

Kereskedelmi és Hitelbank Zrt.



Basel II – Pillar 3 disclosure

Risk Report

FY2010

May 2011



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Chapter I – Background information

Introduction

Structure of Basel II

Basel II Capital Accord is an international initiative with the purpose to implement a more risk sensitive framework for the assessment of risk for the calculation of regulatory capital, i.e. the minimum capital that the institution must hold. The intention is also to align the actual assessment of risk within the institutions with the assessment of the regulatory capital by allowing use of internal models.

Basel II aims at improving the stability and soundness of the financial system by more closely linking capital requirements to risks and by promoting a more forward-looking approach to capital management. It contains a detailed set of minimum requirements to assure the conceptual soundness and integrity of the internal assessment.

With Basel II, the Basel Committee has abandoned the 1988 Capital Accord's "one-size-fits-all" method of calculating minimum regulatory capital requirements and introduced a three-pillar concept that seeks to align regulatory requirements with the economic principles of risk management.

The Basel II framework is based on three pillars:

- Pillar 1 defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. This capital demand has to be covered by regulatory own funds.
- Pillar 2 addresses the bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar 2 also introduces the Supervisory Review and Evaluation Process (SREP), which assesses the internal capital adequacy of credit institutions by the regulators.
- Pillar 3 focuses on minimum disclosure requirements, covering the key pieces of information required to assess the capital adequacy of a credit institution including risk and capital management.

Basel II Capital Framework		
Pillar 1	Pillar 2	Pillar 3
Minimum Capital Requirements	Supervisory Review Process	Market Disclosure
<ul style="list-style-type: none"> ▶ Different approaches and minimum requirements ▶ Credit risk ▶ Operational risk ▶ Market risk 	<ul style="list-style-type: none"> ▶ Addresses a bank's internal capital adequacy assessment process (ICAAP) ▶ Considers additional risks ▶ Capital buffers and targets 	<ul style="list-style-type: none"> ▶ Regular disclosure to the market covering both qualitative and quantitative aspects of capital adequacy and risk management

Figure 1: Basel II capital framework

Scope of the document

This document gathers together the elements of the disclosure foreseen by the third Pillar of the Basel II framework and the corresponding EU directives dispositions, and also its transposition into the Hungarian legislation. Consequently, in this report, K&H discloses a description of the different risk types in Pillar 1 and the management of these risks and capital in accordance with the Pillar 3 rules. The document is organized as outlined below.



First it gives a brief summary how K&H complies with the disclosure requirements. After that an overview is given concerning the K&H Group structure from legal and organizational aspects.

Secondly this disclosure aims to explain the overall risk and capital management strategies in KBC Group (and thus in K&H as well) and how K&H relates risk to the appropriate level of capital, then it details the capital structure of K&H Group. It also provides an overview regarding the capital adequacy and solvency of K&H.

Third main chapter deals with the description of risk governance and the risk management process applied in K&H Group and details the tasks and responsibilities of the organizational units and committees concerned.

Finally this document details more specifically the credit, market and operational risks and sets out the risk management framework, monitoring processes and key mitigation initiatives with respect to these specific risk types. This disclosure is extended with chapters related to liquidity and ALM risk management.

Please note, however, that liquidity aspects are not covered fully by this disclosure. Further details and disclosure of risk, liquidity and capital management are presented in the Annual Report in accordance with the international financial reporting standards (IFRS).

Disclosure requirements in K&H

K&H has committed itself to comply with the Pillar 3 requirements as laid down in EU Directive 2006/48/EC and in the Hungarian legislation. To meet the disclosure requirements stipulated in Article 137/A of ACIFE¹, K&H prepares a document with the contents prescribed by Gov. Decree 234/2007 in the form of a special '*Risk Report*'.

Principles of disclosure

In line with its general communication policy, K&H aims to be as open as possible in communicating with the market about its exposure to risk. Value and risk management information is therefore provided in a separate section of our Annual Report and - even more extensively - in this document.

This specific Pillar 3 document is drawn up according to the disclosure requirements of the Capital Requirements Directive (CRD) (and as transposed into Hungarian legislation), and is aimed at meeting the market's needs as much as practicable. K&H considers that the disclosure requirements as laid down by Annex XII of the Directive are neither proprietary nor confidential.

K&H may omit one or more of the disclosures listed in the EU Directive, if K&H considers that the information provided by such disclosures is not, in the light of the criterion specified in Annex XII, Part 1, par. 1 of CRD (and in the Hungarian legislation), to be regarded as material.

Moreover, in this specific Pillar 3 report, requirements are incorporated if they are deemed relevant for K&H. Accordingly, in order to focus on what is relevant for the market, requirements that are not applicable for K&H are not mentioned in this document. However, K&H will pay attention to the legitimate interest of its customers and, if appropriate, review its policy.

As the Pillar 3 disclosures are intended to be market-driven, K&H plans to follow sound market practices as these develop in future and will consequently consider, when appropriate, extending the level of information disclosed and, if required, will review its initial formal policy on Pillar 3 disclosures.

¹ Act No. CXII of 1996 "on credit institutions and financial enterprises" (ACIFE)



The Bank shall disclose the fact of and the reason for refraining from disclosing any information which is deemed as proprietary or confidential according to the law, and shall disclose any associated information that is not deemed as proprietary or confidential.

Frequency and place of disclosure

K&H will prepare the Risk Report once a year within 15 (fifteen) days counted from the approval of the Annual Report. This specific Pillar 3 document is available in English (and Hungarian) on the K&H corporate website (www.kh.hu). The Risk Report is made for the date relevant to the last day of the financial year as a balance sheet date similarly as the Annual Report.

Simultaneously with publishing the report on K&H corporate website, the Bank will send the Risk Report to HFSA and the regulator may also publish it on its website.

Risk Report will be updated on a yearly basis. Disclosure of the qualitative information is based on the situation at the end of the previous year. Consequently, K&H's next Pillar 3 disclosure is scheduled for the end of April 2012 covering the financial year 2011.

Depending on market needs, K&H may however decide to provide more updates.

Content of disclosure

K&H assesses that the mandatory Pillar 3 disclosures as laid down by the CRD are sufficient to explain the risk profile and capital adequacy position of K&H. K&H will, in the initial phase, disclose only the information as laid down in Annex XII of the CRD and in its transposition into Hungarian legislation (234/2007 Gov. Decree).

Some of the information provided coincides with the information required under HAS and is provided in the relevant sections of the Annual Report. The information and data required by the Pillar 3 disclosures requirements, and which are already published for HAS, are repeated, so as to ensure the completeness of and easy access to the disclosures in order not to compromise on the readability of this document.

The information and data required by the Pillar 3 disclosures are verified and reviewed following a similar process as for the financial statements to the exception of an external audit review. Thus the disclosures have been checked for consistency with other existing risk reports and subjected to a final screening by the senior managers to ensure its overall quality.

Scope of disclosure

The current Risk Report is prepared for K&H Bank on individual basis, however detailed information is also provided regarding the structure of K&H Group. The Risk Report contains information and figures for 31/12/2010, audited in the course of the preparation of the Annual Report.



Legal and organizational structure

The K&H Group is not only a universal commercial bank and a major player in the Hungarian market but also part of the KBC International Bank - and Insurance Group. As such the activities of the K&H cover a wide range, including the retail, corporate and the professional money market segments.

Legal structure of K&H

Kereskedelmi és Hitelbank Bank Zrt. (K&H Bank) is a limited liability company incorporated in the Republic of Hungary. K&H Bank and its subsidiaries (referred collectively as K&H Group) provide a full range of banking services through a nation-wide network of more than 240 branches. K&H Bank is a legal successor of ABN AMRO Magyar Bank Rt. (ABN AMRO Hungary).

The parent company of K&H Bank Zrt. is KBC Bank N.V. (Belgium) as the sole shareholder. Since 2001, KBC Bank N.V. is the controlling shareholder. The ultimate parent is KBC Group N.V. holding company which also possesses KBC Insurance N.V. who is the parent company of K&H Insurance. Therefore K&H Insurance is not part of the K&H Group (K&H Bank itself does not have shares in the insurance company) although the activities of K&H Bank and K&H Insurance are inter-linked at several points (e.g. governance, strategies, distribution channels, etc.). Other K&H Group entities are direct or indirect subsidiaries of K&H Bank.

K&H Group structure

K&H Group can be divided into the following three main parts:

- Bank
- Leasing group
- other subsidiaries

The “Leasing group” of K&H Group currently includes 9 legal entities. The group’s largest company is K&H Pannonlízing Zrt. As a result of the integration of member companies and the optimization of their activities, the following businesses have been deemed active since April 2002 (i.e. those entities that are expected to increase the Leasing group’s portfolio)²:

Structure of the K&H Leasing group		
Company	Main activity	Business line
K&H Pannonlízing Zrt	Lending, Financial lease	Cars, trucks
K&H Autófinanszírozó Zrt.	Financial leasing	Cars, trucks
K&H Autópark Kft.	Operative leasing, fleet management (rental)	Cars, trucks
K&H Eszközfinanszírozó Zrt.	Financial leasing	Other assets
K&H Eszközlízing Kft.	Operative leasing (rental)	Other assets
K&H Ingatlanlízing Zrt.	Financial leasing	Real estate
K&H Alkusz Kft.	Insurance Brokerage	Brokerage
<i>K&H Lízingház Zrt.</i>	<i>Operative lease</i>	<i>Other assets</i>
<i>K&H Lízing Zrt.</i>	<i>Finance lease</i>	<i>Cars, trucks</i>

Table 1: Structure of K&H Leasing Group

² The companies indicated with grey and italic in the Leasing Group are passive (K&H Lízing Zrt., K&H Lízingház Zrt.) These entities do not conclude new contracts; their portfolios will gradually run out over the next few years, or they will be merged into an active company, or they will be wound up (as they have no “live” portfolio). Liquidation of K&H Lízingház Zrt. started in May, 2010.



In case of K&H Group, the “other subsidiaries” contains entities that don’t do any lending activity. These subsidiaries include:

- K&H Befektetési Alapkezelő Zrt.
- K&H Equities Zrt.
- K&H Csoportszolgáltató Kft.

In sum the following companies were pertaining to the scope of full consolidation at year end:

Scope of full consolidation in K&H Group				
Company	Ownership (direct investment, mln HUF)	Planning unit?	Func- tionality	Classification according to ACIFE
K&H Bank Zrt.	KBC Bank N.V. (Belgium, 100.00%)	yes	active	PIBB ³
K&H Befektetési Alapkezelő Zrt.	K&H Bank Zrt. (100.00%, 850.0)	yes	active	PIBB
K&H Faktor Zrt.	K&H Bank Zrt. (100.00%, 250.0)	yes	active	PIBB
K&H Equities Zrt.	K&H Bank Zrt. (100.00%, 25 121.6)	yes	active	other
K&H Csoportszolgáltató Kft.	K&H Bank Zrt. (100.00%, 60.0)	yes	active	additional
K&H Pannonlízing Zrt.	K&H Bank Zrt. (100.00%, 4 484.8)	yes	active	PIBB
K&H Autópark Kft.	K&H Pannonlízing Zrt. (100.00%, 10.0)	yes	active	operative leasing
K&H Autófinanszírozó Zrt.	K&H Pannonlízing Zrt. (100.00%, 50.0)	yes	active	PIBB
K&H Alkusz Kft.*	K&H Pannonlízing Zrt. (100.00%, 22.9)	yes	active	other
K&H Lízing Zrt.	K&H Pannonlízing Zrt. (100.00%, 50.0)	yes	active	PIBB
K&H Ingatlanlízing Zrt.	K&H Pannonlízing Zrt. (100.00%, 50.0)	yes	active	PIBB
K&H Eszközfinanszírozó Zrt.	K&H Pannonlízing Zrt. (100.00%, 100.0)	yes	active	PIBB
K&H Eszközlízing Kft.	K&H Pannonlízing Zrt.. (100.00%, 50.0)	yes	active	operative leasing

Note: K&H Alkusz Kft. of the K&H Leasing group is not within the scope of consolidation under HAS, only under IFRS.

Table 2: Scope of full consolidation within K&H Group

More details regarding the scope of consolidation and other participations of K&H Bank can be found in the [appendix](#).

Since only K&H Bank is within the scope of the current Risk Report the figures throughout the document are indicating the exposures of K&H Bank on standalone basis exclusively.

Organizational structure

The organizational structure changed with the implementation of the ‘Next Project’ in January 2007. This project has not impacted the legal structure of the KBC Group and its entities but it reformed the organizational structure in KBC Group (including K&H Group) which was based on four principles:

- A focus on ‘distribution’ to leverage future competitive advantages and the integration of retail banking, network-driven private banking and insurance activities in local geographic areas into single business units, which will make up the backbone of this competitive advantage.

³ The term “PIBB” covers credit institutions, financial enterprises, investments firms, and insurance companies all together.



- The strengthening of the international dimension of the group and the explicit separation of 'Belgian activities' from 'Head Office' functions to ensure this objective is met.
- The delegation of clear accountability for performance to the business units, whilst ensuring strict compliance with Group Standards and effective Group Steering.
- The enhancement of 'lean processing' by taking advantage of group scale by grouping manufacturing activities into product factories and support operations into shared services.

The functional structure of K&H Group at year end is indicated in the chart below.

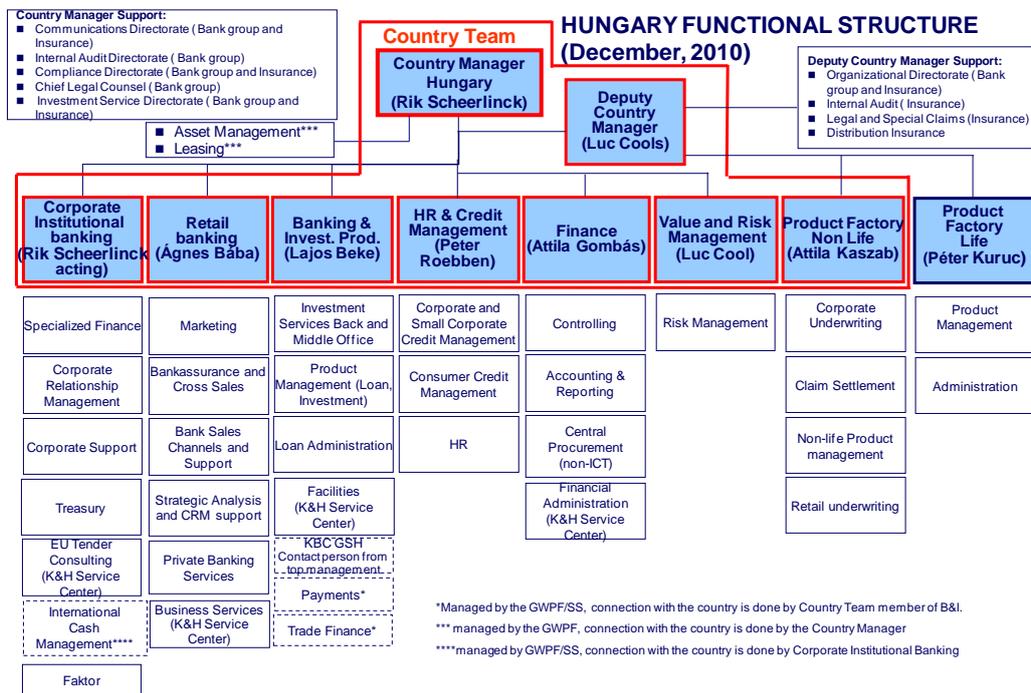


Figure 2: Functional structure of K&H

Chapter II – Capital adequacy

Group risk & capital strategies

In this chapter a brief overview of KBC's general strategies with respect to capital and risk management is provided. These basic fundamentals are applied throughout the KBC Group and provide a general framework for management decisions within KBC group entities thus in K&H Group as well.

