95% of the market price per share. The valuation date will be the payable date for the dividend or distribution.

Whenever we declare a capital gains distribution, an income dividend or a return of capital distribution payable only in cash and the net asset value per share of our common stock exceeds the market price per share on the valuation date (the market discount), the plan agent will apply the amount of that dividend or distribution payable to a participating stockholder (less a participating stockholder's pro rata share of brokerage commissions incurred with respect to open-market purchases in connection with the reinvestment of that dividend or distribution) to the purchase on the open market of our shares for a participating stockholder's account. The valuation date will be the payable date for the dividend or distribution.

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VOLUNTARY CASH PURCHASE PROGRAM AND DIVIDEND REINVESTMENT PLAN

VOLUNTARY CASH PURCHASES

Participating stockholders have the option of making investments in our shares through the plan agent as often as once a month. Participating stockholders may invest as little as \$100 in any month and may invest up to \$36,000 annually through the voluntary cash purchase feature of the plan. The plan agent will apply these funds (less a participating stockholder's pro rata share of

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brokerage commissions or other costs, if any) to the purchase on the NYSE (or, if different, on the principal exchange for our shares) or otherwise on the open market for the participating stockholder's account, regardless of whether there is a market parity or premium or a market discount.

ENROLLMENT AND WITHDRAWAL

Both current stockholders and first-time investors are eligible to participate in the plan. Current stockholders may join the plan by either enrolling their shares with the plan agent or by making an initial cash deposit of at least \$250 with the plan agent. First-time investors may join the plan by making an initial cash deposit of at least \$250 with the plan agent. Stockholders who hold our shares in the name of a brokerage firm, bank or other nominee should contact their nominee to arrange for it to participate in the plan on the stockholder's behalf.

Participating stockholders may withdraw from the plan without charge by written notice to the plan agent. Participating stockholders who choose to withdraw may elect to receive stock certificates representing all of the full shares held by the plan agent on their behalf, or to instruct the plan agent to sell these full shares and distribute the proceeds, net of brokerage commissions, to the withdrawing participating stockholders. Withdrawn participating stockholders will receive a cash adjustment for the market value of any fractional shares held on their behalf at the time of termination.

AMENDMENT AND TERMINATION OF PLAN

The plan may be amended or supplemented by us or by the plan agent only by giving each participating stockholder written notice at least 90 days prior to the effective date of the amendment or supplement, except that the notice period may be shortened when necessary or appropriate in order to comply with applicable law or the rules or policies of the SEC or any other regulatory body. The plan may be terminated by us or by the plan agent by written notice mailed to each participating stockholder. Termination will be effective with respect to all distributions with a record date at least 90 days after the mailing of written notice to the participating stockholders.

FEDERAL TAX IMPLICATIONS OF REINVESTMENT OF FUND SHARES

Reinvestment in our shares does not relieve participating stockholders from any income tax which may be payable on dividends or distributions. For U.S. federal income tax purposes, when we issue shares representing an income dividend or a capital gains dividend, a participating stockholder will include in income fair market value of the shares received as of the payment date, which will be taxed in the same manner as if cash had been received. The shares will have a tax basis equal to the fair market value, and the holding period for the shares will begin on the day after the date of distribution. If shares are purchased on the open market by the plan agent, a participating stockholder will include in income the amount of the cash payment made. The basis of the shares will be the purchase price of the shares, and the holding period for the shares will begin on the day following the date of purchase. State, local and foreign taxes may also be applicable. For more information about taxation, see "Taxation" below.

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Taxation

DISTRIBUTIONS AND TAX MATTERS

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The following is a summary of certain tax considerations generally affecting us and our stockholders. This section is based on the Internal Revenue Code of 1986, as amended (the "Code"), published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. Please consult your own tax advisor concerning the consequences of investing in us in your particular circumstances under the Code and the laws of any other taxing jurisdiction.

QUALIFICATION AS A REGULATED INVESTMENT COMPANY

We have elected to be taxed as a regulated investment company under Subchapter M of the Code and intend to meet all other requirements that are necessary for us to be relieved of federal taxes on income and gains we distribute to stockholders. As a regulated investment company, we are not subject to federal income tax on the portion of our net investment income (i.e., our investment company taxable income, as that term is defined in the Code, without regard to the deduction for dividends paid) and net capital gain (i.e., the excess of net long-term capital gain over net short-term capital loss) that we distribute to stockholders, provided that we distribute at least 90% of the sum of our net investment income for the year (the "Distribution Requirement") and satisfy certain other requirements of the Code that are described below.

In addition to satisfying the Distribution Requirement, we must derive at least 90% of our gross income from dividends, interest, certain payments with respect to loans of stock and securities, gains from the sale or disposition of stock, securities or foreign currencies and other income (including but not limited to gains from options, futures or forward contracts) derived with respect to our business of investing in those stocks, securities or currencies.

We must also satisfy an asset diversification test in order to qualify as a regulated investment company. Under this test, at the close of each quarter of our taxable year, (1) 50% or more of the value of our assets must be represented by cash, United States government securities, securities of other regulated investment companies, and other securities, with these other securities limited, in respect of any one issuer, to an amount not greater than 5% of the value of our assets and 10% of the outstanding voting securities of that issuer, and (2) not more than 25% of the value of our assets may be invested in securities of any one issuer (other than U.S. government securities or securities of other regulated investment companies), or of two or more issuers which we control and which are engaged in the same, similar or related trades or businesses.

If for any year we do not qualify as a regulated investment company, all of our taxable income (including our net capital gain) will be subject to tax at regular corporate rates without any deduction for distributions to stockholders. These distributions will generally be taxable to the stockholders as qualified dividend income, as discussed below, and generally will be eligible for the dividends received deduction in the case of corporate stockholders.

EXCISE TAX ON REGULATED INVESTMENT COMPANIES

A 4% non-deductible excise tax is imposed on a regulated investment company to the extent that it distributes income in such a way that it is taxable to stockholders in a calendar year other than the calendar year in which the regulated investment company earned the income. Specifically, the excise tax will be imposed if the regulated investment company fails to distribute in each calendar year an amount equal to 98% of qualified dividend income and ordinary taxable income for the calendar year and 98% of capital gain net income for the one-year period ending on October 31 of this calendar

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year (or, at the election of a regulated investment company having a taxable year ending November 30 or December 31, for its taxable year). The balance of this income must be distributed during the next calendar year. For the foregoing purposes, a regulated investment company is treated as having distributed otherwise retained amounts if it is subject to income tax on those amounts for any taxable year ending in such calendar year.

We intend to make sufficient distributions or deemed distributions of our qualified dividend income, ordinary income and capital gain net income prior to the end of each calendar year to avoid liability for this excise tax. However, investors should note that we may in certain circumstances be required to liquidate portfolio investments to make sufficient distributions to avoid excise tax liability.

FUND INVESTMENTS

We may make investments or engage in transactions that affect the character, amount and timing of gains or losses that we realized. We may make investments that produce income that is not matched by a corresponding cash receipt by us. Any of this income would be treated as income earned by us and therefore would be subject to the distribution requirements of the Code. These investments may require us to borrow money or dispose of other securities in order to comply with those requirements. We may also make investments that prevent or defer the recognition of losses or the deduction of expenses. These investments may likewise require us to borrow money or dispose of other securities in order to comply with the distribution requirements of the Code. Additionally, we may make investments that result in the recognition of ordinary income rather than capital gain or that prevent us from accruing a long-term holding period. These investments may prevent us from making capital gain distributions as described below. We intend to monitor our transactions, will make the appropriate tax elections and will make the appropriate entries in our books and records when we make any of these investments in order to mitigate the effect of these rules.

We invest in equity securities of foreign issuers. If we purchase shares in certain foreign corporations (referred to as passive foreign investment companies ("PFICs") under the Code), we may be subject to federal income tax on a portion of any "excess distribution" from this foreign corporation, including any gain from the disposition of these shares, even if the income is distributed by us to our stockholders. In addition, certain interest charges may be imposed on us as a result of these distributions. If we were to invest in an eligible PFIC and elected to treat the PFIC as a qualified electing fund (a "QEF"), in lieu of the foregoing requirements, we would be required to include each year in our income and distribute to stockholders in accordance with the distribution requirements of the Code a pro rata portion of the QEF's ordinary earnings and net capital gain, whether or not distributed to us by the QEF. Alternatively, we generally will be permitted to "mark to market" any shares we hold in a PFIC. If we make such an election, we would be required to include in income each year and distribute to stockholders in accordance with the distribution requirements of the Code, an amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the taxable year over the adjusted basis of this stock at that time. We would be allowed a deduction for the excess, if any, of the adjusted basis of the PFIC stock over its fair market value as of the close of the taxable year, but only to the extent of any net mark-to-market gains with respect to the stock included by us for prior taxable years. We will make appropriate basis adjustments in the PFIC stock to take into account the mark-to-market amounts.

Notwithstanding any election that we make, dividends attributable to

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distributions from a foreign corporation will not be eligible for the special tax rates applicable to qualified dividend income if the foreign corporation is a PFIC either in the taxable year of the distribution or the preceding taxable year, but instead will be taxable at rates applicable to ordinary income.

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FUND DISTRIBUTIONS

We anticipate distributing substantially all of our net investment income for each taxable year. Dividends of net investment income paid to a noncorporate U.S. stockholder before January 1, 2009 that are designated as qualified dividend income will generally be taxable to this stockholder at a maximum rate of 15%. However, the amount of dividend income that we may so designate will generally be limited to the aggregate of the eligible dividends we receive. In addition, we must meet certain holding period requirements with respect to the shares on which we receive the eligible dividends, and the noncorporate U.S. stockholder must meet certain holding period requirements with respect to our shares. Dividends of net investment income that are not designated as qualified dividend income and dividends of net short-term capital gains will be taxable to stockholders at ordinary income rates. Dividends paid by us with respect to a taxable year will qualify for the 70% dividends received deduction generally available to corporations to the extent of the amount of dividends we receive from certain domestic corporations for the taxable year. Stockholders will be advised annually as to the U.S. federal income tax consequences of distributions made (or deemed made) during the year, including the portion of dividends paid that qualify for the reduced tax rate.