Risk policy

KBC Group addressed core issues and defined general strategic conditions for the organization based on its fundamental attitude toward risk and risk management. For this reason, a group-wide strategy and policy are formulated regarding risk and capital.

In KBC Group, the following high-level policies constitute the fundament of risk strategy:

- Maintain an environment in which all significant and material risks are identified, assessed, controlled, managed, reported, and monitored
- Guide risk taking activities by an independent oversight with clearly established responsibilities and accountability
- Follow an open risk culture which is designed to effectively facilitate timely risk mitigation
- Optimize risk-return in a controlled manner at high standards

Capital policy

Supplementing the aforementioned risk policies, the capital strategy in KBC Group consist the followings:

- Create lasting value for its shareholders which means putting KBC Group's capital to its most effective use by generating maximum returns on the risks taken and avoiding an excess of unused capital
- Compliance with the constraints set on KBC Group's capital base by regulators and rating agencies
- Maintain capital adequacy whilst taking into account a prospective view of KBC Group's business evolution over one year and beyond as part of the strategic business and capital planning process
- Ensure that KBC Group is capitalized at all times to cover all material risks up to a highly set target solvency level.

Basics of risk management

In accordance with the policies above, the following basic principles form the foundation of risk management at KBC Group:

- A single, coherent approach should be taken to value, risk and capital management
- A single, global, risk governance model applies to all entities according to the proportionality principle
- Value and risk management operates independently of the line having an advisory, supporting and monitoring duty
- KBC Group implements new risk management techniques as soon as they are considered to be industry standards



Capital structure

The amount and quality of the capital of K&H Group is subject to rules, guidelines and/or expectations from many different stakeholders such as regulators, shareholders, fiscal authorities and K&H management. In this chapter we describe the composition of K&H's available regulatory own funds under the first pillar of Basel II.

Capital structure

Regulatory available capital (also referred as regulatory own funds) is divided into Tier 1 and Tier 2 Capital. Tier 1 Capital primarily consists of shareholders' equity plus other capital instruments acceptable to the Hungarian law, less prescribed negative elements. Tier 2 Capital is comprised primarily of hybrid and debt instruments acceptable to the Hungarian legislation less any prescribed negative elements. Total regulatory capital is the aggregate of Tier 1 and Tier 2 Capital minus other deductions. A detailed breakdown of K&H Bank's Tier 1 and Tier 2 Capital is provided hereafter.

ELEMENTS OF REGULATORY CAPITAL	mIn HUF
TIER 1 - BASE CAPITAL	119 643
POSITIVE ELEMENTS OF BASE CAPITAL	127 854
(1) Capital items recognized as base capital	101 779
<i>Registered capital paid in</i>	73 709
<i>Capital reserve</i>	28 070
(2) Reserves recognized as base capital	15 429
<i>General reserve</i>	15 429
<i>Profit reserve</i>	0
<i>Part of tied-up reserve recognizable as base capital</i>	0
<i>Balance sheet P&L certified by statutory auditor</i>	0
(3) General risk provisions recognized as base capital (up to 1.25 % of total assets)	10 646
<i>General risk provisions</i>	13 143
<i>(-) General risk provision tax</i>	-2 497
(4) Base loan capital	0
NEGATIVE ELEMENTS OF BASE CAPITAL	-8 211
<i>(-) Intangible assets</i>	-8 211
<i>(-) Above-limit part of base loan capital</i>	0
<i>(-) Risk provision and impairment deficit (without general risk provision)</i>	0
TIER 2 CAPITAL	20 496
POSITIVE ELEMENTS OF TIER 2 CAPITAL	20 496
<i>Part of base loan capital recognizable as Tier 2 capital</i>	0
<i>Valuation reserves</i>	0
<i>IRB impairment and provision surplus</i>	0
<i>Tier 2 loan capital</i>	0
<i>Subordinated loan capital</i>	20 496
<i>Preferential shares, authorizing payment in profit-making years of yields unpaid in previous year(s), registered and paid in, not yet redeemed</i>	0
<i>Bonds convertible to shares</i>	0
NEGATIVE ELEMENTS OF TIER 2 CAPITAL	0
<i>(-) Above-limit part of subordinated loan capital and preferential shares, authorizing payment in profit-making years of yields unpaid in previous year(s), registered and paid in, not yet redeemed</i>	0
<i>(-) Above-limit part of Tier 2 capital</i>	0



DEDUCTIONS FROM REGULATORY CAPITAL	-4 613
(-) Due to constraint on investments and capital loans in PIBB	-4 613
(-) IRB impairment and provision deficit, and expected loss on IRB participations	0
(-) Limit overruns due to investment constraints	0
(-) Limit overrun due to constraint on legal lending limit	0

REGULATORY CAPITAL SERVING THE COVERAGE OF FINANCIAL AND INVESTMENT SERVICE ACTIVITIES	mIn HUF
Regulatory capital (Tier 1 + Tier 2) BEFORE deductions	140 139
Deductions from regulatory capital	-4 613
of which: (-) Deductions from Tier 1 capital	-4 072
of which: (-) Deductions from Tier 2 capital	-541
Regulatory capital (Tier 1 + Tier 2) AFTER deductions	135 526
from which TIER 1 CAPITAL after deduction	115 571
from which TIER 2 CAPITAL after deduction	19 955

Table 3: Available regulatory capital of K&H Bank

Solvency

This section elaborates on K&H Group's solvency risk. Solvency risk is the risk that the capital base of a financial institution might fall below an acceptable level. In practice, this entails checking solvency against the regulatory and in-house minimum solvency ratios set by the stakeholders of the company.

Solvency for K&H Group

In accordance with the Hungarian law, K&H Group must have a minimum regulatory capital amount higher than 8% of risk weighted assets.

The Bank takes this requirement into consideration as well when preparing its detailed budget and creates further reserves in order to have sufficient guarantee capital in case of a HUF weakening or other unexpected events. The Bank reports its capital adequacy situation to PSZÁF each month and also prepares monthly forecasts to the Capital and Risk Oversight Committee (CROC) of the Bank. When needed, the Bank's Executive Committee decides over the necessary steps to be taken (e.g. capital increase, dividend payment etc.).

Here below an overview is provided regarding the capital adequacy of K&H Bank.

CAPITAL ADEQUACY under PILLAR 1	
RISK WEIGHTED ASSETS (RWA)	mIn HUF
Risk weighted assets of credit risks ('standardized approach', STA)	1 362 951
Risk weighted assets of market risks ('standardized measurement approach', SMA)	56 746
Risk weighted assets of operational risk ('the standardized approach', STA)	195 740
Risk weighted assets of settlement and delivery risk	1 462
TOTAL RISK WEIGHTED ASSETS	1 616 899
REGULATORY CAPITAL REQUIREMENTS (8% of RWA)	mIn HUF
Capital charge for credit risks (credit, counterparty, dilution and open account risk)	109 036
Capital charge for market risks (position, exchange rate and commodities risk)	4 540
Capital charge for operational risk	15 659
Capital charge for settlement and delivery risk	117
TOTAL REGULATORY CAPITAL REQUIREMENTS	129 352



AVAILABLE REGULATORY CAPITAL	mIn HUF
Tier 1 capital after deductions	115 571
Tier 2 capital after deductions	19 955
TOTAL AVAILABLE REGULATORY CAPITAL	135 526

CAPITAL ADEQUACY	mIn HUF
Surplus of regulatory capital	6 174

SOLVENCY	Ratio
Capital adequacy ratio (regulatory minimum: 8%)	8,38%
Tier-1 ratio (regulatory minimum: 4%)	7,15%

Table 4: Capital adequacy of K&H Bank under Pillar 1

Capital adequacy under Pillar 2

The three-pillar model of Basel II and the new Capital Requirements Directives place increased emphasis on risk management in addition to providing guidelines for the calculation of minimum capital requirements and defining extended disclosure requirements. Financial institutions are thus faced with the challenge of developing internal procedures and systems in order to ensure that they possess adequate capital resources in the long term with due attention to all material risks. In the international discussion, these procedures are referred to collectively as the Internal Capital Adequacy Assessment Process (ICAAP).

The methodology of internal calculations may and usually will differ from that of minimum capital requirement calculations set out in the CRD for regulatory purposes. Furthermore, beyond the regulatory minimum capital requirements for credit, market and operational risks captured in Pillar 1 of Basel II, institutions are also required to calculate the adequate capital for all relevant risks under the framework of Pillar 2 along their internal procedures.

KBC's view on ICAAP

KBC considers ICAAP as the ideal steppingstone to gradually steer the whole Group towards the use of solid risk management processes. However the ICAAP should not be seen as a regulatory burden but plays a crucial role in realizing this awakening. Thus KBC Group considers it very important to have a well-founded ICAAP approach. As a consequence, a multi-dimensional view (time, scenarios, capital types, and business scope) was taken in line with best practices in the financial sector.

KBC developed a group-wide ICAAP process in 2007. This process uses internal models to measure capital requirements internally, more specifically economic capital⁴. This ensures KBC's target solvency level associated with predefined confidence level of economic default.

Process of ICAAP in KBC Group

The ICAAP process in KBC assesses both the current and future capital situation. To assess the latter, a three-year forecast is drawn up for required and available capital, according to a basic scenario that takes account of anticipated internal and external growth, and according to various alternative scenarios with a minimum probability of approximately 1 in 25 years. In addition, contingency plans are drawn up that might improve KBC's solvency under more difficult circumstances.

⁴ The concept of economic capital differs from regulatory capital in the sense that regulatory capital is the mandatory minimum level of capital the regulators require to be maintained while economic capital is the best estimate of required capital that financial institutions use internally to manage their own risk and to allocate the cost of maintaining regulatory capital among different units or entities within the organization.

Chapter III – Risk governance and risk management in K&H

Risk governance

Risk governance is integral to a corporation's complete process of governance. It describes the roles and responsibilities that relate to the set-up and working of risk management.

Robust risk management requires a clear definition of roles and responsibilities in its set-up and working. The way risks are governed should be aligned to the general corporate governance process. Essential for good practice risk governance is the existence of an effective risk management process, ensuring that all the material risks of the institution are addressed.

KBC's value and risk management governance model seeks to define the responsibilities and tasks of various bodies and persons within the organizations with a view to ensuring the sound management of value creation and all the associated risks to which the banking and insurance businesses are exposed.

Risk governance model in K&H

The governance model in K&H defines the responsibilities and tasks required to manage value creation and all the associated risks. K&H Group's risk governance model – similarly to KBC Group standards – is organized in three tiers:

Tier I: Overarching company and risk committees

These committees concentrate on global risk management and on monitoring value creation and capital adequacy for the entire group.

These are the Board of Directors (BoD), assisted by the Audit, Risk and Compliance Committee (ARC), the Executive Committee (EXCO), the Country Team (CT), the Capital and Risk Oversight Committee (CROC) and the Crisis Committee (CrisCo).

Tier II: Specialized risk councils

These councils concentrate on maintaining the group-wide framework for one particular type of risk or cluster of activities and monitor the associated risk management process. Chaired by the CRO, the risk councils are composed of representatives from line management and the local Value and Risk Management (VRM).

These are the Credit Risk Council (CRC), Trading Risk Council (TRC) and Operational Risk Councils (ORCs).

Tier III: Line management and activity-specific committees

Line management and activity-specific committees have primary responsibility for value and risk management. Line management ensures that the risk management framework relating to the business is embedded in the business through policies and procedures. It is also entrusted with the task of developing transactional risk models.



The local **Value and Risk Management (VRM)** measures risks, regulatory and economic capital and value creation for all business lines and reports its findings to line management. It is also responsible for maintaining and developing portfolio models, as well as for validating all models (both transactional and portfolio models). In this respect, there is a clear segregation of responsibilities within K&H, as validating staff is different from modeling staff.

In addition to these three tiers, some other parties are also involved in risk governance within K&H Group.

The **Internal Audit Department (IAD)** is responsible for audit planning and audits the compliance of the risk management framework with legal and regulatory requirements, the efficiency and the effectiveness of the risk management system and its compliance with the risk management framework, as well as the way in which line management handles risks outside this formal framework.

Risk governance structure in KBC Group

In KBC Group, a dual reporting system by the local value and risk departments exists: hierarchical reporting to the local Executive Committee via the local risk committees, and functional reporting via the KBC Group Value and Risk Management to the KBC Group risk committees and on to the KBC Group Executive Committee. The general governance structure in KBC Group is indicated in the chart below.

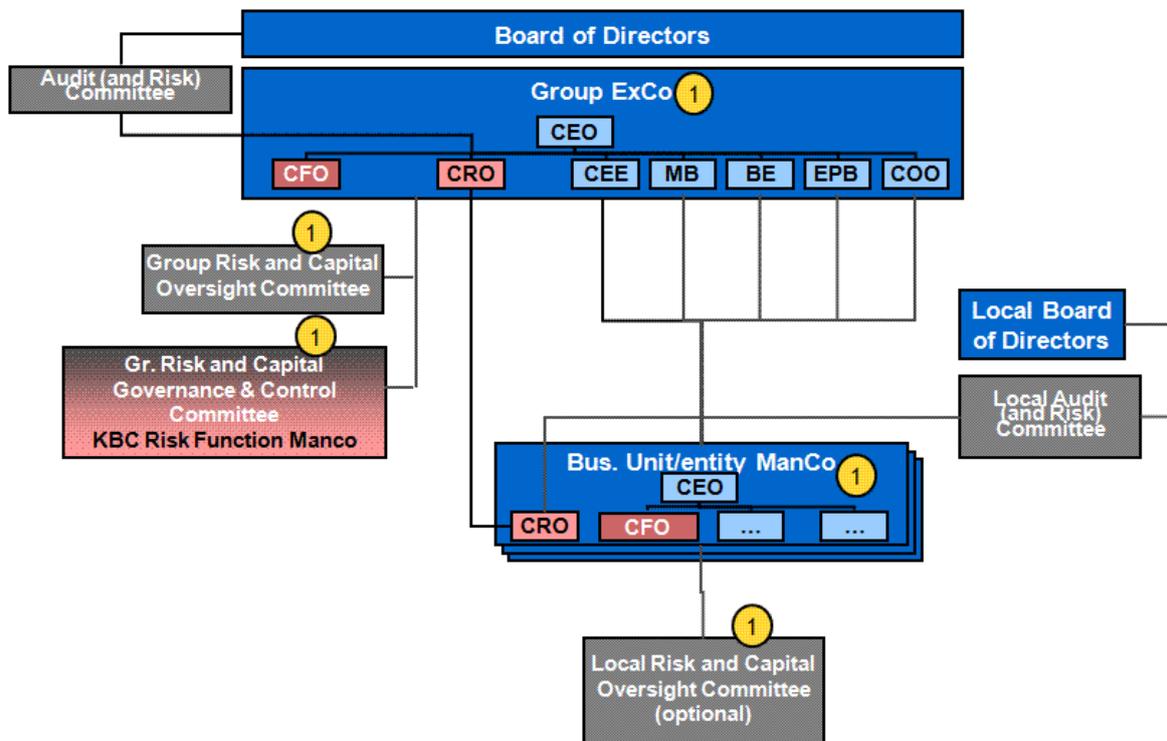


Figure 3: Risk governance structure in KBC Group



Complete risk governance structure in K&H

A detailed description regarding the complete governance structure of K&H Group can be found hereafter.