Ordinarily, stockholders are required to take taxable distributions by us into account in the year in which the distributions are made. However, for federal income tax purposes, dividends that are declared by us in October, November or December as of a record date in such month and actually paid in January of the following year will be treated as if they were paid on December 31 of the year declared. Therefore, these dividends will generally be taxable to a stockholder in the year declared rather than the year paid.

We may either retain or distribute to stockholders our net capital gain for each taxable year. We currently intend to distribute any of these amounts. If net capital gain is distributed and designated as a "capital gain dividend", it will be taxable to stockholders as long-term capital gain, regardless of the length of time the stockholder has held his shares or whether this gain was recognized by us prior to the date on which the stockholder acquired its shares. Capital gain of a noncorporate U.S. stockholder that is recognized before January 1, 2009 is generally taxed at a maximum rate of 15% where the property is held by us for more than one year. Capital gain of a corporate stockholder is taxed at the same rate as ordinary income.

Conversely, if we elect to retain our net capital gain, we will be taxed thereon (except to the extent of any available capital loss carryovers) at the 35% corporate tax rate. In such a case, it is expected that we also will elect to have stockholders of record on the last day of our taxable year treated as if each received a distribution of its pro rata share of this gain, with the result that each stockholder will be required to report its pro rata share of this gain on its tax return as long-term capital gain, will receive a refundable tax credit for its pro rata share of tax paid by us on the gain and will increase the tax basis for its shares by an amount equal to the deemed distribution less the tax credit.

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Distributions by us that do not constitute qualified dividend income, ordinary income dividends or capital gain dividends will be treated as a return of capital to the extent of (and in reduction of) the stockholder's tax basis in its shares; any excess will be treated as gain from the sale of its shares, as discussed below.

Distributions by us will be treated in the manner described above regardless of whether these distributions are paid in cash or reinvested in additional shares of our common stock (or of shares of another fund). Stockholders receiving a distribution in the form of additional shares will be treated as receiving a distribution in an amount equal to the fair market value of the shares received, determined as of the reinvestment date. In addition, prospective investors should be aware that distributions from us will, all other things being equal, have the effect of reducing the net asset value of our shares by the amount of the distribution. If the net asset value is reduced below a stockholder's cost, the distribution

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will nonetheless be taxable as described above, even if the distribution effectively represents a return of invested capital. Investors should consider the tax implications of buying shares just prior to a distribution, when the price of shares may reflect the amount of the forthcoming distribution.

SALE OR REDEMPTION OF SHARES

A stockholder will recognize gain or loss on the sale or redemption of our shares in an amount equal to the difference between the proceeds of the sale or redemption and the stockholder's adjusted tax basis in the shares. All or a portion of any loss so recognized may be disallowed if the stockholder acquires other shares of us within a period of 61 days beginning 30 days before that disposition, such as pursuant to reinvestment of a dividend in our shares. Additionally, if a stockholder disposes of our shares within 90 days following their acquisition, and the stockholder subsequently re-acquires our shares pursuant to a reinvestment right received upon the purchase of the original shares, any load charge (i.e., sales or additional charge) incurred upon the acquisition of the original shares will not be taken into account as part of the stockholder's basis for computing profit or loss upon the sale of the shares.

In general, any gain or loss arising from (or treated as arising from) the sale or redemption of our shares will be considered capital gain or loss and will be long-term capital gain or loss if the shares were held for more than one year. However, any capital loss arising from the sale or redemption of shares held for six months or less will be treated as a long-term capital loss to the extent of the amount of capital gain dividends received on (or undistributed capital gains credited with respect to) those shares. Capital gain of a noncorporate U.S. stockholder that is recognized before January 1, 2009 is generally taxed at a maximum rate of 15% where the property is held by the stockholder for more than one year. Capital gain of a corporate stockholder is taxed at the same rate as ordinary income.

BACKUP WITHHOLDING

We will be required in certain cases to backup withhold and remit to the U.S. Treasury a portion of qualified dividend income, ordinary income dividends and capital gain dividends, and the proceeds of redemption of shares, paid to any stockholder (1) who has provided either an incorrect tax identification number or no number at all, (2) who is subject to backup withholding by the IRS for

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failure to report the receipt of interest or dividend income properly or (3) who has failed to certify to us that it is not subject to backup withholding or that it is a corporation or other "exempt recipient". Backup withholding is not an additional tax and any amounts withheld may be refunded or credited against a stockholder's federal income tax liability, provided the appropriate information is furnished to the IRS.

FOREIGN STOCKHOLDERS

Taxation of a stockholder who, as to the United States, is a nonresident alien individual, foreign trust or estate, foreign corporation, or foreign partnership ("foreign stockholder") depends on whether the income from us is "effectively connected" with a U.S. trade or business carried on by this stockholder. If the income from us is not effectively connected with a U.S. trade or business carried on by a foreign stockholder, dividends paid to this foreign stockholder from net investment income will be subject to U.S. withholding tax at the rate of 30% (or lower treaty rate) on the gross amount of the dividend. This foreign stockholder would generally be exempt from U.S. federal income tax, including withholding tax, on gains realized on the sale of our shares, capital gain dividends and amounts retained by us that are designated as undistributed capital gains. If the income from us is effectively connected with a U.S. trade or business carried on by a foreign stockholder, then ordinary income dividends, capital gain dividends, undistributed capital gains credited to this stockholder and any gains

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realized upon the sale of our shares will be subject to U.S. federal income tax at the graduated rates applicable to U.S. citizens or domestic corporations.

In the case of foreign noncorporate stockholders, we may be required to backup withhold U.S. federal income tax on distributions that are otherwise exempt from withholding tax (or taxable at a reduced treaty rate) unless those stockholders furnish us with proper notification of their foreign status.

The tax consequences to a foreign stockholder entitled to claim the benefits of an applicable tax treaty may be different from those described herein. Foreign stockholders are urged to consult their own tax advisers with respect to the particular tax consequences to them of an investment in us, the procedure for claiming the benefit of a lower treaty rate and the applicability of foreign taxes. Transfers by gift of our shares by an individual foreign stockholder will not be subject to U.S. federal gift tax, but the value of our shares held by this stockholder at his death will generally be includible in his gross estate for U.S. federal estate tax purposes, subject to any applicable estate tax treaty.

FOREIGN TAXES

We may be subject to foreign withholding taxes or other foreign taxes with respect to income (possibly including, in some cases, capital gain) received from sources within foreign countries. So long as more than 50% of the value of our total assets at the close of the taxable year consists of stock or securities of foreign issuers, we may elect to treat any foreign income taxes paid by us as paid directly by our stockholders.

If we make the election, each stockholder will be required to (i) include in gross income, even though not actually received, its pro rata share of our foreign income taxes, and (ii) either deduct (in calculating U.S. taxable

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income) or credit (in calculating U.S. federal income tax) its pro rata share of our income taxes. A foreign tax credit may not exceed the U.S. federal income tax otherwise payable with respect to the foreign source income. For this purpose, each stockholder must treat as foreign source gross income (i) its proportionate share of foreign taxes paid by us and (ii) the portion of any actual dividend paid by us which represents income derived from foreign sources; the gain from the sale of securities will generally be treated as U.S. source income and certain foreign currency gains and losses likewise will be treated as derived from U.S. sources. This foreign tax credit limitation is, with certain exceptions, applied separately to separate categories of income; dividends from us will be treated as "passive" or "financial services" income for this purpose. The effect of this limitation may be to prevent stockholders from claiming as a credit the full amount of their pro rata share of our foreign income taxes. In addition, the foreign tax credit is allowed to offset only 90% of the alternative minimum tax imposed on corporations and individuals, and stockholders will not be eligible to claim a foreign tax credit with respect to foreign income taxes paid by us unless certain holding period requirements are met.

We will make such an election only if we deem it to be in the best interest of our stockholders. A stockholder not subject to U.S. tax may prefer that this election not be made. We will notify stockholders in writing each year if we make the election and of the amount of foreign income taxes, if any, to be passed through to the stockholders and the amount of foreign taxes, if any, for which our stockholders will not be eligible to claim a foreign tax credit because the holding period requirements (described above) have not been satisfied.

STATE AND LOCAL TAX MATTERS

Depending on the residence of the stockholders for tax purposes, distributions may also be subject to state and local taxes. Rules of state and local taxation regarding qualified dividend income, ordinary income dividends and capital gain dividends from regulated investment companies may differ from the

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U.S. federal income tax rules in other respects. Stockholders are urged to consult their tax advisers as to the consequences of these and other state and local tax rules affecting investment in us.

Custodians, dividend-paying agent, transfer agent and registrar

Investors Bank and Trust Company ("IBT"), with principal offices at 200 Clarendon Street, Boston, Massachusetts 02116, acts as our custodian, dividend-paying agent, transfer agent and registrar. IBT has agreements with a global network of sub-custodians, which, together with IBT, maintain custody of our portfolio securities and cash.

Experts

The financial statements, at October 31, 2003, incorporated by reference in this prospectus and in the SAI have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent auditors, given on their authority as experts in auditing and accounting. The principal business address of PwC is 1177 Avenue of the Americas, New York, New York, 10036.

Validity of shares

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The validity of the shares offered in this rights offering will be passed on for us by Sullivan & Cromwell LLP, New York, New York and for the dealer manager by Skadden, Arps, Slate, Meagher & Flom LLP, Chicago, Illinois.

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NO PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS IN CONNECTION WITH THIS OFFERING OTHER THAN THOSE CONTAINED IN THIS PROSPECTUS AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY US. NEITHER THE DELIVERY OF THIS PROSPECTUS NOR ANY SALE MADE HEREUNDER SHALL, UNDER ANY CIRCUMSTANCES, CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF US SINCE THE DATE HEREOF OR THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO ITS DATE. IN THE EVENT THAT A MATERIAL CHANGE IN OUR AFFAIRS OCCURS SUBSEQUENT TO THE DATE HEREOF, A SUPPLEMENTAL PROSPECTUS WILL BE DISTRIBUTED IN ACCORDANCE WITH APPLICABLE LAW. THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF ANY OFFER TO BUY ANY SECURITIES OTHER THAN THE REGISTERED SECURITIES TO WHICH IT RELATES. THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY SUCH SECURITIES IN ANY CIRCUMSTANCES IN WHICH SUCH OFFER OR SOLICITATION IS UNLAWFUL.

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[LOGO]

THE CENTRAL EUROPE AND RUSSIA FUND, INC.
[] SHARES OF
COMMON STOCK ISSUABLE
UPON EXERCISE OF RIGHTS TO
SUBSCRIBE FOR SUCH SHARES

PROSPECTUS

UBS INVESTMENT BANK
, 2004

Subject to Completion, dated January 9, 2004

THE CENTRAL EUROPE AND RUSSIA FUND, INC.

STATEMENT OF ADDITIONAL INFORMATION

This Statement of Additional Information (the "SAI") is not a prospectus, but should be read in conjunction with our prospectus dated , 2004. This SAI does not include all information that a prospective investor should consider

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before purchasing our shares, and investors should obtain and read the prospectus prior to purchasing shares. A copy of the prospectus may be obtained without charge, by calling our information agent at. This SAI incorporates by reference the entire prospectus. Defined terms used in this SAI have the same meaning as provided in the prospectus. The date of this SAI is , 2004.

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THE INFORMATION CONTAINED IN THIS SAI IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE.

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General information

We were incorporated in Maryland on February 6, 1990 as The United Germany Fund, Inc. On February 15, 1990, we changed our name to The Future Germany Fund, Inc., and thereafter commenced investment operations under that name. On June 29, 1995, we changed our name to The Central European Equity Fund, Inc. On June 25, 2003, we changed our name to the current one, The Central Europe and Russia Fund, Inc.

Investment objective and policies

Our investment objective is to seek long-term capital appreciation through investment primarily in equity and equity-linked securities of issuers domiciled in Central Europe and Russia. We may not be able to achieve our objective. For a more detailed discussion of our investment objective and policies, see "Investment Objective and Policies" on page 25 of the prospectus.

The following is a discussion of other investment policies and practices with respect to warrants, participation certificates, futures and options, fixed income securities, securities lending and currency transactions and the special considerations relevant to these practices that supplements the material contained in the prospectus. For purposes of policies and practices discussed below, all percentage limitations apply only immediately after a transaction, and any subsequent change in any applicable percentage resulting from changing values will not require elimination of any security from our portfolio.

WARRANTS

We may also invest in warrants if consistent with our investment objective. The

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warrants in which we may invest are a type of security, usually issued together with another security of an issuer, that entitles the holder to buy a fixed amount of common or preferred stock of that issuer at a specified price for a fixed period of time (which may be in perpetuity). Warrants are commonly issued attached to other securities of the issuer as a method of making these securities more attractive and are usually detachable and thus may be bought or sold separately from the issued security. Warrants can be a speculative instrument. The value of a warrant may decline because of a decrease in the value of the underlying stock, the passage of time or a change in perception as to the potential of the underlying stock, or any combination thereof. If the market price of the underlying stock is below the exercise price set forth in the warrant on the expiration date, the warrant will expire worthless. Publicly traded warrants currently exist with respect to the stock of a significant number of European companies.

PARTICIPATION CERTIFICATES

Certain German, Swiss and Austrian companies have issued participation certificates ("Participation Certificates" or "Genuss-Scheine"), which entitle the holder to participate only in dividend distributions, generally at rates above those declared on the issuers' common stock, but not to vote, nor usually to any claim for assets in liquidation. Participation Certificates trade like common stock, either in the over-the-counter market or through the relevant stock exchanges.

These securities may have higher yields; however, they may be less liquid than common stock. We may invest in Participation Certificates of issuers in any European country or Russia.

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INVESTMENT OBJECTIVE AND POLICIES

FUTURES AND OPTIONS

For hedging purposes, we may also purchase put and call options on stock of European or Russian issuers and, to the extent permitted by applicable United States law, invest in the index and bond futures and any other derivative securities listed on any organized exchange. Options are contracts which give the buyer the right, but not the obligation, to buy or sell a fixed amount of securities at a fixed price for a fixed period of time. A futures contract is a binding obligation to purchase or deliver the specific type of financial instrument, or the cash equivalent of this instrument in certain circumstances, called for in the contract at a specific price at a future date. We will only invest in options or futures in an attempt to hedge against changes or anticipated changes in the value of particular securities in our portfolio or all or a portion of our portfolio. We will not invest in options or futures if, immediately thereafter, more than the amount of our total assets would be hedged. For hedging purposes, we may also purchase put and call options on bonds and other securities, as well as securities indices, if and when such investments become available. We may invest in other options, futures and options on futures with respect to any securities or securities indices compatible with our investment objective that may from time to time become available on any organized exchange, if permitted by applicable law.

We may also write (also referred to as "selling") covered call options on our portfolio securities and appropriate securities indices for purposes of generating income. We may write covered call options on portfolio securities and appropriate securities indices up to the amount of our entire portfolio. A call option gives the holder the right to purchase the underlying securities from us

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at a special price (the "exercise price") for a stated period of time (usually three, six or nine months). Prior to the expiration of the option, the writer (also referred to as the "seller") of the option has an obligation to sell the underlying security to the holder of the option at the exercise price regardless of the market price of the security at the time the option is exercised. The initial purchaser of an option pays the writer a premium, which is paid at time of purchase and is retained by the writer whether or not the option is exercised. A "covered" call option means that so long as we are obligated as the writer of the option, we will own:

- + the underlying securities subject to the option;
- + securities convertible or exchangeable without the payment of any consideration into the securities subject to the option; or
- + warrants on the securities subject to the option exercisable at a price not greater than the option exercise price and, at the time the option is exercisable, the securities subject to the option.

In the case of covered call options on securities indices, references to securities in the bullet points above will include such securities as the investment adviser believes approximate the index (but not necessarily all those comprising the index), as well as, in the case of the second two bullets, securities convertible, exchangeable or exercisable into the value of the index. The writing of a call option may involve the pledge of the underlying security which the call option covers, or other portfolio securities. In order to make use of our authority to write covered call options, we may pledge our assets.

In the event the option is exercised, the writer may either deliver the underlying securities at the exercise price or if it does not wish to deliver its own securities, purchase new securities at a cost to the writer, which may be more than the exercise price premium received, and deliver the new securities for the exercise option. In the event the option is exercised, our potential for gain is limited to the difference between the exercise price plus the premium less the cost of the security. Alternatively, the option's position could be extinguished or closed out by purchasing a like option. It is possible, although considered unlikely, that we might be unable to execute such a closing purchase transaction. If the price of a security declines below the amount to be received from the exercise price less the

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INVESTMENT OBJECTIVE AND POLICIES

amount of the call premium received and if the option could not be closed out, we would hold a security which might otherwise have been sold to protect against depreciation. In addition, our portfolio turnover may increase to the extent that the market price of underlying securities covered by call options written by us increases and we have not entered into closing purchase transactions. Brokerage commissions associated with writing options transactions are normally higher than those associated with other securities transactions.

FIXED INCOME SECURITIES

We may also invest up to 20% of our total assets in fixed income securities of European or Russian issuers. Such investments may include debt instruments issued by private and public entities, including multinational lending institutions and supranational institutions if denominated in a European or Russian currency or composite currency, which have been determined by our investment manager and investment adviser to be of comparable credit quality to

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securities rated in the three highest categories by Moody's Investors Service, Inc. or Standard & Poor's Corporation. When selecting a debt instrument from among several investment opportunities, our investment manager and investment adviser will consider the potential for capital appreciation, taking into account maturity and yield considerations. For temporary defensive purposes, we also may invest in money market instruments denominated in U.S. dollars or in a European or the Russian currency or composite currency, including bank time deposits and certificates of deposit.

LOANED SECURITIES

We may also lend our portfolio securities to banks, securities dealers and other institutions meeting the creditworthiness standards established by our board of directors. We may lend our portfolio securities so long as the terms and the structure of such loans are not inconsistent with the Investment Company Act, which currently requires that:

- + the borrower pledge and maintain with us collateral consisting of cash, a letter of credit issued by a domestic United States bank or securities issued or guaranteed by the United States Government having a value at all times of not less than 100% of the value of the securities loaned;
- + the borrower add to such collateral whenever the price of the loaned securities rises (e.g., the value of the loan is "marked to market" on a daily basis);
- + the loan be made subject to termination by us at any time; and
- + we receive reasonable interest on the loan (which may include a portion of the interest from our investing any cash collateral in interest bearing short-term investments).

Any such collateral may be invested by us in repurchase agreements collateralized by securities issued or guaranteed by the United States Government. Any distributions on the loaned securities and any increase in their market value accrue to us. Loan arrangements made by us will comply with all other applicable regulatory requirements. All relevant facts and circumstances, including the creditworthiness of the borrowing institution, will be monitored by our investment manager and adviser, and will be considered in making decisions with respect to lending of securities, subject to review by our board of directors. We may pay reasonable negotiated fees in connection with loaned securities, so long as such fees are set forth in a written contract and approved by our board of directors. In addition, any voting rights may pass with the loaned securities, but if a material event were to occur affecting an investment on loan, the loan may be called and the securities voted. Any gain or loss in the market price of the loaned securities that may occur during the term of the loan will be for our account.

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INVESTMENT OBJECTIVE AND POLICIES

CURRENCY TRANSACTIONS

We may attempt to hedge our foreign currency exposure by entering into forward currency contracts. We do not currently engage in foreign exchange transactions as an investment strategy. However, at such future time as our investment manager and investment adviser believe that one or more currencies in which our securities are denominated might suffer a substantial decline against the United States dollar, we may, in order to hedge the value of our portfolio, enter into

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forward contracts, e.g., to sell fixed amounts of such currencies for fixed amounts of United States dollars in the interbank market. A forward currency contract involves an obligation to purchase or sell a specific currency at a future date, which may be any fixed number of days from the date of the contract agreed upon by the parties, at a price set at the time of the contract.

Our dealings in forward exchange transactions will be limited to hedging involving either specific transactions or portfolio positions. Transaction hedging is the purchase or sale of forward currency with respect to our specific receivables or payables, which will generally arise in connection with the purchase or sale of our portfolio securities. Position hedging is the sale of forward currency with respect to portfolio security positions denominated or generally quoted in that currency.