Tier I: Overarching company and risk committees

Board of Directors (BoD) is the legal representative and highest managing body of the Bank. Only natural persons shall become members of the Board. The Board membership is not less than 5, but more than 11 – are appointed by the sole shareholders. At least two of the directors shall be employed by the Bank. At least two of the directors shall be exchange-resident Hungarian nationals with permanent residence in Hungary for at least one year. The BoD elects its chairman and appoints the chief executive officer of the Bank.

The BoD is responsible for the definition of a long-term Bank's Strategy and manages and monitors the operations of the Bank.

The Board – in principle – holds 4 meetings a year. Additional meetings are held whenever the interest of the company demands. A BoD meeting has a quorum if attended by more than half of all members. A simple majority of votes is required to pass resolutions, except for cases where the Act prescribes at least 80 % of the votes. In practice, resolutions are passed by consensus.

Within the Board of Directors, two committees have been set up: the Audit, Risk and Compliance Committee, and the Remuneration Committee.

The **Audit, Risk and Compliance Committee (ARC)** is a discussion forum for the Bank's management, members of the Board of Directors delegated to the Committee as well as internal auditors of K&H and the shareholders, where they can discuss risk issues by an adequate and effective exchange of information. Committee meetings provide a good opportunity for attendees to consider issues associated with the audit activity and take action as necessary.

The Audit, Risk and Compliance Committee assists the Board of Directors by supervising, on behalf of the Board, the integrity, efficiency and effectiveness of the internal control measures and the risk management in place, paying special attention to correct financial reporting, and overseeing the company's processes to comply with laws and regulations.

The **Remuneration Committee (RC)** approves the Bank's remuneration policy as well as the salaries of senior managers of the Bank. (Other benefits in excess of salaries are regulated by the Bank's remuneration policy.)

The management of K&H subsidiaries (Group members) is independent in legal terms. However, adherence to a common Group strategy is ensured by the presence of members of K&H's Board of Directors on the Supervisory Boards of individual subsidiaries.

The Board of Directors and the Audit, **Risk and Compliance** Committee have an important role to play in value creation and risk governance. Regular reporting to the Audit, **Risk and Compliance** Committee ensures that there is an ample flow of information to the relevant members of the Board over the course of the year.

The **Executive Committee (EXCO)** is the body in control of the operations of the Bank and a decision-making and consulting forum for the top management of the Bank. This is an executive body responsible for the implementation of Group strategy in all business segments.

The Executive Committee is responsible for the implementation of the value and risk management strategy, and outlines the structure and makes the necessary resources available to allow the risk management tasks to be carried out. A Chief Risk Officer has been appointed within the EXCO and entrusted with the specific task of supervising risk management and the internal control structure. The



Executive Committee is always informed about the topics raised on the below mentioned Risk Committee through the ratification of the meeting minutes.

The Executive Committee is responsible for managing the Group in line with the general strategy set by the Board of Directors. The EXCO has 7 members since June 2010 (6members until then). Its members are appointed by the Board of Directors.

Capital and Risk Oversight Committee (CROC) is to assist the ExCo of K&H Bank Group with the operation, implementation and application of a(n) overall risk management framework that meets the expectations and objectives of the internal and external stakeholders and that complies with the prevailing laws and regulations. The CROC is the single integrating committee on risk and capital matters supporting (and leveraging the time) of the ExCo of K&H Bank Group. The CROC is supported by one or more Risk Councils which act as advisory forums for specific risk areas. The committee is chaired by the Chief Risk Officer.

Crises Committee (CrisCo) is a committee to manage preparations for risk events (crisis) significantly threatening bank operations, to monitor the status of related tasks, and to take over control whenever a crisis actually occurs, manage decision making, as well as internal and external communication and give instructions and monitor the execution of the individual Business Continuity Processes (BCPs) to be followed in the case of the given crisis event. The committee is chaired by the CRO.

Tier II: Specialized risk councils

- **Credit risk council (CRC).** The CRC role is to assist the ExCo and the CROC of K&H Bank Group with the operation, implementation and application of a credit risk management framework that meets the expectations and objectives of the internal and external stakeholders and that complies with the prevailing laws and regulations. The CRC is the basic pre-discussion and advisory forum for all credit risk related activities in K&H Bank Group with close collaboration with the Line Management being the primary responsible and accountable for credit risk management. CRC is chaired by the Chief Risk Officer of the Bank.
Trading risk council (TRC). The TRC role is to assist the ExCo and the CROC of K&H Bank Group with the operation, implementation and application of a trading risk management framework that meets the expectations and objectives of the internal and external stakeholders and that complies with the prevailing laws and regulations. The TRC is the basic pre-discussion and advisory forum for all trading risk related activities in K&H Bank Group with close collaboration with the Line Management being the primary responsible and accountable for trading risk management. TRC is chaired by the Chief Risk Officer of the Bank.
- **Operational Risk Councils (ORCs) are primary organized along main business processes.** The ORCs' role is to assist the ExCo and the CROC of K&H Bank Group with the operation, implementation and application of the operational risk management framework that meets the expectations and objectives of the internal and external stakeholders and that complies with the prevailing laws and regulations. The ORCs are the basic pre-discussion and advice seeking forums for all operational risk related activities with close collaboration with the Line Management being the primary responsible and accountable for Operational risk management. The councils are chaired by the senior line managers.

Tier III: Line management and activity-specific committees

- **New and Active Products Committees (NAPCs).** The main goal of setting up these committees were to establish across the whole K&H Bank a smooth but robust and transparent process for approving new and regularly reviewing existing products whereby

commercial issues are balanced against risk and operational issues. No new product may be offered to KBC clients unless all significant risks have been properly analysed, are duly mitigated; and the residual risks are accepted. All existing products that are still being offered are reviewed at regular intervals to make sure that they are still appropriate from a commercial and risk management perspective in an ever changing world. Special attention is being paid to protecting the bank against claims for mis-selling of products.

- **Retail Credit Committee (RCC).** This committee is responsible for approving consumer credit files with a total exposure of up to 100m HUF (**the threshold is lower for higher risk**). The RCC is chaired by the Head of Retail Credit Management.
- **National Credit Committee (NCC).** This committee is responsible for approving corporate and SME credit files with a total Group exposure of up to 30m EUR (the threshold is lower for higher risk). The NCC is chaired by the Head of Credit Management Division.
- **National Credit Sub-Committee (NCSC).** This committee is responsible for approving corporate and SME credit files with a total Group exposure of up to 15m EUR (the threshold is lower for higher risk). The NCSC is chaired by the Head of Corporate Credit.
- **Retail Committees (RCs).** This committee is responsible for all cross-company distribution channels, sales and marketing issues and for the co-ordination of product factories and pricing strategies regarding Consumer and SME clients. The RC is chaired by the Head of Retail Banking Division.
- **Retail Portfolio Committees (RPCs).** This committee is a general decision-making body responsible for making decisions on products for the retail and SME segments with a main focus on introduction of new products, services, modification of old products, pricing and campaigns, budgets and planning, cooperation with product factories, distribution topics. It constitutes three types of committees: Housing, Mobility and Payments Portfolio Committee, Saving and Investments Portfolio Committee, and SME Portfolio Committee. The RPCs are chaired by the heads of Marketing Directorate in line with the three Portfolio Committees.
- **Corporate Institutional Committee (CIC).** This committee is a general decision-making body responsible for making decisions on about issues and topics related to corporate activities with a main focus on introduction of new products, services, modification of old products, pricing and campaigns, budgets and planning, cooperation with product factories, distribution topics. The CIC is chaired by the Head of Corporate Institutional Banking Division.

Further to the above-mentioned committees, new governing bodies have been introduced since January 2007 when the 'Next Project' (a strategic exercise undertaken at KBC Group) was implemented.

As a result of this project, Central European banking and insurance entities are grouped together in the Central Europe Business Unit, which is managed by a CEO who sits on the Executive Committee of KBC Group. The relevant new governing bodies for K&H are:

- **Country Team Hungary (CT-H).** This is a group of the top managers of K&H Bank and K&H Insurance who are in the key managerial positions in Hungary (members of the Board of Directors or persons holding other key top managerial positions). The goal of the Country Team is the improvement of mutual communication among managers and coordination of key activities of KBC Group in Hungary. Country Teams are headed by a Country Manager, who reports to the CEO of the Central Europe Business Unit.
- **Management Committee Central & Eastern Europe and Russia (MCCEER).** The goal of the MCCEER is the improvement of mutual communication among the Country Teams and coordination of key activities of KBC Group in Central and Eastern Europe and Russia.



Risk management

Principles of risk management in KBC Group

Risk management makes it possible for senior management to effectively deal with the uncertainty and the risks and opportunities linked to it, enhancing capacity to build value. Therefore at both KBC Group and K&H Group, risk management is based on the following fundamental principles:

- Value, risk and capital management are inextricably linked to one another and form an inseparable triplet. Managing one of them will always affect the other. KBC entities must have adequate capital to be able to deal with any unforeseen consequences of adverse developments.
- Risk management should be approached from a comprehensive, enterprise-wide angle, taking into account all the risks a company is exposed to and all the activities it engages in. As such, this entails that policies and methodologies are intended to be coherent and consistent throughout the KBC Group.
- Every material subsidiary is required to adhere to the same risk governance model as the parent company (KBC) which is, concerning risk management, based on the following underlying principle: primary responsibility for value and risk management lies within line management, while a separate organizational unit – operating independently of line management – performs an advisory, supporting and supervisory role.
- The risk management framework needs to be drawn up in line with advanced sector standards. KBC primary focus lies on implementing 'industry' standards, as soon as they become best practice. As such, KBC endeavors to remain at the forefront of risk management.

For KBC Group, this entails a gradual transition towards an integrated, holistic and group-wide value and risk management approach, which is both proactive (acting up-front) and prospective (looking forward). In addition, the scale shifts from the transaction level to a portfolio level. Generally speaking, the ultimate goal is to create a sound risk culture within KBC Group and thus in K&H Group as well.

Role of 'line management'

According to the risk governance model applied throughout the KBC Group, line management has primary responsibility for value and risk management which includes the following tasks:

- is accountable for risk management and incurred risks within its area of responsibility to superiors in the management structure and to senior management in the legal entity
- ensures that the risk management framework that relates to their business is embedded in policies and procedures and communicated to the staff
- takes measures to manage the risks that are not (yet) addressed in the risk management framework; additionally, report the shortcomings compliant the bottom-up communication line applicable to their business
- delivers risk data in the required format and within specified deadlines to the local Value and Risk Management department and ensure integrity by performing the specified controls

Role of 'value and risk management'

Value and risk management (VRM) is a separate department which is assigned to tackle with value, risk and capital management issues independently of business lines. VRM performs an advisory, supporting and supervisory role with respect to risk management according to the KBC Group standards.



Although an efficient cooperation between line management and value and risk management is indispensable, value and risk management operates independently from the line. The risk management department will assist the line in taking calculated risks, thus assuming an advisory, supporting and monitoring role.

The department reports to the CRO and assists the CRO in performing his function; namely value, risk and capital management. Therefore this organizational unit ensures the 'risk control' functions within the different KBC Group entities.

The main goals of VRM can be summarized in the following mission statement:

"Independently of the line and in keeping with advanced industry standards to maintain a group-wide framework for value, risk and capital management, monitor the implementation of this framework, and provide assistance to the line on the use of value and risk management instruments and techniques."

The risk governance in K&H is organized according to these KBC Group principles.

Value and Risk Management Division (VRM)

In K&H, Value and Risk Management Division (VRM) is assigned with the tasks and responsibilities of value and risk management in accordance with the KBC Group standards as defined above.

Tasks of VRM

In more details, the main activities of Value and Risk Management Division are as follows:

1. Setting up and maintaining the framework for value, risk and capital management, account taken of, among other things, the KBC standards as well as the requirements of Basel II, IFRS and other developments. For the aforementioned purposes, VRM watches and assesses material developments or events in the internal or external environment, elaborates and acquires methods as the local owner of the methodological frameworks. Being the primary advocate of value, risk and capital management, the VRM must ensure that the organization acts in line with these relevant principles.
2. Reporting to the CRO on the performance of value, risk and capital management. The measurement and reporting tasks of the VRM relate to the consolidated risk positions. In other cases, these tasks must be left to the line management however VRM supports line management fulfilling its duties with respect to risk identification, measurement, evaluation, and reporting.
3. Supervising the performance of value, risk and capital management within K&H. This means that VRM assesses and reports the implementation and completion status of the different risk management frameworks and the applied risk response within K&H. VRM also performs regular risk evaluations. In this sense, the Directorate monitors the adequacy of risk management and ensures overall consistency of the risk management framework. Consequently, there is some overlap between the activities of the VRM and the audit function.
4. Participating and supporting various projects and developments related to value, risk and capital management issues within K&H.
5. Developing risk models at the portfolio level on the one hand, and validating transaction and portfolio risk models on the other hand.
6. Fulfilling advisory roles during the decision making process of the various senior management bodies by means of preparing risk advices.



7. Coordinating the drawing-up of proposals regarding risk limits submitted to the EXCO for decision. As a matter of fact, line management submits its limit proposals to VRM which later aggregates the proposals and adds an advice on behalf of the Local Risk Committees.
8. Ensures implementation of the decisions made by the Local or Group Risk Committees after ratification and takes care of the distribution / communication of the decisions to the parties concerned.
9. Coordinating the operations of the Local Risk Committees and Councils and performing the secretary function of these committees.
10. Performing close cooperation between all Value- and Risk Management units within KBC, especially with KBC Group Value and Risk Management (GVRM).
11. Setting up and maintaining a good professional network that includes regulatory bodies and other financial institutions, as well as becoming a member of specific organizations and attending conferences and seminars.

Structure of VRM

Although there is an undeniable link between value, risk and capital, a distinction is made in the activities of the directorate between risk management on the one hand, and value and capital management on the other. This is due to differences in the degree to which the two areas have been developed in the banking business in general. A start has recently made regarding the value and capital management, whereas risk management has already achieved a well matured status and already implemented in every financial institutions.

These evolutionary differences are observable in K&H as well. Risk Management Directorate is currently organized according to reflect the structure of the different risk committees; consequently it is structured mainly along risk-type lines. Value and capital management is currently performed by joint operations of the different departments within VRM, mainly by Market Risk Department.