We may engage in "conventional hedging," which involves entering into forward currency contracts to sell fixed amounts of a foreign currency (such as Polish zlotys) for fixed amounts of United States dollars in order to hedge the United States dollar value of our portfolio. We may also engage in "cross-hedging", which involves entering into forward currency contracts to sell fixed amounts of such foreign currency (such as Polish zlotys) for fixed amounts of another foreign currency to which we may seek exposure (such as euros).

We may not position a hedge with respect to any currency to an extent greater than the aggregate market value (at the time of making such sale) of the securities held in our portfolio denominated or generally quoted in or currently convertible into such currency. If we enter into a hedging transaction, our custodian or subcustodian will place cash or United States Government or other liquid securities in a segregated account of ours in an amount equal to the value of our total assets committed to the consummation of the forward contract, which value will be adjusted on a daily basis. If the value of the securities placed in the segregated account declines, additional cash or securities will be placed in the account so that the value of the account will equal the amount of our commitment with respect to the contract.

Investment restrictions

In addition to its investment objective and the other investment policies described under "Investment Objective and Policies" above and in the prospectus, we have adopted certain investment restrictions, which are fundamental policies and may be changed only by the approval of a majority of our outstanding voting securities. Under the Investment Company Act, a "majority" means 67% of our shares present at a meeting of our stockholders if the owners of more than 50% of our shares then outstanding are present in person or by proxy or, if lower, more than 50% of our outstanding shares. We refer to this approval voting level as a "majority vote." For purposes of the restrictions listed below, all percentage limitations apply only immediately after a transaction, and any subsequent change in any applicable percentage resulting from changing values will not require elimination of any security from our portfolio.

We may not:

1. purchase more than 10% of the voting securities of any single issuer;
2. invest 25% or more of our total assets in the securities of issuers in any one industry;

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INVESTMENT RESTRICTIONS

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3. issue senior securities, borrow money or pledge its assets, except that we may borrow for temporary or emergency purposes or for the clearance of transactions in amounts not exceeding 10% of the value of our total assets (not including the amount borrowed) and will not purchase securities while any of these borrowings are outstanding, and except that we may pledge our assets in connection with writing covered call options;
4. make real estate mortgage loans or other loans, except through the purchase of debt obligations consistent with our investment policies;
5. buy or sell commodities, commodity contracts, futures contracts, real estate or interests in real estate (other than as described under "Investment Objective and Policies--Portfolio Structure" in the prospectus and under "Investment Objective and Policies--Currency Transactions" in this SAI);
6. make short sales of securities or maintain a short position in any security;
7. buy, sell or write put or call options (other than as described under "Investment Objective and Policies--Portfolio Structure" on page 26 of the prospectus and under "Investment Objective and Policies--Futures and Options" on page B-3 in this SAI);
8. purchase securities on margin, except such short-term credits as may be necessary or routine for the clearance or settlement of transactions;
9. act as an underwriter, except to the extent we may be deemed to be an underwriter in connection with the sale of securities in our portfolio; or
10. purchase securities, the sale of which by us could not be effected without prior registration under the Securities Act, except that this restriction shall not preclude us from acquiring non-U.S. securities.

We are classified as a "non-diversified" investment company under the Investment Company Act, which means we are not limited by the Investment Company Act in the proportion of our assets that may be invested in the securities of a single issuer. However, we conduct our operations so as to qualify as a "regulated investment company" for purposes of the Internal Revenue Code, which relieves us of any liability for Federal income tax to the extent that our earnings are distributed to stockholders. To so qualify, among other requirements, we must limit our investments so that, at the close of each quarter of the taxable year, (i) not more than 25% of the market value of our total assets may be invested in the securities of a single issuer or a group of related issuers and (ii) at least 50% of the market value of our total assets must be represented by cash, United States Government securities and other securities, with such other securities limited, in respect of any one issuer, to not more than 5% of the market value of our total assets and not more than 10% of the issuer's outstanding voting securities.

For purposes of our policy not to invest 25% or more of the total value of our assets in a particular industry, our investment manager generally classifies the issuers of our portfolio securities according to the broad industry classification used by Standard & Poor's Corporation.

Net asset value

Net asset value per share is determined on each business day that the NYSE is open for trading as of 5:00 p.m. New York City time and made available to stockholders. Net asset value per share is calculated by dividing the value of our net assets (the value of our assets less our liabilities) by the total number of shares of our common stock outstanding. Any assets or liabilities initially expressed in terms of non-US dollar currencies are translated into U.S. dollars at the 10:00 a.m. mid-point of the buying and selling spot rates

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quoted by the Federal Reserve Bank of New York.

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NET ASSET VALUE

All securities for which market quotations are readily available are valued at the last quoted sale price on the primary exchange on which they are traded prior to the time of determination. If no sale occurs on that business day or there is otherwise no last quoted sale price available at that time, and both bid and asked prices are available, the securities are valued at the mean between the last current bid and asked prices (but if no quoted asked prices are available, they are valued at the last quoted bid price). Unlisted securities and listed securities whose primary market is over-the-counter will be valued, if both bid and asked prices are available, at the mean between the last current bid and asked prices prior to the time of determination (but if no quoted asked prices are available, they are valued at the last quoted bid price). If bid and asked quotations are not available, then these securities are valued at their fair value as determined in good faith by or under the direction of our board of directors.

Warrants issued separately from any other security will be valued upon their issuance and prior to commencement of trading at the stated value ascribed by the issuing entity. Warrants attached to other securities (also known as a unit) are given no separate value. Warrants that become detached from a unit are initially valued at the difference between the value of the unit prior to detachment and the value of the other security after detachment. Warrants are then valued at the quoted last sales price. Rights that are trading will be valued as any other equity security. If the rights are not trading and the shares resulting from exercising the rights are trading, then the rights will be valued at the market value of the new shares minus the cost to subscribe to the new shares multiplied by the subscription ratio. If the rights are not trading and the shares resulting from exercising the rights are not trading, then the rights are valued at their fair value as determined in good faith by or under the direction of our board of directors. Upon commencement of trading, both warrants and rights are valued as any other security.

New shares initially issued resulting from the exercise of rights will be valued as any other security if the new shares are trading. If the new shares are not trading and the rights are still trading, then the shares will be valued at the market value of the number of rights needed to exercise to receive the new shares less the cost to subscribe to the new shares. If the rights are not trading and the new shares are not trading, then the shares are valued at their fair value as determined in good faith by or under the direction of our board of directors.

Initial public offering securities will be initially valued at the offer price, and, upon commencement of trading, will be valued as any other security. Any securities tendered by us will continue to be valued at the closing market price until the tender is completed. Debt securities with a remaining maturity of 60 days or less at the time of purchase will be valued at amortized cost unless the circumstances indicate that amortized cost does not approximate fair value. Overnight repurchase agreements and other repurchase agreements maturing in seven days or less will be valued at par. Longer-term repurchase agreements will be valued at the bid quotations. All other securities and assets are valued at their fair value as determined in good faith by or under the direction of our board of directors.

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Management

DIRECTORS AND OFFICERS

The names and addresses of our directors and officers are set forth below, together with their positions and their principal occupations during the past five years and, in the case of directors, their positions with certain other organizations and companies.

NAME, ADDRESS(1) & AGE	POSITION(S) WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS	NUMB PORTF IN COMPL OVER BY DI
INTERESTED DIRECTORS(3)				
Detlef Bierbaum, 61(3)	Director	Since 1990.	Partner of Sal. Oppenheim Jr. & Cie KGaA (investment management).	
John Bult, 67(3)	Director	Since 1990.	Chairman, PaineWebber International (since 1985).	
Christian H. Strenger, 60(3)	Director	Since 1990.	Director (since 1999) and Managing Director (1991-1999) of DWS Investment GmbH (investment management).	

NAME, ADDRESS(1) & AGE	OTHER DIRECTORSHIPS HELD BY DIRECTOR
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INTERESTED DIRECTORS(3)	
Detlef Bierbaum, 61(3)	Director, The Germany Fund, Inc. (since 1986).(4) Member of the Supervisory Board, Tertia Handelsbeteiligungsgesellschaft mbH (electronic retailer). Member of Supervisory Board, Douglas AG (retailer). Member of Supervisory Board, LVM Landwirtschaftlicher Versicherungsverein (insurance). Member of Supervisory Board, Monega KAG. Member of Supervisory Board, AXA Investment Managers.
John Bult, 67(3)	Director, The Germany Fund, Inc. (since 1986) and The New Germany Fund, Inc. (since 1990).(4) Director,

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Christian H. Strenger,
60(3)

The France Growth Fund,
Inc. (closed-end fund).
Director, The Greater China
Fund, Inc. (closed end
fund).
Director, The Germany Fund,
Inc. (since 1986) and The
New Germany Fund, Inc.
(since 1990). (4) Member,
Supervisory Board, Fraport
AG (international airport
business). Board member,
Incepta PLC (media and
advertising).