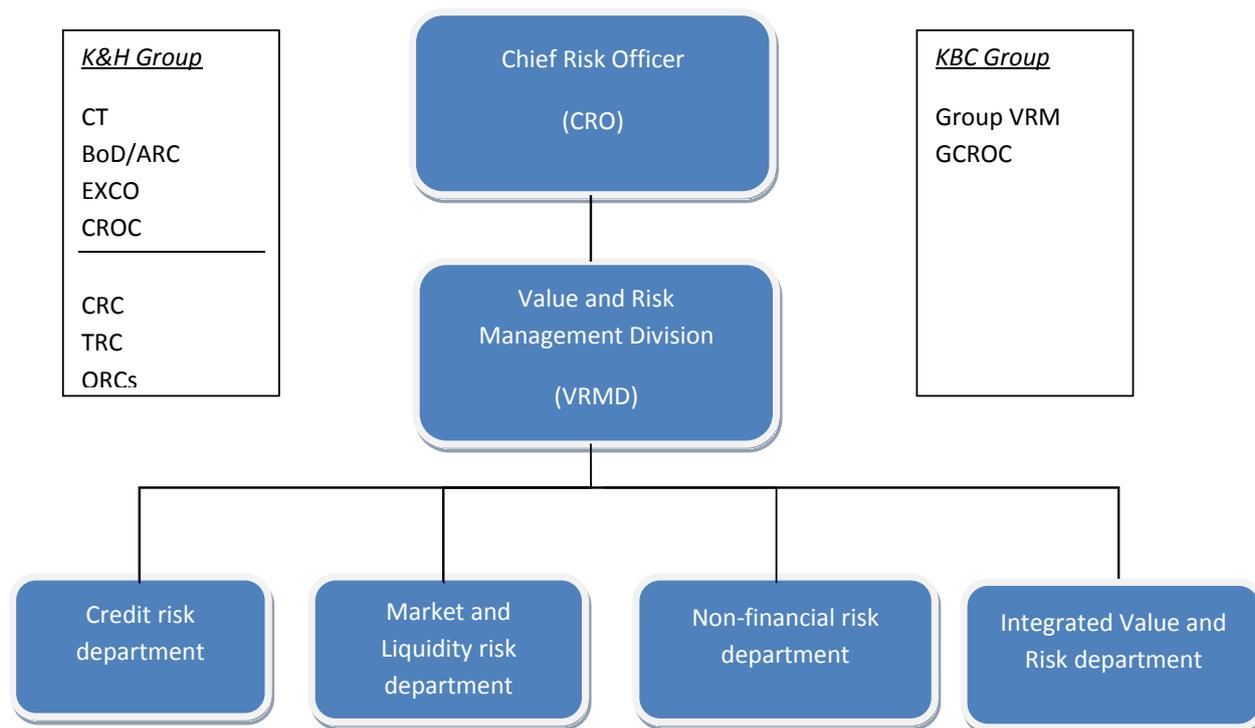


Figure 4: Structure of K&H Value and Risk Management Division

Credit Risk Department

General description

Objective of the department is to measure, monitor, analyse and report all credit risks of the Bank and its subsidiaries at portfolio level (partner, debtor, issuer and country risk) additionally it validates the credit risk models. Further, it is to arrange for the IT background necessary for the analyses and provide data and produce reports for the proprietors, the management and authorities as well as perform tasks with regard to the analyses and decision preparations.

Responsibilities

The Credit Risk Department is to perform the tasks described above in an accurate manner, in good quality and by the given deadline and obtain the approval thereof. Also, Credit Risk Department is in charge of providing the personnel, professional and technical conditions necessary to achieve the above.

The Head of the department is responsible for the reports, data provisions and proposals.

Competence

The department and its staff do not have a decision-making competence; they are only entitled to prepare decisions and supplement proposals with risk advices. In order to perform the duties described above, Credit Risk Department is authorized to obtain any related information or get an insight into any relevant document.



Market and Liquidity Risk Department

General description

The department is responsible for developing and implementing trading and non-trading market risk management methodologies, guidelines and systems, and managing such risks.

Responsibilities

The Market and Liquidity Risk Department is responsible for developing market risk management procedures and for documentation related to the appropriate institutional framework. Market and Liquidity Risk provides assistance in ensuring the adequacy from the point of view of market risk of every new procedure and existing procedure in need of changing, and in the definition of special products.

The Market and Liquidity Risk Department monitors local and international market developments, as well as products and banking practices that may affect the Bank's FX risks or total market risk level. The Market and Liquidity Risk Department is responsible for monitoring both internal and external limits - whenever possible on-line -, in accordance with the procedures stipulated by management.

Competence

The department and its staff do not have a decision-making competence; they are only entitled to prepare decisions and supplement proposals with risk advices. The Market and Liquidity Risk Department may attach a written recommendation with every proposal concerning market and liquidity risks. In order to perform the duties described above, Market and Liquidity Risk Department is authorized to obtain any related information or get an insight into any relevant document, that the department is entitled to review all internal regulations governing the activities of the Bank from the aspect of market risk.

Reporting

The Market and Liquidity Risk Department provides management with easy-to-understand, comprehensive reports with the appropriate frequency to compare risk positions with the relevant limits. Management uses this report to define its risk strategy (acceptable risk levels, diversification of risk categories, setting priorities).

Non-financial Risk Department

General description

The Non-Financial Risk Department has to ensure that the Bank takes the adequately efficient measures to mitigate, measure and neutralize operational risks (the risk of direct or indirect losses arising from internal procedures, systems or human factors operating other than intended, or due to the possible adverse effect of external events), and/or operates appropriate systems to that end. In order to achieve this objective, it examines and facilitates the availability of adequate guarantees across the Bank as a whole, to avoid intolerable material and prestige losses due to such risks.



Responsibilities

The Non-financial Risk Department is responsible for adapting the methods and requirements of KBC to K&H's specific environment regarding operational, business and reputation risks, and for meeting KBC's information requirement.

Competence

To fulfill its task, the department has the right to ask permanent or ad-hoc information from other departments of the Bank, to get an insight into any relevant electronic database or document and formulating proposal in order to mitigate risks. The Non-Financial Risk Department is also responsible for high-risk complaints handling and for meeting the related legal requirements.

Integrated Value and Risk Department

General description

The department will support overall limit setting (transversal) and Capital Allocation process locally. Also will support Local CRO in advising business, including on e.g. Economic Capital and drivers of change in the business. It will monitor and report on risk and capital profile against limits at local level, report and manage transversal risk metrics (incl. Economic Capital), provide input to define mitigating actions for limit overruns, risk report production and submission. The department is not operational yet.

Risk management process

Risk management makes it possible for senior management to effectively deal with the uncertainty inherent in any business activity and the risks and opportunities linked to it, enhancing capacity to build value. Therefore, KBC continuously strives for a well-founded risk management process; that is embedded throughout the whole group.

Process steps

The risk management process is indicated in the chart below:



Figure 5: Risk management process

The risk management process itself is a methodological process that can be broken down in a number of sub-processes that are carried out in sequence and that form, in essence, a continuous loop. The purpose of the risk management process is to provide a systematic, effective and efficient way for managing risk at every level of the organisation. Management needs to select techniques for each process step.

The risk management process consists of the following process steps as indicated in the chart above:

1. *Risk detection and identification:* This can be translated as ‘to discover and define material risks’, namely those risks that could have a positive or negative impact on achieving the institution’s objectives. Part of the risk identification process is deciding on the tools to identify risks (e.g. risk classifications, impact categories, etc.).
2. *Risk measurement and assessment:* Measuring risk can best be defined as the qualitative or quantitative assessment of exposure to risk. The method for risk measurement depends on whether the risk is more-or-less measurable or not. Part of the risk measurement/assessment process is deciding on the tools to assess risks, i.e. finding the adequate risks measures including the type of measurement (i.e. quantitative or qualitative), criteria of measurement (e.g. likelihood or impact), scales to be defined, etc.
3. *Monitoring and limit-setting:* In order to monitor risks and to provide reasonable assurance that the organization will achieve its objectives, risk limits should be defined. Limit is a way of authorizing specific forms of risk taking. A limit indicates how much risk the Group considers



being 'an acceptable maximum' for a portfolio or a segment of a portfolio. Risk limits reflect the general risk appetite, set by the Board of Directors. This general risk appetite cascades down in specific risk limits or tolerances that reflect the degree of acceptable variation to the achievement of objectives. Risk limits are agreed upon by the Board of Directors.

4. *Evaluation, analysis and advice*: Risk evaluation is the appreciation of the risk exposure. This is usually done by comparing the risk exposure with the risk limits. Risk exposures are compared to the limit and analyzed to inform and facilitate decisions regarding the risk response.
5. *Reporting*: Risk measurement and evaluation results should be presented to the decision-makers (mainly local risk committees) in a structured report in order to be able to follow-up the evolution of risk exposures and risk controls, the compliance with risk limits; and to make remedial actions in time if necessary.
6. *Response*: The purpose of responding to risks is to constrain threats and take advantage of opportunities. Management needs to come up with a risk response and define, implement and execute the activities that help to achieve a residual risk level aligned with the entity's risk tolerance. Control instruments are instruments that are put in place to carry out these responses and thereby help an organization to achieve its business objectives. The response can be risk reduction, risk acceptance, risk transfer or risk avoidance.

In order to guarantee consistency in the treatment of all risks KBC Group is exposed to, a number of risk-overarching documents have been worked out, serving as guidelines for some of these steps. Risk management in K&H is continuously developed and improved in line with these frameworks and it is also governed by and according to the relevant group-wide guidelines.

In the following chapters, the current practices and processes in K&H as a member of KBC Group are described regarding the management and governance of different risk types explicitly mentioned in the Pillar 1 of Basel II. These are credit risk, market risk and operational risk. The disclosure is also complemented with the description of ALM and liquidity risk management and governance.



Chapter IV – Credit risk

Credit risk management

Credit risk management refers to the structural and repetitive tasks with regard to the identification, measurement and reporting of credit risks. Credit risk is managed by means of rules and procedures approved by the Executive Committee that govern the acceptance process for new loan and limit applications, the process of monitoring and supervising credit risks, and portfolio management.

Definition

'*Credit risk*' is the risk of losses because a counterpart fails to meet all or part of the payment obligations towards the financial institution that is the risk of non-payment or non-performance of the counterpart. The term "counterpart" is used as generic (aggregate) term for borrower, guarantor, (re-)insurer, counterparty, issuer etc.

Credit risk can be caused by the counterpart's lack of ability or willingness to pay or perform, or by events or measures taken by external parties preventing them to do so. Therefore credit risk includes country, dilution, settlement, and counterparty risks as well.

Credit risk arises primarily from lending activities, contingent liabilities, the provision of guarantees including letters of credit and commitments to lend, investments in bonds and notes, financial markets transactions and other associated activities.

Framework for credit risk management governance in KBC

Credit risk management decisions are taken by the capital and risk oversight committees (CROC), organized at the group and/or local level (to be endorsed by the Executive Committee (EXCO) at group or local level).

The ultimate responsibility of managing credit risk is lies in line management which is assisted by several activity-specific committees. A separate credit risk department is established which performs an advisory, supporting and supervisory role with respect to credit risk management.

Material entities in KBC Group must put in place a credit risk governance structure that includes a risk committee and a credit risk management department that is independent of the business. K&H complies with these requirements.

Credit risk governance

Responsible organizational units in K&H

Credit risk is managed at two levels: the transactional and the portfolio level. Managing credit risk at the transactional level means that there are sound procedures, processes and applications in place to estimate the risks before and after individual credit exposures are accepted. Managing the risk on a portfolio level entails periodic reporting on (parts of) the consolidated credit portfolio, monitoring limit discipline and portfolio management.



Within the Value and Risk Management Division, Credit Risk Department is responsible for analyzing issues associated with credit policy and portfolio management, for internal credit risk reporting (as a basis for external and management reporting) and for the validation of credit risk models.

Other entities involved in credit risk management at transactional level differ according to the segment the client belongs to. The duties and the objectives of these different organizational units (i.e. credit management departments; see later for more details) are as follows:

- contribute to the profitability of the given segment
- contribute to the strengthening of the position of K&H in the credit market
- responsible for statistical-based modeling and monitoring of risks at transactional level inherent in the lending activities and in credit management processes

In order to achieve these major objectives, these organizational units – in close cooperation with the relevant business areas – develop and operate:

- the credit strategy and the lending processes within the segment
- provides practical support to branches via trainings and credit policies
- assumes, controls and monitors transactional credit risks
- works to restore/recover the non-performing loan portfolio

Consumer Credit Management Department

The units of the department participate in drawing up and regularly updating the Bank's retail risk taking policies, retail and private banking policies, policies on collections, new product regulations and modifications prepared by the business area.

They are to participate in the work of the Bank's different committees dealing with the risk inherent in private persons' deals. The membership includes:

- Retail Credit Committee (RCC)
- Retail Portfolio Committees (RPCs)
- Retail Committee (RC)
- Credit Risk Council (CRC)

Consumer Credit Unit

It is in charge of rating and checking private person clients applying for a risky product (loans, cards, etc.) prior to approval, and of approving loan applications.

Collections Unit

The Consumer Collections Unit is responsible for:

- Managing defaulting consumer (private persons') deals and debtors, and recovering overdue loans
- Contacting debtors on telephone, in person, through work-out companies or legal means

Consumer MIS and Modeling Unit

The task of the organizational unit includes:

- Preparing and regularly updating framework regulations on risky products offered to consumer clients
- Development of lending procedures (documentation, decision making mechanisms, development of procedures, ICT systems, etc.)
- Statistics-based modeling and monitoring of risks inherent in consumer credit products and in credit management processes
- Preparing regular and ad-hoc analyses and reports

Consumer Credit Architecture Unit

Duties:



- Prepare, provide credit products and processes in line with domain strategy and system capabilities, supporting business by managing credit process taking into account process cost and risk cost.
- Develop lending policies, regulations & procedures (documentation, decision making mechanisms, etc)
- Ensure Business / ICT dialogue.

Corporate and SME Credit Management Directorate

The units of the directorate participate in drawing up and regularly updating the Bank's non-retail risk taking policies, corporate and institutional banking policies, new product regulations and modifications prepared by the corporate business area.

They are to participate in the work of the Bank's different committees dealing with the risk inherent in non-retail deals. The membership includes:

- National Credit Committee (NCC)
- National Credit Sub-Committee (NCSC)
- Corporate Institutional Committee (CIC)
- Credit Risk Council (CRC)

SME Advice & Underwriting Department

It is responsible for the credit advice & underwriting activities related to SME clients, and also for the compliance with statutory credit risk management requirements. It is to manage and analyse credit proposals and draw up recommendations. It is to check the form and content of the Bank's credit portfolio and undertake or initiate actions if & when deemed required.

The Department is to participate actively in the elaboration of an SME credit policy in line with the Bank's strategy, in the preparation of credit policies for each industry, and in the development of the Bank's SME strategy.

Corporate Advice & Underwriting Department

The Corporate Advice & Underwriting Department is further broken down to the following organizational units:

- Corporate Advice & Underwriting Unit
- Bank and Country Risk Unit

The Corporate Advice & Underwriting Unit is responsible for the corporate credit origination and monitoring process: advising, decision making and credit monitoring activity.

The unit provides expert input into the credit related process and system development, regulation updates un light of the Basel II requirements.

Credit related competences (industry studies, product risk) and credit schools are also owned and organised by CAU.

The Bank and Country Risk Unit is responsible for the financial institutions and country risk decisions in the frame the group level risk management and the follow up bank limit utilisation.

This unit also provides expert input into the credit related process and system development, regulation updates un light of the Basel II requirements.

Corporate and SME Credit Administration Department



The department is responsible for:

- Recording total commitments and approved limits.
- Checking standard/non-standard contracts associated with commitments.
- Checking/following up the conditions of prompt and term contracts.
- Supporting, supervising and checking corporate/small corporate relationship management from a credit risk management aspect.
- Performing monitoring duties.
- Managing, sorting and storing the original copies of all commitment contracts.

Corporate and SME Credit Architecture Department

Process management defines the needed processes in order to meet the requirements set-out by Product Management and coordinate the management and pro-active optimization of these processes.

Process management develops lending policies, regulations & procedures (documentation, decision making mechanisms, etc).

Product management transforms domain business strategy towards his/her products, develop & manage high quality and cost effective products, prepare and manage product reviews for NAPCs.

Application management provides information on feasibility and optimal way of application changes.

Project management leads/supports large transformation projects, such as SME Lending, IRB-advanced, etc.

Corporate and SME MIS & Modeling Unit

Duties of the Corporate and SME MIS & Modeling Unit includes

- Development of management information system, including regular and ad-hoc reporting needs
- Reporting for management & CRC
- Modelling PD-usage, average PD, etc.
- Development of Credit management database, DWH
- Guarding implementation of models and usage compliance etc.

Special Credits Department

The department is responsible for solving (restructuring and recovery) of all actual and potential problematic corporate, middle cases and small corporate client credit files.

It manages the non-performing credit portfolio given thereto, and participates in the management of non-performing as well as potentially non-performing clients being under joint management with the financing branch.



Credit risk measurement

With respect to credit risk, the possible loss to be measured stems from the non-payment or non-performance of the counterpart (referred collectively as '*default*'). Thus the purpose of credit risk is quantifying credit losses in case of default.

Rating systems

A key element in many approaches to credit risk measurement is having a credit rating system. Although these systems vary considerably in detail, they are generally recognized as being reasonably successful at distinguishing the relative riskiness of different borrowers and facilities at a given point in time. Several types of credit risk models, developed internally or by KBC, are used to determine Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD) estimations for different obligors or facilities.

General description

Financial institutions are to perform a rating exercise including the assessment of the client's financial situation, creditworthiness, and future solvency, as well as the evaluation of the allocated collaterals in order to measure credit risks associated with the business activity.

Credit institutions justify their credit rating decisions for obligors and/or facilities based on the several aspects. Every rating of clients and commitments is subject of regular review at least once a year. During this review process it is possible to assess and identify the changes in the creditworthiness of the counterparty, including the change in collateral characteristics.

As a consequence of the preparation for IRB approach in Basel II, internal ratings have become available for all counterparts in the K&H portfolio.

In KBC Group and thus in K&H, external ratings provided by the following External Credit Assessment Institutions are approved: Standard and Poor's, Fitch and Moody's. No external ratings of Export Credit Agencies are used.

Ratings in corporate segment

Debtor ratings based on the obligor's probability of default (PD). Default in the KBC Group is defined as a situation where full repayment at maturity is (at the least) uncertain. There are 3 categories of default, depending on whether the obligor is performing and what the chances for recovery are.

Within the KBC Group, one master scale of PD ratings is used for counterparts. External ratings provided by rating agencies (Standard & Poor's, Fitch, and Moody's) are also mapped to this master scale. There are 9 PD rating buckets for 'non-defaulted' counterparties (PD 1-9) and, as said before, 3 PD rating buckets for defaulted counterparties (PD10: possible loss - performing; PD11: possible loss – non-performing; PD12: irrecoverable).

Ratings in consumer segment

Ratings in retail segment are assigned at pool level that is on the basis of exposures grouped together with similar characteristics.

Debtor ratings in consumer segment are achieved by means of different scorecard models like application scorecards and behavioral scorecards which are used as inputs for credit risk models on pool level. Separate models are used for the estimation of other credit risk parameters (i.e. LGD and EAD) for retail exposures.



Further steps of credit management

Credit risk monitoring

Corporate and SME segment

In order to avoid losses in its lending operations – arising from the fact that regular monitoring of client commitments and the measures aimed at reducing the associated risks are not performed in a timely manner, or not at all – the K&H has introduced strict monitoring rules.

Apart from the normal review process of client-ratings, which has to be executed for every client annually or semi-annually depending on the client's actual debtor rating (i.e. PD rating), there are three basic types of credit monitoring activities in K&H Bank for non-retail exposures which are not in Special Credits Department's front-seat management, namely:

- ad-hoc monitoring procedure
- regular monitoring procedure
- 'watch-list' procedure

Regular monitoring tasks are performed repeatedly at regular intervals. One part of the regular monitoring activity is linked to calendar quarters while the other one, the so-called 'watch-list procedure', is not linked to calendar quarters.

Ad-hoc monitoring triggered by the several 'early warning signs' that are deemed the most critical in the KBC Group's practice and are to be monitored for every non-retail client. The occurrence of certain 'early warning signs' may warrant immediate action by the Bank in its relationship with any client (or client-group). It is the primary responsibility of the 'account manager' to contact the client immediately upon the occurrence of any warning sign that clearly threatens the repayment of the client's commitments (or debts).

Consumer segment

Exposures related to retail clients and the evolution of the consumer portfolio are monitored regularly in the course of the preparation the monthly segment reports. Non-performing loans are managed separately by the Consumer Collections Unit from the very beginning of any observed default in payment obligations.

Credit risk limits

The maximum credit risk exposure and/or credit risk concentration is managed and monitored via limits, which define the maximum credit risk exposure allowed in terms of a specific measurement approach. Credit risk limits in terms of maximum (worst case) risk are gradually being complemented and/or replaced by alternative measurement approaches.

A transaction bearing credit risk may, in principle, only be concluded when authorized by a positive credit decision, which will stipulate, amongst others the maximum acceptable credit risk exposure (limit), which may either refer to:

- Case-by-case approval of a particular transaction (with a particular party);
- A pre-approved limit for all the transactions of a particular risk type.

Limits at individual counterparty level

An overall KBC Group limit (as decided by the KBC Group Executive Committee), however, applies for corporate exposure in terms of Loss Given Default (LGD) and Expected Loss (EL). These are "hard limits", meaning that immediate action is required if such limit is or would be exceeded.



Apart from internally determined limits at debtor/guarantor/counterparty and country level, local regulation exists, setting limits with regard to so called large exposures at group level. These limits are typically stated as a percentage of own funds (e.g. 25% for non-related groups, 20 % for related groups). Such “large exposures” typically need to be reported when a certain threshold is crossed (e.g. 10 % of own funds), either monthly or quarterly.

Limits at group/sector/portfolio level

Counterpart group- and sector/portfolio based limits are aimed at defining the maximum desirable exposure concentration on counterpart groups, activity sectors, etc. These limits are not approved on a counterpart-by-counterpart basis but apply to all counterparts that fit the particular scope of the limit (e.g. particular activity sector).

Credit risk evaluation & advice

Credit risk management departments have the responsibility to assess (evaluate) credit risk exposure and include their analysis in their credit risk reporting to risk committees. Such evaluation includes the regular comparison of risk exposure with existing limits (internal limits or external limits) or targets.

Apart from comparison with existing limits, such assessment may result in proposing new limits or amendment of existing limits and/or in adjustment of methodology or procedures. Alternatively such assessment may result in suggestions for risk reducing measures. The process typically entails request for amendments or introduction of new elements of credit policy, delegated authority, new or increased limits and changes to methodology. As a result, business proposals are made and submitted to the competent decision bodies.

An important task of the Credit Risk Department in Value and Risk Management Division (VRMD) is to analyze data (exposures, results of risk calculations, limit use and so on) and to formulate advice regarding proposals submitted by the various business lines to the Credit Risk Council (CRC). Where applicable, also the business unit should provide its advice. Typically, in its advice, the competent department will check whether the proposal is consistent with the existing policies, methodology, limits, overall strategy, and so on. The competent department never has the authority to decide, but only gives advice regarding the perceived level of risk.

Credit risk reporting

There are various credit risk reports presented mainly to the Credit Risk Council or to the senior management covering the aforementioned portfolio of loans.

Management reports

Credit Risk Department prepares a quarterly report to the senior management regarding the whole consolidated credit portfolio of K&H including both retail (i.e. consumer + leasing) and non-retail (i.e. corporate + SME) segment. The so-called “*Credit Risk report*” is prepared for the Credit Risk Council, and the Country Team.

The Integrated Risk Dashboard also contains credit risk related figures. This report is presented to the Country Team.

The report provides an overview of the evolution of K&H’s credit portfolio in terms of granted and outstanding exposures, delinquencies, provisions and loan loss ratios. The structure of the portfolio is also represented by applying breakdown by business lines, credit products or industry. The report contains information about the major risk indicators of the portfolio and the highest risk exposures towards clients too.

Segment reports



Risk Management of K&H prepares regular reports on monthly basis in cooperation with the different credit management departments concerning the portfolio within their competence. These reports are made for the following segments separately:

- Consumer
- SME
- Corporate

These reports provide a comprehensive overview of the given segment with respect to the evolution of the portfolio in terms of exposures (e.g. granted limits, outstanding credits), credit quality (e.g. delinquency, ratings, impairments, loan loss ratios, etc.); and the assessment of the credit portfolio in breakdown by major risk indicators or sub-portfolios.

Portfolio overview

The total lending portfolio – including both on-balance and off-balance sheet items – is indicated in the table below by asset classes. In K&H Bank, there are no exposures on multilateral development banks and international organizations, or claims in the form of collective investment undertakings or covered bonds. Therefore these asset classes are not included in the tables.

Code	Asset classes (mln HUF)	On-balance items	Off-balance items	Original exposure pre credit conversion factors
CGCB	Central governments and central banks	1 136 933	0	1 136 933
RGLA	Regional governments and local authorities	116 375	6 426	122 800
PSE	Public sector entities	116	1 138	1 254
INST	Institutions	96 761	83 857	180 618
CORP	Corporates	797 638	496 167	1 293 805
RETAIL	Retail	24 264	13 343	37 607
SECRE	Secured by real estate	689 492	7	689 499
PDUE	Past due	102 459	983	103 442
OTHER	Other	129 309	0	129 309
TOTAL	TOTAL	3 093 347	601 920	3 695 267

Table 5: Lending portfolio of K&H Bank per asset class

More detailed breakdown of the lending portfolio of K&H Bank is provided in the [appendix](#).

Credit risk response

Once risks have been identified, measured, monitored and reported, it is the responsibility both of line management and committees to respond, i.e. to bring risks in line with the risk appetite, either by avoiding (further) risk, reducing it (mitigation) or transferring the risk or by simply accepting the risk.

Risk avoidance can be achieved by the introduction of credit policies (e.g. forbidding credit risk resulting from lending to specific borrowers), withdrawing or reducing limits (e.g. country limit suspension upon actions of monetary authorities) or deciding to stop certain activities (e.g. when risk and return are felt unbalanced).

A transaction bearing credit risk may only be concluded when authorized by a positive credit decision or when it can be accommodated under the appropriate limit or delegated authority, as decided at the authorized decision level.

Whereas it is everybody's responsibility to reduce credit risk as much as possible, risk committees are expected to respond to excessive credit risk being reported or expected to emerge by taking appropriate risk reducing actions. CROC, CRC and line management have the essential responsibility to respond to the outcomes of risk measurement, monitoring and reporting.



Loan loss allowances

Banks must establish allowances for losses because there is credit risk in their loan portfolios. The allowance, which is a valuation reserve, exists to cover the losses that occur in the loan portfolio of every bank. As such, adequate management of the allowances is an integral part of a bank's credit risk management process.

According to the current Hungarian legislation⁵, for impaired assets specific risk provisions has to be determined based on the facility-ratings defined according to the national regulations; while general risk provisions can be determined optionally for future expected losses which can be included in the Tier 1 capital up to 1.25% of the balance-sheet total of the financial institution.

Corporate segment

The Bank uses a '*normal rating process*' for all receivables related to corporate clients that is all of the aspects, as stipulated in the law, are taken into account during the valuation. No '*group valuation procedure*' is applied in the corporate segment thus all items are rated using the '*individual valuation procedure*' manually in all cases.

The valuation is done on quarterly basis unless new, negative information revealed concerning the client's financial status or regarding the allocated collaterals which triggers out-of-session revision of the rating classifications of the client and all of its exposures. The impairment loss and provisions are defined on the basis of the '*gross risk*'.

Proposals should be prepared with detailed reasoning concerning each of the rating classifications or when setting the required level of impairment loss and provisions related to exposures of corporate clients. The proposals should be submitted to the competent forum authorized with decision rights.

SME segment

In case of SME clients, the rating classification is based on '*group valuation procedure*' by default, taken into account the relatively high number of exposures in this segment. As the legislation permits it, '*simplified rating process*' is applied for this purpose. The classifications are revised on a monthly basis automatically and the results are reported to the senior management.

The rating process takes into consideration the past due status and the collaterals as well. A ratio derived from the '*net risk*' serves as the final basis for classifying the exposures for SME clients and also used for setting the required level of impairment loss and provisions to these exposures. As a consequence, the impairment loss and provisions are defined on the basis of the '*net risk*'.

In case of exposures related to clients managed by the Special Credits Department, the rating classification and the determination of the required level of impairment loss and provision is based on the same '*individual valuation procedure*' as it is applied for corporate clients.

Consumer segment

The Bank uses '*simplified rating process*' for all its retail receivables. By default, the Bank assigns retail items into '*valuation groups*' in accordance with the rules of '*group valuation procedure*' prescribed in the Hungarian law. The Bank sets up the '*valuation groups*' in such a way that transactions with similar risk profile are included in the same group.

⁵ Appendix VII of the Gov. Decree No. 250/2000 (XII. 24.) "on the specifics regarding the annual reporting and bookkeeping requirements for credit institutions and financial enterprises"



Each cell of a cross-table, based on credit products and delinquency categories, corresponds to a 'valuation group' for which specific provisioning percentages (so-called 'impairment factors') are defined. This process was supported by statistical modeling based on actual historical loss data.

In case of 'group valuation procedure', items are assigned automatically to 'valuation groups' and the impairment loss and provisions is determined automatically during the preparation of the regular portfolio reports by the Consumer MIS and Modeling Unit; that is without the need for a separate proposal or decision of a competent authority.

Besides the default process of 'group valuation procedure', in certain special cases, the Bank uses 'individual valuation procedure' applying the 'simplified rating process' when the Bank decides on the rating of each transaction on a case-by-case basis, also determining the required level of impairment loss and provisions. Thus 'individual valuation procedure' is used as a secondary alternative and occasional scenario for rating classification.

The rating of claims under the "individual valuation procedure" are reviewed once a quarter, on the basis of the previously determined "asset rating categories" and the required impairment loss and provisions. Accordingly, the impairment on these items may change prior to a new review only as a result of changes to the total exposure of the given item.

These reviews are carried out and documented by the entities preparing the individual proposals. Special proposals for the original decision-makers need to be prepared only if the "asset rating category" or the underlying "impairment factors" changed in the meantime.

Individual rating and provisioning in all cases are submitted to and approved by the Retail Credit Committee (RCC) based on proposal made by the corresponding entity. In certain predefined cases, the Retail Credit Committee (RCC) may delegate its decision rights to organizational units authorized to prepare such proposals (e.g. Consumer Collections Unit).

Disclosures

The changes in value adjustments and provisions during the year are summarized in the table below:

Value adjustments and provisions (mln HUF)	Opening balance (01/01/2009)	Newly raised (+)	Write-back or utilization (-)	Other changes (+/-)	Closing balance (31/12/2009)
For on-balance items	74 170	53 140	25 039	5 310	107 581
For off-balance items	3 613	1 959	2 640	6	2 938
Total	77 783	55 099	27 679	5 316	110 519

Table 6: Changes in value adjustments and provisions during the year

The following tables provide an overview regarding the lending portfolio of K&H Bank affected by loan loss allowances.