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MANAGEMENT

NAME, ADDRESS(1) & AGE	POSITION(S) WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS	NUMB PORTF IN COMPL OVER BY DI
NON-INTERESTED DIRECTORS				
Ambassador Richard R. Burt, 56	Director	Since 2000.	Chairman, Diligence LLC, formerly IEP Advisors, Inc. (information collection, analysis, consulting and intelligence) (since 1998). Chairman of the Board, Weirton Steel Corp. (since 1996). Partner, McKinsey & Company (1991-1994). U.S. Ambassador to the Federal Republic of Germany (1985-1989). Chairman, IEP Advisor, LLP (international consulting).	6
Fred H. Langhammer, 59(8)	Director	Since 2003.	Chief Executive Officer, The Estee Lauder Companies Inc. (manufacturer and marketer of cosmetics) (since 2000), President (since 1995), Chief Operating Officer (1985- 1999), Managing Director, operations in Germany (1982-1985), President, operations in Japan (1975- 1982).	
Edward C. Schmults, 72	Director	Since 1990.	Consultant (since 1994). Senior Vice President--External Affairs and General Counsel, GTE	

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Eggert Voscherau, 60(5)	Director	Since 2003.	Corporation (telecommunications) (1984-1994); Deputy Attorney General of the U.S. Department of Justice (1981-1984). Vice Chairman, BASF Aktiengesellschaft (chemicals) (since 2002). Deputy Chairman, Ressort II (Europe Region) (Industrials) (1998-2002). Chairman and Chief Executive Officer and Executive Director, BASF Corporation (chemicals) (United States) (1997-1998). Executive Director, BASF Aktiengesellschaft (1996-1997), Executive Vice President, BASF Corporation (United States) and President, North American Consumer Products division (1991-1994). President, BASF Aktiengesellschaft (Germany) (1986-1991).
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NAME, ADDRESS(1) & AGE	OTHER DIRECTORSHIPS HELD BY DIRECTOR
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NON-INTERESTED DIRECTORS

Ambassador Richard R. Burt, 56	Director, The Germany Fund, Inc., as well as other funds in the Fund Complex as indicated.(4) Board Member, IGT, Inc. (gaming technology) (since 1995). Board Member, Hollinger International (printing and publishing) (since 1995). Board Member, HCL Technologies, Inc. (information technology and product engineering) (since 1999). Member, Textron Corporation International Advisory Council (aviation, automotive, industrial operations and finance) (since 1996). Director, UBS-Paine Webber family of Mutual Funds.
Fred H. Langhammer, 59(8)	Director, The Germany Fund, Inc. (since 2003).(4) Director, Gillette Company. Director, Inditex, S.A (fashion manufacturer and

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<p>Edward C. Schmults, 72</p>	<p>retailer). Director, Cosmetics, Toiletries and Fragrance Association. Director, German-American Chamber of Commerce, Inc. Co-Chairman, American Institute for Contemporary German Studies at Johns Hopkins University. Senior Fellow, Foreign Policy Association. Director, Japan Society.</p>
<p>Eggert Voscherau, 60 (5)</p>	<p>Director, The Germany Fund, Inc. (since 1986). (4) Board Member, Green Point Financial Corp. (since 1994).</p> <p>Director The Germany Fund Inc. (since 2003). (4) Member, Supervisory Boards of: Dresdner Bank Lateinamerika AG, Haftpflichtverband der Deutschen Industrie V.a.G., Basell N.V., BASF Espanola S.A., BASF Schwarzheide GmbH. President, Cefic (European Chemical Industry Council). President, International Council of Chemical Associations. Board Member, BASF Aktiengesellschaft.</p>

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MANAGEMENT

NAME, ADDRESS(1) & AGE	POSITION(S) WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS	NUMB PORTF IN COMPL OVER BY DI
Robert H. Wadsworth, 63	Director	Since 1990.	President, Robert H. Wadsworth Associates, Inc. (mutual fund consulting) (since 1982). President and Trustee, Trust for Investment Managers (1999-2002). President, Investment Company Administration, L.L.C. (1992-2001). President, Treasurer and Director, First Fund Distributors,	6

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Werner Walbrol, 66	Director	Since 1990.	Inc. (mutual fund distribution) (1990-2002). Vice President, Professionally Managed Portfolios (1991-2002). Vice President, Advisors Series Trust (registered investment companies) (1997-2002). President and Chief Executive Officer, The European American Chamber of Commerce, Inc. Formerly, President and Chief Executive Officer, The German American Chamber of Commerce, Inc.
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NAME, ADDRESS(1) & AGE	OTHER DIRECTORSHIPS HELD BY DIRECTOR
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Robert H. Wadsworth, 63	Director, The Germany Fund, Inc. (since 1986) and The New Germany Fund, Inc. (since 1992) as well as other funds in the Fund Complex as indicated.(4)
Werner Walbrol, 66	Director, The Germany Fund, Inc. (since 1986).(4) Director, TUV Rheinland of North America, Inc. (independent testing and assessment services). President and Director, German-American Partnership Program (student exchange programs). Director, AXA Nordstern Art Insurance Corporation (fine art and collectible insurer). Member, Advisory Board, Abels & Grey.

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MANAGEMENT

NAME, ADDRESS(1) & AGE	POSITION(S) WITH FUND(6)	TERM OF OFFICE AND LENGTH OF TIME SERVED
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OFFICERS		
Richard T. Hale, 58	President and Chief Executive Officer	Year to year since 2001.
Hanspeter Ackermann, 46(7)	Chief Investment Officer	Year to year since 1996.
Bruce A Rosenblum, 43	Secretary	Year to year since 2003.

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Charles A. Rizzo, 46	Treasurer and Chief Financial Officer	Year to year since 2003.
Kathleen Sullivan D'Eramo, 46	Assistant Treasurer	Year to year since 2003.

NAME, ADDRESS(1) & AGE	PRINCIPAL OCCUPATION(S) DURING PAST FIVE YEARS
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OFFICERS

Richard T. Hale, 58	Managing Director, Deutsche Investment Management Americas Inc. (2003-present); Managing Director, Deutsche Bank Securities Inc. (formerly Deutsche Banc Alex. Brown Inc.) and Deutsche Asset Management (1999 to present); Director and President, Investment Company Capital Corp. (registered investment advisor) (1996 to present); Director Deutsche Global Funds, Ltd. (2000 to present). CABEI Fund (2000 to present), North American Income Fund (2000 to present) (registered investment companies); Director Scudder Global Opportunities Fund (since 2003); Director/ Officer, Deutsche/Scudder Mutual Funds (various dates); President, Montgomery Street Income Securities, Inc. (2002 to present) (registered investment companies); Vice President, Deutsche Asset Management, Inc. (2000 to present); Formerly, Director, ISI Family of Funds (registered investment companies; 4 funds overseen) (1992-1999).
Hanspeter Ackermann, 46(7)	President of Deutsche Bank Investment Management Inc. Managing Director, Deutsche Bank Securities Inc. Managing Director and Senior International Equity Portfolio Manager, Bankers Trust Co. President and Managing Partner, Eiger Asset Management (1993-1996), Managing Director and CIO, SBC Brinson, formerly SBC Portfolio Management International Inc. (institutional investment management) (1983--1993).
Bruce A Rosenblum, 43	Director of Deutsche Asset Management (2000 to present); prior thereto, Vice President of Deutsche Asset Management (2000-2002); and partner with the law firm of Freedman, Levy, Kroll & Simonds (1997-2000).
Charles A. Rizzo, 46	Director, Deutsche Asset Management (April 2000 to present). Formerly, Vice President and Department Head, BT Alex, Brown Incorporated (now Deutsche Bank Securities Inc.) (1998-1999); Senior Manager, Coopers and Lybrand L.L.P. (now PricewaterhouseCoopers LLP) (1993-1998).
Kathleen Sullivan D'Eramo, 46	Director, Deutsche Asset Management (2003 to present).

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- (1) Unless otherwise indicated, the address of all directors and officers is c/o Deutsche Asset Management., 345 Park Avenue, New York, New York 10154.
- (2) Includes The Germany Fund, Inc. and the New Germany Fund, Inc., which are the other closed-end registered investment companies for which Deutsche Bank Securities Inc. acts as manager. It also includes 204 other open-and closed-end funds advised by wholly-owned entities of the Deutsche Bank Group in the United States.
- (3) Indicates "Interested Person", as defined in the Investment Company Act. Mr. Bierbaum is an "interested" Director because of his affiliation with Sal. Oppenheim Jr. & Cie KGaA, which is the parent company of a registered broker-dealer; and Mr. Bult is an "interested" Director because of his affiliation with UBS Securities LLC, a registered broker-dealer, and the dealer manager in this rights offering; and Mr. Strenger is an "interested" Director because of his affiliation with DWS-Deutsche Gesellschaft für Wertpapiersparen mbH ("DWS"), a majority-owned subsidiary of Deutsche Bank and because of his ownership of Deutsche Bank shares.
- (4) The Germany Fund, Inc. and the New Germany Fund, Inc. are the other closed-end registered investment companies for which Deutsche Bank Securities, Inc. acts as manager. Messrs. Burt and Wadsworth also serve as Directors/Trustees of the following open-end investment companies: Scudder Advisor Funds, Scudder Advisor Funds II, Scudder Advisor Funds III, Scudder Institutional Funds, Scudder Investment Portfolios, Scudder Cash Management Portfolio, Scudder Treasury Money

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MANAGEMENT

- Portfolio, Scudder International Equity Portfolio, Scudder Equity 500 Index Portfolio, Scudder Asset Management Portfolio, Scudder Investments VIT Funds, Scudder MG Investments Trust, Scudder Investors Portfolios Trust, Scudder Investors Funds, Inc., Scudder Flag Investors Value Builder Fund, Inc., Scudder Flag Investors Equity Partners Fund, Inc., Scudder Flag Investors Communications Fund, Inc., Cash Reserves Fund, Inc. and Scudder RREEF Securities Trust. They also serve as Directors of Scudder RREEF Real Estate Fund, Inc. and Scudder RREEF Real Estate Fund II, Inc., closed-end investment companies. These Funds are advised by either Deutsche Asset Management, Inc., Deutsche Asset Management Investment Services Limited, or Investment Company Capital Corp, each an indirect, wholly-owned subsidiary of Deutsche Bank AG.
- (5) Dr. Tessen von Heydebreck, a managing director of Deutsche Bank, is a member of the supervisory board of BASF AG, Mr. Voscherau's employer.
 - (6) Each also serving as an officer of The Germany Fund, Inc. and The New Germany Fund, Inc. Our officers are elected annually by our board of directors at their meeting following the Annual Meeting of Stockholders.
 - (7) Indicates ownership of securities of Deutsche Bank AG either directly or through Deutsche Bank's deferred compensation plan.
 - (8) In December 2001, Mr. Langhammer's two adult children borrowed \$1 million from a Deutsche Bank Group company. The loan, which is secured by collateral furnished by Mr. Langhammer, bears interest at 3-month LIBOR and is of indefinite duration. As of May 9, 2003, the full principal remained outstanding.

The following table contains additional information with respect to the

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beneficial ownership of equity securities by each of our directors and, on an aggregated basis, in any registered investment companies overseen by the director within our same Family of Investment Companies:

NAME OF DIRECTOR	DOLLAR RANGE OF EQUITY SECURITIES IN THE FUND (1)	AGGREGATE DOLLAR RANGE OF EQUITY ALL FUNDS OVERSEEN BY DIRECTOR INVESTMENT CO
Detlef Bierbaum.....	None.....	
John Bult.....	\$10,001-\$50,000	\$50
Ambassador Richard R Burt.....	\$10,001-\$50,000	\$1
Fred H. Langhammer.....	None.....	
Edward C. Schmults.....	\$10,001-\$50,000	\$50
Christian H. Strenger.....	\$10,001-\$50,000	\$1
Eggert Voscherau.....	None.....	
Robert H. Wadsworth.....	\$50,001-\$100,000	
Werner Walbrol.....	\$10,001-\$50,000	\$50

(1) Valuation date is January 2, 2004.

(2) The Family of Investment Companies consists of us, The Germany Fund, Inc. and The New Germany Fund, Inc., which are closed-end funds and share the same investment adviser and manager and hold themselves out as related companies.

Our board of directors presently has an audit committee (composed of Messrs. Burt, Schmults, Wadsworth and Walbrol). The audit committee makes recommendations to the full board with respect to the engagement of independent accountants and reviews with the independent accountants the plan and results of the audit engagement and matters having a material effect upon our financial operations. The audit committee met three times during the fiscal year ended October 31, 2003. In addition, our board of directors has an advisory committee composed of Messrs. Burt, Schmults, Wadsworth and Walbrol. The advisory committee makes recommendations to the full board with respect to our management agreement with Deutsche Bank Securities Inc. ("DBSI") and our investment advisory agreement with Deutsche Asset Management International GmbH ("DeAMI"). The advisory committee met once during the past fiscal year. The board of directors also has an executive committee and a nominating committee. During the past fiscal year, the nominating committee met twice and the executive committee did not meet. The members of the executive committee are Messrs. Burt, Schmults, Strenger, Wadsworth and Walbrol. The executive committee has the authority to act for the board on all matters between meetings of the board, subject to any limitations under applicable state law. The members of the nominating committee are Messrs. Burt, Wadsworth and Walbrol. The

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MANAGEMENT

nominating committee makes recommendations to the full board with respect to the selection of candidates to fill vacancies on the board of directors intended to be filled by persons not affiliated with DBSI or DeAMI, and the nominating committee evaluates the qualifications of all nominees for directorship pursuant to the director qualification provisions in our bylaws. The nominating committee will consider suggestions from stockholders submitted in writing to our

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secretary that comply with the requirements for such proposals contained in our bylaws. All members on each of the four committees of the board are non-interested persons (except that Mr. Strenger, an interested person, is a member of the executive committee).

During the past fiscal year, our board of directors had four regular meetings, and each director (except Messrs. Voscherau and Langhammer) attended at least 75% of the aggregate number of meetings of the board and meetings of board committees on which that director served.

We pay each of our directors who are not interested persons of us, our investment adviser or our investment manager an annual fee of \$7,500 plus \$750 for each meeting attended. Each director who is also a director of The Germany Fund, Inc. or The New Germany Fund, Inc. also receives the same annual and per-meeting fees for services as a director of each fund. Effective as of April 24, 2002, no director of all three funds is paid for attending more than two funds' board and committee meetings when meetings of the three funds are held concurrently, and, effective as of January 1, 2002, no director receives more than the annual fee of two funds. We reimburse directors (except for those employed by the Deutsche Bank group) for travel expenses in connection with board meetings. The following table sets forth (a) the aggregate compensation from us for the fiscal year ended October 31, 2003, and (b) the total compensation from the fund complex that includes us for our fiscal year ended October 31, 2003, and such other funds in the fund complex for the fiscal year ended December 31, 2003, for each director, and for all directors as a group:

NAME OF DIRECTOR	AGGREGATE COMPENSATION FROM FUND	TOTAL COMPENSATION FROM FUND COMPLEX(1)
Detlef Bierbaum(2).....	N/A	N/A
John Bult (2).....	N/A	N/A
Richard R. Burt.....	\$16,500	\$168,640
Fred H. Langhammer.....	\$6,500	\$13,000
Edward C. Schmults.....	\$15,750	\$30,750
Christian Strenger(2).....	N/A	N/A
Eggert Voscherau.....	\$5,000	\$10,000
Robert H. Wadsworth.....	\$12,000	\$34,000
Werner Walbrol.....	\$18,000	\$170,000
	-----	-----
Total	\$73,750	\$154,500
	-----	-----

(1) Includes us, The Germany Fund, Inc. and the New Germany Fund, Inc., which are the other closed-end registered investment companies for which Deutsche Bank Securities Inc. acts as manager. It also includes 204 other open- and closed-end funds advised by wholly-owned entities of the Deutsche Bank AG in the United States.

(2) Indicates "Interested Person", as defined in the Investment Company Act. Mr. Bierbaum is an "interested" Director because of his affiliation with Sal. Oppenheim Jr. & Cie KGaA, which is the parent company of a registered broker-dealer; and Mr. Bult is an "interested" Director because of his affiliation with UBS Securities LLC, a registered broker-dealer, and the dealer manager in this rights offering; and Mr. Strenger is an "interested" Director because of his affiliation with DWS-Deutsche Gesellschaft fur

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Wertpapiersparen mbH ("DWS"), a majority-owned subsidiary of Deutsche Bank and because of his ownership of Deutsche Bank shares.

No compensation is paid us to directors or officers who are interested persons of us or of any entity affiliated with Deutsche Bank AG.

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CODE OF ETHICS

Our board of directors has adopted a code of ethics pursuant to Rule 17j-1 under the Investment Company Act. This code of ethics permits access persons to trade in securities that may be purchased or held by us for their own accounts, subject to compliance with the code of ethic's preclearance requirements. In addition, the code of ethics provides for trading "blackout periods" that prohibit trading by personnel within periods of trading by us in the same security. The code of ethics prohibits short-term trading profits and personal investment in initial public offerings and requires prior approval with respect to purchases of securities in private placements.

Our investment manager (in its capacity as our investment manager) has adopted a code of ethics pursuant to Rule 17j-1 under Investment Company Act. This code of ethics permits access persons to trade in securities that may be purchased or held by us for their own accounts, subject to compliance with the code of ethics preclearance requirements. In addition, the code of ethics provides for trading "blackout periods" that prohibit trading by personnel within periods of trading by us in the same security. The code of ethics prohibits short-term trading profits and personal investment in initial public offerings and requires prior approval with respect to purchases of securities in private placements.

Our investment adviser has adopted a code of ethics pursuant to Rule 17j-1 under the Investment Company Act. This code of ethics permits access persons to trade in securities that may be purchased or held by us for their own accounts, subject to compliance with the code of ethic's requirements. The code of ethics requires prior approval for personal investment in initial public offerings and prohibits short-term trading profits, "front running" trades placed by us, naked short sales, and personal investment in private placements.

These code of ethics are on file with and available from the SEC at <http://www.sec.gov> or by calling 1-202-942-8090. Copies may also be obtained, after paying a duplication fee, by electronic request at the following email address: publicinfo@sec.gov, or by writing the SEC's Public Reference Section, Washington, D.C. 20549-0102.

PROXY VOTING POLICIES AND PROCEDURES

We have delegated proxy voting responsibilities to our investment manager, subject to our board of directors' general oversight. We have delegated proxy voting to our investment manager with the direction that proxies should be voted consistent with our best economic interests. Our investment manager has adopted its own Proxy Voting Policies and Procedures ("Policies"), a Proxy Voting Desktop Manual ("Manual") and Proxy Voting Guidelines ("Guidelines") for this purpose. The Policies address, among other things, conflicts of interest that may arise between our interests, and the interests of our investment manager and its affiliates. The Manual sets forth the procedures that the investment manager has implemented to vote proxies, including monitoring for corporate events, communicating with our custodian regarding proxies, considering the merits of each proposal, and executing and recording the proxy vote. The Guidelines set

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forth our investment manager's general position on various proposals, such as:

- + Stockholder Rights--Our investment manager generally votes against proposals that restrict stockholder rights.
- + Corporate Governance--Our investment manager generally votes for confidential and cumulative voting and against supermajority voting requirements for charter and bylaw amendments.
- + Anti-Takeover Matters--Our investment manager generally votes for proposals that require stockholder ratification of poison pills or that request boards to redeem poison pills, and votes

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MANAGEMENT

"against" the adoption of poison pills if they are submitted for stockholder ratification. Our investment manager generally votes for fair price proposals.

- + Routine Matters--Our investment manager generally votes for the ratification of auditors, procedural matters related to the annual meeting, and changes in company name, and against bundled proposals and adjournment.

The general provisions described above do not apply to investment companies. Our investment manager generally votes proxies solicited by investment companies in accordance with the recommendations of an independent third-party, except for proxies solicited by or with respect to investment companies for which our investment manager or any of its affiliates serve as investment adviser or principal underwriter ("affiliated investment companies"). Our investment manager votes affiliated investment company proxies in the same proportion as the vote of the investment company's other stockholder (sometimes called "mirror" or "echo" voting). Master fund proxies solicited from feeder funds are voted in accordance with applicable requirements of the Investment Company Act.

Although the Guidelines set forth our investment manager's general voting positions on various proposals, our investment manager may, consistent with our best interest, determine under some circumstances to vote contrary to those positions.

The Guidelines on a particular issue may or may not reflect the view of individual members of our board of directors, or of a majority of our board of directors. In addition, the Guidelines may reflect a voting position that differs from the actual practices of the public companies within the Deutsche Bank organization or of the investment companies for which our investment manager or any of its affiliates serve as investment adviser or sponsor.

Our investment manager may consider the views of a portfolio company's management in deciding how to vote a proxy or in establishing general voting positions for the Guidelines, but management's views are not determinative.