Code	Asset classes (mln HUF)	Original exposure pre credit conversion factors	Exposure net of value adjustments and provisions
CGCB	Central governments and central banks	0	0
RGLA	Regional governments and local authorities	0	0
PSE	Public sector entities	0	0
INST	Institutions	2 899	522
CORP	Corporates	117 002	15 413
RETAIL	Retail	503	314
SECRE	Secured by real estate	69 951	5 425
PDUE	Past due	92 199	54 421
OTHER	Other	34 425	34 425
TOTAL	TOTAL	316 979	110 519

Table 7: Lending portfolio of K&H Bank affected by loan loss allowances per asset class

Code	Continent (mln HUF)	Original exposure pre credit conversion factors	Exposure net of value adjustments and provisions
CCE	Central Eastern Europe	314 915	110 281
WEU	Western Europe	2 065	238
ASIA	Asia	0	0
NAM	North America	0	0
LAM	Latin America	0	0
ME	Middle East	0	0
AFR	Africa	0	0
OAU	Oceania & Australia	0	0
TOT	TOTAL	316 979	110 519

Table 8: Lending portfolio of K&H Bank affected by loan loss allowances per continent

Sector (mln HUF)	Original exposure pre credit conversion factors	Exposure net of value adjustments and provisions
Agriculture, Farming & Fishing	13 929	4 067
Authorities	4 592	301
Automotive	1 326	135
Aviation	2	0
Beverages	17 314	9 221
Building & Construction	12 844	2 702
Chemicals	27 081	4 836
Commercial Real Estate	34	21
Consumer Products	29 491	7 611
Distribution	919	533
Electricity	723	413
Electrotechnics	3 669	1 291
Finance & Insurance	4 376	1 460
Food Producers	9 797	693
Horeca	18	9
IT	2 072	1 376
Machinery & Heavy Equipment	313	81
Media	8 556	3 395
Metals	4	2
Paper & Pulp	262	262
Privat Individuals	118 970	23 736
Services	14 490	3 544
Shipping	572	121
Telecom	282	221
Textile & Apparel	195	81
Timber & Wooden Furniture	754	272
Traders	455	195
OTHERS	43 940	43 938
TOTAL	316 979	110 519

Table 9: Lending portfolio of K&H Bank affected by loan loss allowances per sector

Further breakdown of these figures by asset classes can be found in the [appendix](#).

Credit risk capital charge

Approaches

The minimum capital requirement for credit risk calculated under Pillar 1 of Basel II is 8% of the risk weighted assets (RWA). There are, however, significant differences how these risk weighted assets are defined in the approaches applied for regulatory purposes.

In the 'standardized approach' (STA), risk weighted assets are computed by multiplying individual credit exposures by appropriate 'risk weights'. These 'risk weights' determined by external ratings of obligors, where available; or set by the regulators for example retail products (overdrafts and credit cards) have weight 75% and claims secured by residential property have weight 35%.

However, the RWA can be also calculated by using more sophisticated and risk sensitive methods under the Internal Ratings Based (IRB) approaches in Basel II. The basic idea is that banks make their own internal assessments of PD, LGD, and EAD. These assessments should be based on quantitative models that are satisfactory to the regulator.

K&H uses the 'standardized approach' for calculating regulatory capital requirement for the time being. However, K&H is currently making the necessary preparations for getting the supervisory approval for switching over to the Foundation Internal Ratings Based (IRB) approach.

Calculation of capital charge

The calculation of the capital requirement for credit risk exposures was done in accordance with the relevant Government Decree using the 'standardized approach'. The total capital charge for credit risk is summarized in the table below. The capital requirement for the lending portfolio of K&H Bank is indicated in the other table broken down by asset classes. More details on the capital charge for counterparty credit risk are included in the next chapter.

(mln HUF)	Original exposure pre credit conversion factors	Exposure net of value adjustments and provisions	Risk weighted exposure amount	Capital requirements
On-balance (1)	3 093 347	2 985 766	1 200 325	96 026
Off-balance (2)	601 920	598 982	129 605	10 368
Lending (1+2)	3 695 267	3 584 748	1 329 930	106 394
Derivatives (3)	71 244	71 244	33 021	2 642
Repo-like (4)	0	0	0	0
TOTAL	3 766 511	3 655 992	1 362 951	109 036

Table 10: Capital requirements for credit risk of K&H Bank

Asset classes (mln HUF)	Original exposure pre credit conversion factors	Exposure net of value adjustments and provisions	Risk weighted exposure amount	Capital requirements
CGCB	1 136 933	1 136 933	802	64
RGLA	122 800	122 800	118 142	9 451
PSE	1 254	1 254	88	7
INST	180 618	180 096	35 591	2 847
CORP	1 293 805	1 278 393	817 797	65 424
RETAIL	37 607	37 293	22 715	1 817
SECRE	689 499	684 074	267 382	21 391
PDUE	103 442	49 021	38 442	3 075
OTHER	129 309	94 885	28 972	2 318
TOTAL	3 695 267	3 584 748	1 329 930	106 394

Table 11: Capital requirements of the lending portfolio of K&H Bank per asset class



Counterparty credit risk

K&H defines counterparty credit risk as the credit risk resulting from over-the-counter transactions (i.e. where there is no formal exchange) such as foreign exchange or interest rate swaps, Credit Default Swaps (CDS), and caps/floors. The pre-settlement counterparty credit risk is the sum of the (positive) current replacement value (marked-to-market) of a transaction and the applicable add-on (= current exposure method).

Counterparty limits are set for each individual counterparty taking into account the general rules and procedures set out in a document applicable in K&H Bank. The risk is monitored by a daily monitoring report that is available to all the Bank's employees on the Bank's intranet. Dealers are obliged to make a pre-deal check before the conclusion of each transaction using 'heavy' add-ons which are higher than the regulatory add-ons.

Close-out netting and collateral techniques are used in the internal limit utilization monitoring process to manage counterparty risk. The netting benefits and mitigation through collateral for OTC-derivative transactions are however not yet used in the capital calculation procedure due to system constraints; hence they are not included in the table below.

Transaction type	Mark-to-market	Add-on	Counterparty exposure	Notional value of contracts	Capital requirement
Total credit derivatives	-	-	-	-	-
CDS bought - Trading	-	-	-	-	-
CDS bought - Hedging	-	-	-	-	-
CDS sold - Trading	-	-	-	-	-
CDS sold - Hedging	-	-	-	-	-
Other	-	-	-	-	-
Total interest related transactions	27 086	12 750	34 555	2 052 899	1 513
Interest rate swaps	19 559	4 283	23 842	1 339 837	627
Caps/Floors	7 466	8 466	10 652	229 777	884
Other	61	0	61	483 286	3
Total currency related transactions	3 274	30 251	36 689	938 466	1 128
FX-forward	425	1 846	2 271	87 288	109
FX-swap	2 229	3 447	5 676	307 922	178
CIRS	616	24 950	25 566	543 178	525
Other	4	8	3 176	79	316
Total equity related transactions	-	-	-	-	-
Equity swaps	-	-	-	-	-
Equity options	-	-	-	-	-
TOTAL gross counterparty risk	30 360	43 001	71 244	2 991 365	2 642
- Netting benefit	-	-	-	-	-
- Collateral benefit	-	-	-	-	-
TOTAL net counterparty risk	30 360	43 001	71 244	2 991 365	2 642

Table 12: Capital requirements for counterparty credit risk of K&H Bank

Below, a breakdown of the net counterparty risk of K&H Bank is provided by geographic regions (i.e. where the counterparty is located), per economic sector and per residual maturity.

Net derivative exposure (mln HUF)	Original exposure pre credit conversion factors
<1 year	11 672
1 <= to <5 years	42 680
5 <= to <10 years	3 999
10 <= years	12 893
TOTAL	71 244

Table 13: Counterparty credit risk of K&H Bank per maturity

Code	Net derivative exposure (mln HUF)	Original exposure pre credit conversion factors
CEE	Central Eastern Europe	20 814
WEU	Western Europe	50 065
NAM	North America	364
LAM	Latin America	0
ASIA	Asia	0
ME	Middle East	1
OAU	Oceania & Australia	0
AFR	Africa	0
TOT	TOTAL	71 244

Table 14: Counterparty credit risk of K&H Bank per continent

Net derivative exposure (mln HUF)	Original exposure pre credit conversion factors
Agriculture, Farming & Fishing	4 981
Authorities	570
Automotive	509
Aviation	322
Beverages	153
Building & Construction	908
Chemicals	359
Commercial Real Estate	4
Consumer Products	641
Distribution	1 524
Electricity	263
Electrotechnics	54 044
Finance & Insurance	685
Food Producers	294
Horeca	13
Machinery & Heavy Equipment	483
Metals	549
Paper & Pulp	826
Services	0
Telecom	647
Textile & Apparel	8
Timber & Wooden Furniture	5
Traders	30
OTHERS	3 386
Water	41
TOTAL	71 244

Table 15: Counterparty credit risk of K&H Bank per sector

Credit risk mitigation applied during the calculation of capital requirement

Credit risk mitigation entails the use of techniques to lower capital needs when calculating the minimum capital required for credit risk. Credit risk may be mitigated by a number of risk mitigants of which the most important are:

- netting and delivery versus payment systems
- received guarantees / collateral
- credit derivatives (bought credit protection)

K&H did not engage in on-balance-sheet-netting (i.e. the offsetting of balance-sheet products such as loans and deposits), and in relation to counterparty credit risk, close-out netting is also not applied in capital requirement calculation. With regard to collateral for counterparty risk arising from derivative transactions, collateral is not taken into account in the capital requirement calculation due to system



constraints, however the Bank has clear internal policy to monitor and manage collaterals provided behind derivative transactions.

Collateralized lending portfolio

The table below gives the total exposure covered by eligible financial and physical collateral for each exposure class. The table shows that in case of funded credit protection, only cash collateral is taken into account in the capital calculation process, while unfunded credit protection is provided through guarantees. Collateral covering retail exposure is not included in this section of the report because – in line with requirements of the ‘*standardized approach*’ – exposure covered by real estate is handled as a separate asset class; while in retail no other collateral is taken into account in the capital requirement calculation.

It is clear that credit risk mitigation is only applied when the necessary policies and procedures are in place. Only the collateral meeting the eligibility criteria and minimum requirements (as imposed by the capital requirements directive) to qualify for credit risk mitigation has been included in the figures. For these reasons, the figures under the asset class “secured by real estate” is rather limited since this asset class is dominated by retail (consumer) exposures, and in non-retail segment eligibility of these collaterals currently cannot be proven in its entirety.

Hence, bearing in mind that the figures refer to collateralized exposure in course of capital requirement calculations as described in the previous paragraphs, the effective amount of collaterals obtained by K&H Bank is much higher than the figure taken into account for risk mitigation purposes during the calculation of capital requirements and indicated in the table below.

Code	Asset classes (mln HUF)	Cash collateral	Guarantees	Total collateralized
CGCB	Central governments and central banks	0	0	0
RGLA	Regional governments and local authorities	92	350	441
PSE	Public sector entities	148	922	1 070
INST	Institutions	0	9 006	9 006
CORP	Corporates	35 308	62 770	98 078
RETAIL	Retail	264	0	264
SECRE	Secured by real estate	0	0	0
PDUE	Past due	44	0	44
OTHER	Other	0	0	0
TOTAL	TOTAL	35 856	73 047	108 903

Table 16: Credit risk mitigation of K&H Bank per asset class

The table above represents that portion of the lending exposures of K&H Bank which were classified as collateralized, implying that a lower LGD percentage is applied to this portion of exposure in the capital calculations. The impacted exposure is to be interpreted as the total collateralized exposure – after the application of haircuts, mismatch corrections and collateralization floors – to which a different (lower) EAD amount was calculated based on the provided credit protection.

Chapter V – Market (trading) risk

Trading risk management

Definition

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market risk factors such as prices (e.g. bond, security or commodity prices), rates (e.g. interest rates or foreign exchange rates) or other factors (e.g. spreads). This risk can arise from market-making, dealing, and position-taking on various financial instruments.

The Group classifies exposures to market risk into either trading or non-trading portfolios. The interest rate risks of the non-trading positions are included in banking book exposure thus they managed within the scope of ALM risk management (see next chapter).

Therefore the objective of trading risk management is to measure and report the market risk of the aggregate trading position at K&H, taking into account the main risk factors and specific risk related to these position-takings.

Governance of trading risk management

Within KBC group, trading risk management has been centralized. This decision has been taken in order to map the trading risk management organization on the centralized organization of the trading activities and to improve efficiency by avoiding duplication of tasks. The centralization implies that:

- The development of models, the measurement of the risk position, the monitoring and reporting is performed centrally; there is no need to duplicate the aforementioned tasks locally;
- The Trading risk manager within K&H is responsible for:
 - the analysis of outliers and stress tests;
 - the performance of parameter reviews;
 - the follow up on counterparty limits and operational risk tasks;
 - the support of local internal and external reporting.
- The related tasks with respect to operational and credit risk are governed by the group-wide policies (and procedures) for operational and credit risk.

Process of trading risk management

Detection and identification

The primary 'formal' tool for identifying and detecting risks related to the Trading activities is the mandatory New and Active Product Committee (NAPC) procedure. The aim of the Group Standard is to ensure that before new or modified products / activities / businesses are launched the organization is ready and able to properly process these products and that all legal, tax, compliance, accounting, risk management issues, etc. have been properly addressed upfront.

All entities of KBC Group active in the area of Trading and Sales are requested to implement the Group Standard for New Products Development and subsequently assess the compliance of local procedures with the Group Standard.



Every New and Active Product requires a business case that analyses the material risks and the way these will be managed (= measured, mitigated, monitored and reported). Every business case must be accompanied by a written advice of group or local Risk Management before submission to the NAPC. Each active product is reviewed in a 3 years cycle.

Note that, twice a year, every entity needs to provide a comprehensive overview of its NAPC activity to Group Value and Risk Management (listing out all new products, either approved or rejected, and active product reviews together with a short description).

Measurement

A variety of measures is used to capture the market risk stemming from the trading activities like:

- Value-at-Risk (VaR)
- Economic capital (ECap)
- Basis Point Value (BPV)
- Concentrations
- Nominal position limits
- Etc.

The market risk for the trading portfolio is managed and monitored based on a VaR methodology. The KBC Group has chosen to use the historical VaR (hVaR) methodology to measure, manage and monitor market risks in the trading book. KBC's current hVaR methodology is based on: 10 days holding period and 99% one-sided confidence level, calculated on an un-weighted 500-day observation period.

There are also several stress tests applied in order to evaluate the potential impact that a specific stress event and / or 'extreme' movement in a set of financial variables can have on a firm's positions. K&H applies the KBC group-wide scenarios for analyzing stress tests but also developed local scenarios that reflect more the Hungarian historical and hypothetical scenarios.

Beside the hVaR calculations and stress-test, risk concentrations are also monitored via secondary limits: FX concentration limits to limit FX risk stemming from a particular foreign currency position, and basis-point-value (BPV) limits for interest rate risk. BPV limits are set per currency and per time bucket.

Monitoring

In order to monitor market risk, limits are set, which are a means for authorizing specific forms of risk taking. Limits make explicit how much risk is considered to be 'an acceptable maximum' for a portfolio or a segment of a portfolio. Reference is made to a limit framework because:

- A combination of limits is used to monitor the market risk in KBC's and also K&H Trading activities (often a hierarchy, where each sub-segment has its own limits).
- A number of 'guiding principles' are defined, aimed at increasing coherency and consistency of risk monitoring across all trading activities subject to market risk.
- A clear and unambiguous description is given of:
 - The risk limits and the way a limit's utilization is calculated.
 - The authority, responsibilities and interaction between the various actors involved.

The limit framework for Trading originates within the business and obtains enforceability through a formal decision process, involving Local and Group VRM, the Group Risk and Capital Oversight Committee (GRCOC), the Executive Committee of KBC Group (EXCO) and the Board of Directors of KBC Group.

K&H is monitoring hVaR global limit for the entire trading activity and BPV limits for the interest rate risk position per time bucket and per currency. There are also nominal limits applied for activities that are not in the scope of the hVaR limitation.