As mentioned above, the Policies describe the way in which our investment manager resolves conflicts of interest. To resolve conflicts, our investment manager, under normal circumstances, votes proxies in accordance with its Guidelines. If our investment manager departs from the Guidelines with respect to a particular proxy or if the Guidelines do not specifically address a certain proxy proposal, a proxy voting committee established by our investment manager will vote the proxy. Before voting any such proxy, however, the committee will exclude from the voting discussions and determinations any member who is

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involved in or aware of a material conflict of interest. If, after excluding any and all such members, there are fewer than three voting members remaining, the investment manager will engage an independent third party to vote the proxy or follow the proxy voting recommendations of an independent third party.

Under certain circumstances, our investment manager may not be able to vote proxies, or may find that the expected costs associated with voting outweigh the economic benefits. For example, our investment manager may not vote proxies on certain foreign securities due to local restrictions or customs. Our investment manager generally does not vote proxies on securities subject to share blocking restrictions.

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MANAGEMENT

Control persons and principal holders of securities

As of January 8, 2004 no person, to the knowledge of management, owned of record or beneficially more than 5% of our outstanding common stock, other than as set forth below:

NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP	PERCENT OUTSTANDING COMMON STOCK
MeAG Munich Ergo Kapitalanlage-gesellschaft mbH(1) (Munich, Germany).....	507,076	6.

(1) This information is based exclusively on information provided by such person on Schedules 13G filed with respect to us on February 14, 2003. To the knowledge of management, no other Schedules 13D or 13G had been filed with respect to us as of December 10, 2003.

As of , 2004, all directors and executive officers as a group (14 persons) owned approximately shares of our common stock, which constitutes less than 1% of our outstanding common stock.

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Investment advisory and other services

INVESTMENT ADVISER AND INVESTMENT MANAGER

We entered into a management agreement with DBSI (at the time of execution of the agreement, Deutsche Bank Capital Corporation) and an investment advisory agreement with DeAMI (at the time of execution of the agreement, DB Capital Management International GmbH) on March 6, 1990. Both agreements continue in effect for successive twelve-month periods from their initial term, but only if the agreements are approved for continuance annually by our board of directors in accordance with the requirements of the Investment Company Act. Our board of

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directors last voted to continue both the management agreement and the investment advisory agreement on May 9, 2003. Both agreements are terminable without penalty by vote of a majority of our board of directors or by a vote of the holders of a majority of our outstanding common stock, or by DBSI or DeAMI, as the case may be, at any time upon not less than sixty days' written notice to the other party. Since neither DBSI nor DeAMI is willing to provide services separately, each agreement provides that it shall automatically terminate upon assignment or upon termination of the other agreement. Both DBSI and DeAMI are wholly owned direct or indirect subsidiaries of Deutsche Bank AG, a major German banking institution.

Pursuant to the management agreement, DBSI is our corporate manager and administrator and, subject to the supervision of our board of directors and pursuant to recommendations made by the investment adviser, determines which securities are suitable securities for our investment. DBSI (i) handles our relationships with our stockholders, including stockholder inquiries, (ii) is responsible for, arranges and monitors compliance with regulatory requirements and New York Stock Exchange listing requirements and (iii) negotiates contractual arrangements with third-party service providers, including, but not limited to, custodians, transfer agents, auditors and printers. DBSI also provides office facilities and personnel to carry out these services, together with clerical and bookkeeping services which are not being furnished by our custodian or transfer and dividend-paying agent. In addition, DBSI (i) determines and publishes our net asset value in accordance with our policy as adopted from time to time by our board of directors, (ii) establishes our operating expense budgets and authorizes the payment of actual operating expenses incurred, (iii) calculates the amounts of dividends and distributions to be declared and paid by us to our stockholders, (iv) provides our board of directors with financial analyses and reports necessary for our board to fulfill its fiduciary responsibilities, (v) maintains our books and records required under the Investment Company Act (other than those being maintained by our custodian and transfer and dividend-paying agent and registrar, as to which DBSI oversees such maintenance), (vi) prepares our United States federal, state and local income tax returns, (vii) prepares financial information for our proxy statements and quarterly and annual reports to stockholders and (viii) prepares the our reports to the SEC.

We pay DBSI a management fee, computed weekly and payable monthly, at an annual rate of 0.65% of our average weekly net assets up to \$100,000,000 and 0.55% of such assets in excess of \$100,000,000. During the fiscal years ended October 31, 2003, October 31, 2002 and October 31, 2001, we paid DBSI a management fee of \$911,794, \$786,424 and \$775,596, respectively. Besides its role as our investment manager, DBSI also acts as the investment manager for The Germany Fund, Inc. and The New Germany Fund, Inc. The Germany Fund, Inc. pays DBSI an annual management fee of 0.65% of its average weekly net assets up to \$50,000,000 and 0.55% of such assets over \$50,000,000. The New Germany Fund, Inc. pays DBSI an annual management fee of 0.65% of its average weekly net assets up to \$100,000,000 and 0.55% of such assets over \$100,000,000 and up to \$500,000,000 and 0.50% of such amounts in excess of \$500,000,000. We, together with The

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INVESTMENT ADVISORY AND OTHER SERVICES

Germany Fund, Inc. and The New Germany Fund, Inc., represent the entire fund complex managed by DBSI.

Pursuant to our investment advisory agreement, DeAMI, in accordance with our investment objective, policies and restrictions, makes recommendations to our

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investment manager with respect to our investments and, upon instructions given by our investment manager as to which securities are suitable for investment, transmits purchase and sale orders and selects brokers and dealers to execute portfolio transactions on our behalf.

We pay DeAMI an investment advisory fee, computed weekly and payable monthly, at an annual rate of 0.35% of our average weekly net assets up to \$100 million and 0.25% of such assets in excess of \$100 million. During the fiscal years ended October 31, 2003, October 31, 2002 and October 31, 2001, we paid DeAMI an investment advisory fee of \$469,148, \$412,158 and \$407,237, respectively. Besides its role as our investment manager, DBSI also acts as the investment manager of The Germany Fund, Inc. and The New Germany Fund, Inc. The Germany Fund, Inc. and The New Germany Fund, Inc. each pay DeAMI an investment advisory fee, computed weekly and payable monthly, at an annual rate of 0.35% of their average weekly net assets up to \$100 million and 0.25% of such assets in excess of \$100 million. We, together with The Germany Fund, Inc. and The New Germany Fund, Inc., represent the entire fund complex advised by DeAMI.

Both the management agreement and the investment advisory agreement provide that DBSI and DeAMI, respectively, are responsible for all expenses of all employees and overhead incurred by them in connection with their duties under their respective agreements. DBSI pays all salaries and fees of our directors and officers who are "interested persons" under the Investment Company Act. An "interested person" is a director who is not independent under the specific requirements of the Investment Company Act. We bear all of our own expenses, including those expenses described in "Our Management" on page 37 of the prospectus.

In reaching their decision on May 9, 2003 to continue the management agreement and the investment advisory agreement for another twelve-month period, our board of directors reviewed information derived from a number of sources covering a range of issues. Our board of directors considered, among other things, the experience, expertise and availability of the executive and professional personnel of DBSI and DeAMI, as well as the management and investment advisory services that DBSI and DeAMI, respectively, provided to us. With respect to DBSI, this entailed a review of the portfolio services performed by DBSI, a review of the general nature of the corporate services performed by DBSI in addition to those provided by others (such as the registrar and transfer agent), and a review of any current changes to DBSI's asset management operations that could be relevant to the services DBSI provides to us. With respect to DeAMI, this entailed a review of the investment advisory services performed by DeAMI. Our board of directors also reviewed the performance of DBSI's and DeAMI's other advisory clients as well as comparative information with respect to the performance of certain securities indices for the equity markets relevant to us. In addition, our board of directors also compared the management and investment advisory fees charged by DBSI and DeAMI, respectively, with information on fees charged by other investment managers and investment advisers for comparative services. Taking into account this review, our board of directors determined that it was satisfied with the nature and quality of services provided by DBSI and DeAMI, and that fees charged for these services were reasonable.

Brokerage allocation and other practices

The primary objective in placing orders for the purchase and sale of securities for the our portfolio is to obtain best price together with efficient execution, taking into account such factors as commission,

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BROKERAGE ALLOCATION AND OTHER PRACTICES

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size of order, difficulty of execution and skill required of the broker. Brokerage commission rates in Central Europe and Russia for transactions executed on the exchanges may be discounted for certain large domestic and foreign investors such as us. Off-board transactions outside of the exchanges' regular business hours are executed on a "net" basis with dealers acting as principal for their own accounts without a stated commission, although the price of the security usually includes a profit to the dealer. Subject to best price together with efficient execution, orders for brokerage transactions may be placed with Deutsche Bank AG or any of its affiliates. Our policy requires that commissions paid to Deutsche Bank AG or any of its affiliates be reasonable and fair compared with commissions received by other brokers in connection with comparable transactions involving similar securities being purchased or sold on a securities exchange during a comparable period of time.

During our fiscal years ended October 31, 2003, October 31, 2002, and October 31, 2001, we incurred brokerage commissions amounting in the aggregate to \$162,271, \$288,097 and \$282,266, respectively. During such periods, we paid brokerage commissions to Deutsche Bank AG or its affiliates amounting to \$5,665, which constituted 3.49% of our aggregate brokerage commissions, \$20,790, which constituted 7.22% of our aggregate brokerage commissions, and \$25,202, which constituted 8.93% of our aggregate brokerage commissions, respectively.

At each board meeting, our board of directors reviews the commissions paid by us to determine if the commissions paid over representative periods of time were reasonable in relation to the benefits we receive. They have determined that the aforementioned commissions were at the best rate available for institutions such as ours.

Subject to best price together with efficient execution, orders are placed with brokers and dealers who supply research, market and statistical information ("research" as defined in Section 28(e) of the Exchange Act) to us, our investment manager and investment adviser. Our commissions to such brokers may not represent the lowest obtainable commission rates, although they must be reasonable in relation to the benefits received. The research may be used by our investment manager and investment adviser in advising other clients. Conversely, the information provided to our investment manager and investment adviser by brokers and dealers through whom their other clients effect securities transactions may be useful to them in providing services to us. Although research from brokers and dealers may be useful to our investment manager and investment adviser, it is only supplementary to their own efforts. For our fiscal years ended October 31, 2003, October 31, 2002, and October 31, 2001, transactions in our portfolio securities with associated brokerage commissions of approximately \$162,271, \$288,097 and \$282,266, respectively, were allocated to persons or firms supplying research to us, our investment manager or our investment adviser.

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Financial statements

The required financials statements are included in our 2003 Annual Report, and are incorporated by reference into this SAI. These statements include: Schedule of Investments as of October 31, 2003; the Statement of Assets and Liabilities as of October 31, 2003; Statement of Operations for the fiscal year ended October 31, 2003; Statements of Changes in Net Assets for the fiscal years ended October 31, 2003 and October 31, 2002; Notes to Financial Statements; and Financial Highlights for a share of common stock outstanding during each of the

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fiscal years ended October 31, 2003, 2002, 2001, 2000 and 1999. A copy of our 2003 Annual Report is available on the SEC's website at <http://www.sec.gov>. A copy may also be obtained without charge upon written or oral request from our information agent at _____ or 1-800-_____.

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Part C

OTHER INFORMATION

ITEM 24. FINANCIAL STATEMENTS AND EXHIBITS.

(1) Financial Statements

Part B--The Central Europe and Russia Fund, Inc. Financial Statements are included in the Fund's 2003 Annual Report and are incorporated by reference into the Statement of Incorporation. These statements include: Schedule of Investments as of October 31, 2003; the Statement of Assets and Liabilities as of October 31, 2003; Statement of Operations for the fiscal year ended October 31, 2003; Statements of Changes in Net Assets for the fiscal years ended October 31, 2003 and October 31, 2002; Notes to Financial Statements; and Financial Highlights for a share of common stock outstanding during each of the fiscal years ended October 31, 2003, 2002, 2001, 2000 and 1999.

(2) Exhibits

- * (a) -- Articles of Incorporation of the Fund
- * (b) -- By-Laws of the Fund
- (c) -- Not applicable
- * (d) (1) -- Form of Subscription Certificate
- * (d) (2) -- Form of Notice of Guaranteed Delivery
- * (d) (3) -- Form of Nominee Holder Over-Subscription Exercise Form
- * (d) (4) -- Form of Beneficial Owner Certification Form
- * (d) (5) -- Form of Subscription Agent Agreement
- * (d) (6) -- Form of Information Agent Agreement
- (e) -- Voluntary Cash Purchase Program and Dividend Reinvestment Plan
- (f) -- Not applicable
- * (g) (1) -- Management Agreement, dated as of March 6, 1990, between the Fund and Deutsche Bank Securities Inc. (formerly Deutsche Bank Capital Corporation)
- * (g) (2) -- Investment Advisory Agreement, dated as of March 6, 1990, between the Fund and Deutsche Asset Management International GmbH (formerly DB Capital Management International GmbH)
- * (h) (1) -- Form of Dealer Manager Agreement
- * (h) (2) -- Form of Soliciting Dealer Agreement
- (i) -- Not applicable
- * (j) (1) -- Amended and Restated Custody Agreement between the the Fund and Investors Bank & Trust Company
- * (j) (2) -- Delegation Agreement between the Fund and Investors Bank & Trust Company
- * (k) -- Transfer Agency and Service Agreement between the Fund and Investors Bank & Trust Company
- * (l) (1) -- Opinion and Consent of Sullivan & Cromwell LLP
- * (m) -- Consent of Deutsche Asset Management International GmbH to

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service of process in the United States

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- (n) -- Consent of PricewaterhouseCoopers LLP
 - (o) -- Not applicable
 - (p) -- Not applicable
 - (q) -- Not applicable
 - * (r) (1) -- Code of Ethics of the Fund adopted pursuant to Rule 17j-1 of the Investment Company Act
 - * (r) (2) -- Code of Ethics of Deutsche Bank Securities Inc. adopted pursuant to Rule 17j-1 of the Investment Company Act
 - * (r) (3) -- Code of Ethics of Deutsche Asset Management International GmbH adopted pursuant to Rule 17j-1 of the Investment Company Act
 - Other -- Power of Attorney
- Exhibits

* To be filed by amendment

ITEM 25. MARKETING ARRANGEMENTS.

- (a) See Section (...) of the Dealer Manager Agreement, to be filed as Exhibit (...).
- (b) See Section (...) of Exhibit (...).
- (c) Not Applicable

ITEM 26. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION.

The following table sets forth the estimated expenses to be incurred in connection with this rights offering described in this Registration Statement:

Registration Fee.....	
New York Stock Exchange listing fee.....	
Printing (other than stock certificates).....	
Fees and expenses of qualifications under state.....	
securities laws (including fees of counsel).....	
Legal fees and expenses.....	
Accounting fees and expenses.....	
Underwriter's expense allowance.....	
NASD filing fee.....	
Miscellaneous expenses.....	
TOTAL.....	=====

ITEM 27. PERSONS CONTROLLED BY OR UNDER COMMON CONTROL WITH THE FUND.

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None.

ITEM 28. NUMBER OF HOLDERS OF SECURITIES.

As of January 2, 2004, the Fund had approximately 7,500 holders of record of its common stock, par value \$0.001 per shares.

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ITEM 29. INDEMNIFICATION.

Under Article Eleventh of our Amended and Restated Articles of Incorporation and Article XII of our Amended and Restated By-Laws, our directors and officers will be indemnified to the fullest extent allowed and in the manner provided by Maryland law and provisions of the 1940 Act, including advancing of expenses incurred in connection therewith. Indemnification shall not be provided however to any officer or director against any liability to us or our security-holders to which he or she would otherwise be subject by reasons of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office.

We maintain insurance on behalf of any person who is or was a director of officer of the Fund, against certain liability asserted against him or her and incurred by him or her or arising out of his or her position. In no event, however, will we pay that portion of the premium, if any, for insurance to indemnify any such person or any act for which we ourselves are not permitted to indemnify.

Insofar as indemnification for liabilities under the Securities Act of 1933 may be permitted to the directors and officers, we have been advised that in the opinion of the SEC such indemnification is against public policy as expressed in such Act and is therefore unenforceable. If a claim for indemnification against such liabilities under the Securities Act of 1933 (other than for expenses incurred in a successful defense) is asserted against us by the directors or officers in connection with this rights offering, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether such indemnification by us is against public policy as expressed in such Act and will be governed by the final adjudication of such issue.

Our Management Agreement and Investment Advisory Agreement, filed as exhibits (g)(1) and (g)(2), respectively, limit the liability of our investment advisor and our investment manager.

ITEM 30. BUSINESS AND OTHER CONNECTIONS OF INVESTMENT ADVISER.

We are fulfilling the requirement of this Item 30 to provide a list of the officers and directors of our investment adviser and investment manager, together with information as to any other business, profession, vocation or employment of a substantial nature engaged in by those entities or those of its officers and directors during the past two years, by incorporating herein by reference the information contained in the current Form ADV filed on January 21, 2003 and July 24, 2003, respectively, with the Securities and Exchange Commission by each of Deutsche Asset management International GmbH (Commission File No. 801-20289) and Deutsche Bank Securities Inc. (Commission File No. 801-9638) pursuant to the Investment Advisers Act of 1940, as amended.

ITEM 31. LOCATION OF ACCOUNTS AND RECORDS.

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All accounts, books and other documents required to be maintained by Section 31(a) of the Investment Company Act and the rules thereunder will be maintained at the offices of Investors Bank & Trust Company, 200 Clarendon Street, Boston Massachusetts 02116, and at our offices, 345 Park Avenue, New York, New York 10154.

ITEM 32. MANAGEMENT SERVICES.

Not Applicable.

ITEM 33. UNDERTAKINGS.

(a) Registrant undertakes to suspend offering of the shares covered under this registration statement until it amends its prospectus contained herein if (1) subsequent to the effective date of this

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Registration Statement, its net asset value per share declines more than ten percent from its net asset value as of the effective date of this Registration Statement, or (2) its net asset value increases to an amount greater than its net proceeds as stated in the prospectus contained herein.

(b) Registrant undertakes:

- (1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement: (i) to include any prospectus required by Section 10(a)(3) of the Securities Act of 1933; (ii) to reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) in the registration statement; and (iii) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.
- (2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.
- (3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.
- (4) For the purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant under Rule 497(h) under the Securities Act of 1933 shall be deemed to be part of this registration statement as of the time it was declared effective.

(c) Registrant undertakes to send by first class mail or other means designed to ensure equally prompt delivery, within two business days of receipt of a written or oral request, the Statement of Additional Information.

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Signatures

Pursuant to the requirements of the Securities Act of 1933 and the Investment Company Act of 1940, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of New York, and the state of New York, on the 9th day of January, 2004.

THE CENTRAL EUROPE AND RUSSIA FUND, INC.

(Registrant)

By: /s/ RICHARD T. HALE

Richard T. Hale
President and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed below by the following persons and on the date indicated.

NAME	TITLE
* ----- Christian H. Strenger	Chairman of the Board and Director
----- Detlef Bierbaum	Director
* ----- John Bult	Director
----- Richard R. Burt	Director
* ----- Fred H. Langhammer	Director
* ----- Edward C. Schmults	Director
* ----- Robert H. Wadsworth	Director
* ----- Werner Walbrol	Director

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Director

Eggert Voscherau

/s/ RICHARD T. HALE

President and Chief Executive
Officer

Richard T. Hale

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NAME

TITLE

*

Treasurer and Chief Financial
Officer (Principal Financial
Accounting Officer)

Charles A. Rizzo

* Richard T. Hale, by signing his name hereto, does sign this document in behalf
of the persons indicated above pursuant to a power of attorney duly executed
by such person and filed as an exhibit to this Registration Statement.

/s/ RICHARD T. HALE

January 9, 2004

Richard T. Hale
Attorney-in Fact

Date

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INDEX TO EXHIBITS

EXHIBIT
NUMBER

EXHIBIT

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- * (d) (6) -- Form of Information Agent Agreement
- (e) -- Voluntary Cash Purchase Program and Dividend Reinvestment

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- Plan
- (f) -- Not applicable
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 - * (g) (2) -- Investment Advisory Agreement, dated as of March 6, 1990, between the Fund and Deutsche Asset Management International GmbH (formerly DB Capital Management International GmbH)
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* To be filed by amendment

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