Analyze and advice

An important task of Market Risk Department in K&H is to analyse data (results of risk calculations, positions, and so on) and to formulate advice regarding proposals submitted by the various business lines to the local and Group level risk committees.

Business proposals typically entail request for new or increased limits, changes to methodology, and so on. This task is formalized seeing that no limit request can be discussed at the level of the KBC unless it is accompanied by a recommendation from the local VRM. Typically, in its advice, local VRM will check whether the proposal is consistent with the existing methodology, limits and delegation framework (in case of a limit increase), overall strategy, and so on. It is important to understand that local VRM never has the authority to decide, but only gives advice regarding the perceived level of risk. In order to do so, local VRM also offers limits usage studies and comparisons with other entities of the group.

Reporting

Although reporting is done through various channels, Trading Risk Management in KBC (abbreviated as RMA hereafter) itself has opted to bundle a large part of its reporting on its dedicated 'Risk Management' intranet site, named eRIS and GroupNet (part of KBC's intranet).

eRIS contains detailed reports for Global Treasury and all related entities (with the possibility to drill down to lower levels for more detailed results). The site also contains back-testing, stress testing and limit-overrun information. Access is granted to senior management (EXCO and MC members) as well as to Global Treasury staff, local risk managers and local Treasury traders in K&H.

In addition, RMA has set up a website on KBC's GroupNet. The site contains, amongst others, a section dedicated to KBC's limits framework, which can be regarded as RMA's 'bible' seeing that it gives an overview of all limits for treasury and equity, the overrun delegations and all supporting decisions. In addition, the latest version of the VaR model documentation is made available on this website. The site is updated at each change by RMA and hence presents - at any moment in time - the latest stand with regard to KBC's limit framework and risk amounts.

Next to eRIS and GroupNET, communication through traditional, paper channels still remains important. Finally, RMA also does a lot of ad-hoc reporting (to the Board, Rating Agencies, Regulators, Audit Committee).

K&H Market and Liquidity Risk Department also provides daily an extract of the available trading exposure information for local traders, head of Treasury and head of Local Value and Risk Management Division by using eRIS. Limit utilization report is monthly presented to the local Executive Committee for information (via monthly Integrated Risk Report) and quarterly to the Board of Directors. The Audit Committee is also quarterly informed about main Market Risk indicators and issues.

Response

Once risks have been identified and assessed, all techniques to manage the risk fall into one or more of the following categories: accept the risk, transfer the risk to another party, reduce the risk or avoid the risk by not performing a specific activity that could carry risk.

As was said before, the ultimate risk appetite for the KBC Group is set by the Board, which is refined into a detailed limits framework by the Group EXCO and the GRCOC. Within the boundaries of this limit framework, it is up to the business to decide how to manage risk (accept/transfer/reduce/avoid).

In the case that 'too much' risk is taken (resulting in a limit break) it is line management which decides how to act: allow the over-limit within the boundaries set by the delegation authority framework or decide to cut back or hedge the risk. In the case of an over-limit outside of delegation authority, it is up to line management to decide to ask for approval or initiate other actions to cut back the exposure



within the limit. Note that, for new activities a specific NAPC procedure is in place which investigates whether a particular new activity 'fits' K&H's overall risk profile.

Capital charge for market risk

The Bank uses the standard method for the calculation of its capital requirement of the trading book positions, thus internal model is not used for capital requirement measurement.

For the local regulator (PSZÁF) the Bank every day calculates the sum of capital requirement for bonds and other securities, together with deposits and derivatives. Additionally, the capital requirement of the Bank's foreign currency rate risk and commodity risk is also calculated and reported daily.

Moreover, based on the standard method, the Bank prepares an additional report monthly for PSZÁF regarding the sum of the capital requirement of bond's and share's position risk, foreign currency rate risk and commodity risk. The next table shows the market risk capital charge for K&H Bank.

Regulatory capital requirements for market risk		
Risks	Value of position (mln HUF)	Capital requirement (mln HUF)
Position risk of bonds	236 349	2 750
Position risk of shares	5 981	415
Foreign currency rate risk	17 146	1372
Commodity risk	57	3
TOTAL	259 533	4 540

Table 17: Capital requirements for market risk of K&H Bank

Quarterly the bank reports to PSZAF the trading book risks of the large risk counterparties as well. The total was HUF 44,689 million at year end. In connection with this value the Bank did not have to allocate additional capital requirement. This is due to the fact that there was no large risk client with trading book risk who exceeded the determined percentage of the guarantee capital (20% in case of the owner and its subsidiaries, and 25% for the other clients).

Chapter VI – Operational risk

Operational risk management

Operational risks are inherent in every material activities, products, processes, and systems. The operational risks cannot be completely eliminated but using sound control framework these risks can be mitigated to an acceptable level. When controls fail to adequately perform, operational risks can result in financial loss, damage to reputation, have legal or regulatory consequences. Operational risk management refers to the structural and repetitive tasks of handling these kinds of operational risks.

Definition

In line with KBC Group, K&H applies the same definition for operational risk which is similar to the one given in the Basel II Capital Accord and the Capital Requirements Directive. That is:

“Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems and from external events.”

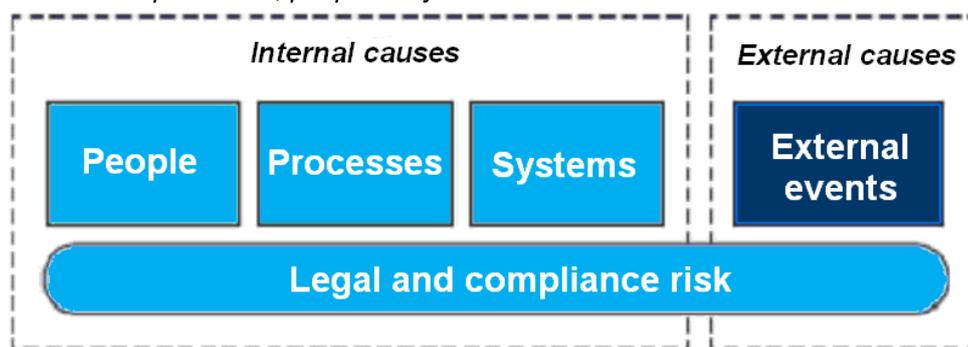


Figure 6: Schematic figure on the definition of operational risk

The definition of operational risk at K&H includes the risk of fraud, as well as legal and compliance risks but it excludes strategic and systemic risks. K&H takes reputation risk into account to a certain level that is the impact of incidents on the K&H's reputation is taken into consideration when establishing vulnerability to operational risk incidents.

Principles of operational risk management in KBC Group

Following principles apply for the development and implementation of the methodology for the management of operational risk in KBC Group:

- main responsibility lies in the line management
- the management of operational risk is an on-going and iterative process
- the focus is on key operational risks
- all group entities must implement the approved group strategy
- the pace of implementation of the methodology and the prioritization is set by the business, within the overall framework approved by the Group Risk Management Committee
- end-to-end approach is applied that the methodology covers all aspects of the management of operational risk
- the methodology for the management of operational risk is developed centrally by the Group Value and Risk Management Directorate in close cooperation with representatives from the Business and Internal Audit



- the methodology must be intuitive and easy to understand

KBC framework for operational risk management

According to the aforementioned principles, KBC developed a single global framework to manage operational risk throughout KBC Group. This single framework consists of a governance model, a unique methodology, a single set of concepts and tools, centrally developed supporting ICT applications for reporting and monitoring operational risks.

These sets of provided concepts and tools are understood as the main pillars and building blocks of operational risk management within KBC Group which is referred to as '*KBC Group Operational Risk Management Framework*'.

The framework covers all aspects of managing operational risk end-to-end, from risk identification to reporting. KBC Group implemented the use of a uniform set of processes, risk event types and risk mitigating/measuring methods. Processes and risk event types together are used as common and universal/uniform framework of reference for reporting purposes. The mitigating controls are the proper segregation of duties and responsibilities, access management, reconciliation and monitoring processes.

The current tools for the management of the operational risk are intended to cover the whole spectrum of expected, unexpected and even catastrophic loss events.

Implementing the framework in KBC Group entities

As a rule new entities should catch up with the other KBC Group entities that are in the same category in terms of KBC's risk materiality after an initial period of 3 years after the closing of the acquisition / start of the new activities. Entities must prepare a 3 year rolling plan for achieving this which is proposed by the local Chief Risk Officer after discussion with Group Value and Risk Management and which takes into account local regulations and business priorities.

The plan should in the first place aim to implement

- the operational risk governance framework and toolkit
- the '*Product Development and Marketing*' Group Standard
- a selection of the Group Standards
- the loss data collection process

Since K&H is deemed as a material entity for KBC in terms of operational risks therefore K&H is within the scope of this framework developed for operational risk management. This means that the same principles, processes and tools have to be applied in K&H and most of them are already or started to be implemented in K&H as well.

Operational risk governance

A clear definition of the respective roles, responsibilities, the communication and reporting lines of all parties directly or indirectly involved is a prerequisite for the successful management of operational risks.

Framework of risk governance in KBC Group

The governance framework of operational risk in KBC Group is based on multiple layers.

Key players in operational risk governance

Group Risk Management Committee

The Group Risk Management Committee (GRMC) the highest-ranking body responsible for the management of operational risks for the entire KBC Group. The GRMC advises the Group Executive



Committee on the group-wide framework for managing operational risks and monitors the implementation of this framework throughout the group – including in the new group entities – and oversees the main operational risks. The GRMC also advises the Group Executive Committee on setting the internal capital targets that are consistent with the Group's operational risk profile and operating environment.

The GRMC is chaired by the Group CRO, the ordinary members are the Local CROs, and the Head of KBC VRM.

Group VRM – operational risk division

The operational risk division within the Group Value and Risk Management Directorate (Group VRM-OPR) in KBC is responsible for the definition of a comprehensive group-wide framework for the management of operational risk and the approval thereof by the GRMC.

As a consequence, the Group VRM-OPR is primarily responsible for defining the operational risk management framework for the entire group. This framework is submitted to the GRMC for approval. The unit is also responsible for overseeing the practical implementation of this framework by line management. In addition, it supervises the quality of the risk management process, analyses the main risk data and reports to the GRMC.

Local VRM – operational risk department (Non-financial Risk Department)

The local Value and Risk Management – Operational risk department (Local VRM-NFR) acts as the local point of contact/entry for Group Value and Risk Management with respect to operational risk issues and matters. As such the local VRM-NFR is e.g., responsible for:

- communication of the 'Group Operational Risk Management Framework', concepts, etc. within the own organization
- coordination of the implementation and proper functioning of the framework within the own organization
- providing training and coaching to local 'Local Operational Risk Managers' (LORMs)
- monitoring progress of implementation and the proper functioning of the framework

The Local VRM-NFR department reports to the CROC meetings, organizes the Crisis Committee meetings, and takes part in the local Operational Risk Council meetings as well. The Local VRM-NFR is also responsible for the quality and timing of all reporting to the:

- Capital and Risk Oversight Committee (CROC)
- Group Risk Management Committee / Group Value and Risk Management (GVRM)
- local regulators

Line management

The main precept of operational risk management is that ultimate responsibility for managing operational risk lies with line management.

The line management of each KBC Group entity or business area is expected to observe and implement the operational risk management framework and all decisions related thereto (e.g. decisions made by the GRMC, CROC, Country Team, Executive Committee, or others) to the extent that such decisions are consistent with their own local obligations or would infringe on the legitimate minority interests where the subsidiary is not wholly owned.

Local operational risk managers (LORMs)

In order to adequately manage operational risks within the different business lines, the line managers are assisted by one or more 'local operational risk managers' (LORMs). KBC defined processes to cover all business territory operating in a bank and for each process nominated responsible LORMs should be assigned.



The main task of a LORM is putting risk management on the agenda of their business area and keeping it there. LORMs organize and facilitate the implementation and proper functioning of the 'KBC Group Operational Risk Management Framework' in their area.

As such Local Operational Risk Managers are responsible for the:

- actual implementation of operational risk management framework and methodology
- monitoring and reporting of operational risks for their area
- analysis of findings,
- ensuring that the right lessons are learned
- proposing an adequate risk response to their line management
- other risk related duties

Local Operational Risk Managers belong to the business. They report hierarchically to the senior line management. There is however a functional reporting line to the independent Value and Risk Management function, NFR. The activity of LORMs is also supervised by the Operational Risk Councils.

Internal Audit

Internal Audit also has a crucial role to play in the management of operational risk. Internal Audit closely cooperates with the business for identifying key risks (during risk self assessments), proposing appropriate mitigation measures, etc. Internal Audit acts thereby as a challenger of the risk tolerance of the business. As a consequence, Internal Audit and the business are involved right from the beginning in the development of all building blocks of the operational risk management framework.

Internal Audit's role is to provide assurance on the correct implementation of the operational risk management framework and the outcome of the various operational risk management exercises. This could be done through specific audit assignments or in the framework of the regular audit program.

Last but not least Internal Audit has a standing invitation to attend all Operational Risk Council meetings as an observer.

Operational risk governance in K&H

At K&H, the Non-financial Risk Department (NFR) within Value and Risk Management Division is responsible to adapt these KBC standards and instructions and also to give professional back-up for line management and 'local operational risk managers' (LORMs) to get through these tasks.

K&H NFR organizes the Crisis Committee quarterly, and reports to Capital and Risk Oversight Committee for the management about the work done on operational risk field. These meetings have standard agenda points like the result of the performed risk self assessments and the status of group standard assessments, a report on loss events and also include the compliance incident reports.

As a consensus seeking and discussion forum Operational Risk Council meetings are held quarterly for each business lines as:

- ORC Credits – Corporate
- ORC Credits – Retail
- ORC Market Domain & Custody
- ORC Insurance
- ORC Asset Management
- ORC Payment
- ORC Trade Finance
- ORC ICT
- ORC Leasing
- ORC Banking Sales Channels and Support



Building blocks of operational risk management

The following chapters are structured along the six key steps of risk management as it was described earlier, introducing the various set of concepts and tools developed for each process step of operational risk management. This toolkit is also implemented and used in K&H.

Detection and identification

The following tools are used to detect and identify operational risks in KBC Group entities.

Global Risk Scans (GRS): The GRS is a top down scenario-based questionnaire, asking top management to report on their major concerns, as well for operational as for business risks. This mandatory exercise is done on a yearly basis.

Risk Self-Assessments (RSA): These bottom up assessments focus on actual (= residual) key operational risks at critical points which are inherent in all material products, activities, processes and systems but not yet properly mitigated. RSAs are forward-looking and allow taking into account future evolutions and developments. Line management and LORMs have to plan RSAs for 3 years using the process definitions and their professional experiences on the given business territory.

Case Study Assessment (CSA): This is the process of testing and assessing the level of protection of the current control environment against severe operational risk events that have actually happened in the banking or insurance industry.

Product Development and Marketing (NPDM): The main goal of the Group Standard is to establish across the whole KBC Group a smooth but robust and transparent process for approving new products and for regularly reviewing existing products whereby risk issues are balanced against commercial ones.

Measurement

The following tools are used to measure operational risks in KBC Group entities.

Loss Event Database (LED): KBC Group has been uniformly recording all operational losses of 1 000 euros or more in a central database since 2004. This database also includes all legal claims filed against group companies. K&H was decided to report to the central database each and every loss event regardless of the loss amount.

In 2007, KBC developed and implemented an internet-based Loss Event Reporter system for the purpose of collecting loss event through-out the KBC Group in a more standardized and efficient way.

Key Risk Indicators (KRI): KRIs are measurable metrics or indicators that track the exposure to loss or other potential incidents. KRIs may be relevant for the whole organization or only parts thereof. KRIs aim to combine the measurement of risk with the actual management of risk in a very pragmatic way that is immediately relevant for the business. Most important KRIs are reported to the CROC.

Monitoring / Limit setting

Operational risks and loss events are monitored via KBC internal benchmarking and external benchmarking as well to a certain extent.



Currently, no hard limits are set concerning operational risks just certain risk limits are defined in terms of the Key Risk Indicators. In a later stage, risk limits may be defined in terms of operational risk capital charge as well.

Analyze and advice

The operational risk framework provides the tools that help line management and senior management analyze operational risks in the organizational units that are within their remit.

These tools also help identify and analyze significant threats and initiate action to be taken via the appropriate channels created under this framework and provide advice on how to mitigate key risks.

Reporting

Internal

The Capital and Risk Oversight Committee is responsible for a high level monitoring of the operational risk management framework. This monitoring (reporting) includes among others the:

- development and maintenance of adequate controls of operational risks
- reliability of operational risk management data, both financial and non-financial, reported or disclosed internally and/or externally
- compliance with laws, internal and external regulations and procedures
- ensuring resources for the management of operational risks
- systematic review of significant operational risk related loss events that happened in K&H

The Minutes of the Operational Risk Council meeting are distributed to the CROC.

External

The (consolidated) Operational Risk Capital Charge is reported to KBC VRM each year.

Periodic reports are prepared to the Hungarian Financial Supervisory Authority (PSZÁF) and the National Bank of Hungary (MNB).

Response

The following tools are used to mitigate operational risks in KBC Group entities.

Group Standards (GS) / Group Key Controls and Zero Tolerances: Group Standards are key principles for controlling or mitigating otherwise major inherent risks. KBC has now 39 Group Standards to ensure that important operational risks are managed uniformly throughout the group. The Group Standards are being transformed to Group Key Controls as a part of the new concept in KBC's operational risk management framework.

The implementation starts with a Group Standard Assessments ("GSA") that aims to benchmark the current status of internal controls against the best practice embedded in the Group Standards. Each group entity has to translate these group standards into specific local procedures. Local management is responsible for an intelligent translation of Group Standards taking into account the local situation, legislation, etc.

The implementation of Group Standards is monitored by the Local and Group Value and Risk Management and is reported to the CROC.

Recommended Practices (RP): Recommended Practices are a "light version" of the Group Standards. Recommended Practices are control principles to help line management defining appropriate controls for key operational risks.



These help sharpen the internal controls against key risks that 1) were identified during Risk Self-Assessments, 2) are inherent in new activities started by a group entity, 3) have manifested themselves through a significant loss event, or 4) were identified by Internal Audit during an audit assignment.

Insurance: Unexpected losses can be covered by insurance. Certain parts of operational risks are insured by a Group Global Insurance Program. This is also supported with described policies that should be concluded locally. Group Legal manages the KBC Group Insurance Program.

Capital charge: Other part of unexpected losses due to operational risks can be covered by capital charge. KBC applies the 'Standardized Approach' (TSA) for the calculation of regulatory operational risk capital (see later for more details).

Capital charge for operational risks

Approach

In 2002, KBC has decided managing the operational risks according to the 'Standardized Approach' (TSA) as stipulated in Basel II and calculating capital charge for operational risks in line with these rules. KBC Group wants to focus in first place on the actual (qualitative) management of operational risks, rather than concentrate on the optimization of the operational risk capital charge via use of a financial model. K&H applies the 'Standardized Approach' since the first of January 2008.

Nevertheless, KBC applies the same strict standards as required under the 'Advanced Measurement Approach' (AMA) as it was indicated in the previous chapters. The current KBC approach does not, however, preclude a switch to the 'Advanced Measurement Approach'.

The consolidated operational risk capital numbers are submitted for approval to the Group Operational Risk Committee on yearly base.

Calculation of capital charge

Under the 'Standardized Approach', the total capital requirement for operational risk is the simple sum of the capital requirements calculated per 'Basel Business Line'. The capital for each business line is calculated by multiplying the 3-year average eligible gross operating income by the 'beta factor' assigned by the Capital Requirements Directive to that business line. Figures for operational risk capital charge (HAS) in mln HUF are indicated in the table below.

Regulatory capital requirement for operational risk						
Business Lines	Operating income, 2007	Operating income, 2008	Operating income, 2009	3-year average	Beta factor	Capital charge
Corporate finance	422	1,309	911	880	18%	158
Trading & sales	8,324	12,967	13,613	11,635	18%	2,094
Retail banking	57,500	57,811	67,947	61,086	12%	7,330
Commercial banking	42,301	36,438	40,965	39,902	15%	5,985
Payment & settlement	0	0	0	0	18%	0
Agency services	580	607	634	607	15%	91
Asset management	0	0	0		12%	0
Retail brokerage	0	0	0		12%	0
TOTAL Business	109,127	109,131	124,069	14,109	100%	15,659

Table 18: Capital requirements for operational risk of K&H Bank

Chapter VII – ALM risk

ALM risk management

Definition

Asset & Liability Management

Asset/Liability Management (ALM) is the process of managing a credit institution's structural exposure to macroeconomic risks. These risks include:

- interest rate risk,
- equity risk,
- real estate risk,
- foreign exchange risk,
- inflation risk,
- credit risk (limited to the investment portfolios).

'Structural exposure' encompasses all exposure inherent in the commercial activity of the bank or the long-term positions held by the institution. This includes all activities with the exception of the exposures taken in the trading activities of the group (i.e. activities with a short holding period). Trading activities are consequently not included.

Specifically, this covers two kinds of positions:

- All positions stemming from client driven production in banking;
- Positions for the reinvestment of own equity.

ALM risk

As a consequence of the above, ALM risk is the potential negative deviation from the expected net asset value of the financial investment book due to changes in the level or in the volatility of market prices. ALM risk can also be defined as the volatility of the net asset value due to changes in market risk factors (e.g. equity prices, interest rates, etc.).

The ALM risk drivers of K&H Group are interest rate risk and foreign exchange risk since all other risks are not present significantly in K&H Group. ALM risk is also managed by Market and Liquidity Risk Department in K&H.

Governance applicable to ALM risk management

The main purpose of ALM is to optimize the risk/return profile of the institution, subject to the risk tolerance limits set by the Board of Directors. Therefore the highest authority with regard to ALM ultimately remains the Board of Directors (BoD);

- The Executive Committee (EXCO) is responsible for implementing the ALM strategy as approved by the BoD;
-

Material entities as K&H, has to comply to the full extent with the requirements of KBC governance:

- Set-up of a Risk Committee (CROC) and an ALM risk management department that is independent of the business
- The role and responsibilities of the CROC should be defined in a charter that meets the criteria approved by the Group RCOC
- Implement KBC ALM methodology (e.g. definition of benchmarks, profit-sharing formulas, prepayment modeling, etc.)



- Compliance with KBC ALM reporting requirements (e.g. deliver all elements of periodic and ad hoc group-wide ALM reports; produce local reports according to group standards).

At K&H Bank the local CROC is controlling the value creation and the risks of the banking book. K&H ALM (Asset and Liability Management) is in accordance with international and KBC Group standards. K&H Group applies the KBC ALM risk management methodology. Risk tolerance levels are decided and allocated by the KBC Group RCOG.

Process of ALM risk management

Detection and identification

Primary formal means of identifying and detecting risk is the mandatory New and Active Product Committee (NAPC) procedure. The aim of this Group Standard is to ensure that before positions are taken in either new, either in active products, the organization is ready and able to properly process these products and that all legal, tax, compliance, accounting, risk management issues, etc. have been properly addressed upfront.

In line with the general framework for NAPC's in KBC, ALM is integrated into each business lines' specific NAPC which tackle the modeling, accounting and other issues related to investments in new or active products in ALM positions. All entities of KBC Group active in the area of Asset and Liability Management are consequently requested to implement the Group Standard and to assess the compliance of local procedures with the Group Standard.

More specifically this means that the NAPCs should consider the pricing of the ALM risks attached to the new or active products. Every product in which ALM positions are taken, requires a business case that analyses the material risks and the way these will be managed (i.e. measured, mitigated, monitored and reported). Every Product business case must be accompanied by a written advice of GVRM ALM Risk / local VRM ALM Risk before submission to the NAPC.

Measurement

A variety of measures is used to capture the ALM risk stemming from the ALM activities within the entities of KBC Group:

Value at Risk

Because of the adoption of value as the central concept in the value and risk management of KBC and therefore also in ALM, but also because of the growing importance of the value concept in the new accounting framework (IFRS) and the new regulatory frameworks the principal ALM limits are set in terms of maximum volatility of the value of the ALM portfolios or the Value-at-Risk (VaR). This VaR captures the risk from all ALM risk drivers mentioned above (where models exist) and summarizes these risks into one figure.

The ALM VaR limit is calculated for a 99% confidence interval and a one year holding period.

However, this time the VaR calculations are done using parametric VaR (pVaR) approach and limited to the interest rate risk of the banking book since K&H Group does not assume any equity or real-estate risk in the banking book.

Basis Point Value

A specific measure used with respect to interest rate risk is the Basis Point Value (BPV). The BPV represents the change in Fair Value due to a parallel shift in the interest rate curve of 10 basis points (i.e. 0.10%). The BPV provides the CROC with insight in the positions taken, as the direction of the



risk is known. Moreover, the BPV can be easily aggregated. On a more ad-hoc basis also results of non-parallel shifts on the economic value are calculated and monitored (next to the fact that this risk is included in all VaR calculations).

Interest rate gaps

Interest rate gaps are an additional interest rate risk measurement tool which is reported periodically. It is one of the basic methods for the analysis of interest rate sensitivity. A positive cumulative gap means a net excess of assets to re-price in the corresponding time bucket. Hence a positive cumulative gap helps the bank to increase its net interest margin in case of an increase in the interest rate curve.

Scenario analysis and stress tests

Scenario analyses and stress tests on individual risk drivers as well as on the overall ALM risk drivers are used to measure the ALM risks to which KBC Group is exposed.

The BPV tables below presents the results of stress testing of the economic value of the Banking Book at year end. Stressing was done based on the scenarios of 10, 100, 200 BP parallel shifts in yield curves. Banking book is limited in BPV by an internally set limit; K&H performed within this limit during the year.

Denomination	BPV in million HUF	Denomination	BPV in million HUF
10 bp parallel, UP scenario		10 bp parallel, DOWN scenario	
CHF	-1,91	CHF	1,92
EUR	17,26	EUR	-17,57
HUF	-643,45	HUF	651,41
USD	2,45	USD	-2,45
TOTAL	-625,65	TOTAL	633,31
100 bp parallel, UP scenario		100 bp parallel, DOWN scenario	
CHF	-18,95	CHF	14,85
EUR	159,78	EUR	-220,50
HUF	-6 283,35	HUF	6 675,83
USD	24,30	USD	-25,58
TOTAL	-6 118,22	TOTAL	6 444,60
200 bp parallel, UP scenario		200 bp parallel, DOWN scenario	
CHF	-37,53	CHF	14,85
EUR	293,40	EUR	-458,47
HUF	-12 210,73	HUF	13 771,59
USD	48,17	USD	-25,82
TOTAL	-11 906,69	TOTAL	13 302,15

Table 19: Stress testing results of banking book positions

Monitoring & Limit settings

In order to monitor risk, limits are set, which are a means for authorizing specific forms of risk taking. Limits make explicit how much risk is considered to be 'an acceptable maximum' for a portfolio or a segment of a portfolio. In K&H, as being part of the KBC Group, an ALM activity risk limit framework exists consisting of a hierarchy of several limits.

The combination of the goals & constraints and the risk drivers included in ALM gives a clear view on the ALM limits framework that has to be elaborated upon. A limits framework needs to be reviewed periodically in order to safeguard its relevance. As such, a procedure is in place for establishing and reviewing these limits in order to assure that the limits framework remains effective. This procedure is called the yearly 'limit review process'.



Since in K&H Group the majority of the ALM is covered by interest rate risks, the tolerance level is limited in BPV terms. The interest rate risk is also measured with scenario analyses on the net interest income (see before). ALM VaR limit exists on KBC group level but not on K&H level.

Analyze and advice

An important task of local VRM (specifically Market and Liquidity Risk Department in K&H) is to analyze data (results of risk calculations, positions, and so on) and to formulate advice regarding proposals submitted by the various business lines to the CROC. In this way the analysis and advice function of Risk Management could be split in a proactive and a more reactive role.

The proactive role is the one in which local VRM analyses the results of its value & risk calculations, of market evolutions, industry trends, new modeling insights and changes in regulation, etc.; and formulates advices to the CROC to change or refine either measurement methods, risk appetites (limits), hedging methods or strategic positions. Advices in this context are given in the periodic (mostly monthly) reporting, but can also be given as separate proposals addressing specific issues.

The reactive role is the one in which local VRM issues its mandatory advice on business proposals which typically entail request for new or increased limits, new investment instruments, retail products with specific ALM features, etc.

Typically, in its advice, local VRM will check whether the proposal is consistent with the existing methodology, limits and delegation framework (in case of a limit increase), overall strategy, and so on. It is important to understand that local VRM never has the authority to decide, but only gives advice to the decision making body (in most cases the CROC).

Reporting

The following paragraphs describe the ALM reports drawn up on a periodic basis by Risk Management.

- BPV Limit Monitoring report monthly to local and Group VRM
- VaR calculation report monthly to KBC local and Group VRM
- Net Interest Income simulations monthly to local and Group VRM
- Capital and income sensitivity analyses under imposed interest rate scenarios monthly to local and Group VRM
- As part of the monthly Integrated Risk Report to the Executive Committee.

The K&H Board of Directors and the Audit Committee is also informed quarterly about the main ALM risk indicators and limit utilization.

Response

Creating economic value is the primary objective of Asset & Liability management in KBC and K&H. The role of ALM in the value creation process is limited to supplying the market consistent pricing of ALM risks to the business units (transfer pricing) in order to allow the business units to take well-considered transactional pricing decisions. Moreover, it is also necessary for ALM to set the appropriate risk/return profile (i.e. optimizing it) by:

- Changing the activity mix in general that risk/return trade-off is in line with the expectations of the shareholders and in line with their maximum risk tolerance;
- And more specifically in ALM context by making hedging or investment mix decisions such that it fits better with shareholder preferences / market expectations.

CROC/EXCO/BoD at Group or local level determine the risk/return profile that the company wishes to take by specifying the minimum and maximum VaR limits by risk driver as discussed earlier. The difference between the minimum and maximum limits gives some room for tactical and operational



investment decisions by the CROC/investment manager. These decisions lead to the actual investment mix of the Bank.

Chapter VIII – Liquidity risk

Liquidity Risk Management

Definition

Liquidity risk is the risk that an organisation may not be able to fund increases in assets or meet obligations as they fall due, unless at an unreasonable cost. Therefore liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances.

A liquidity crisis will only occur because of problems in other risk domains such as credit risk, operational risk or market risk. Trying to assess the impact of such liquidity crises (with preceding events in these other risk domains) via e.g. stress testing, is an inherent part of KBC Group's liquidity risk management framework and K&H Group liquidity policies.

Scope of liquidity risk management in KBC Group

The principal objective of KBC's liquidity management is to be able to fund the group and to enable the core business activities of the group to continue to generate revenue, even under adverse circumstances.

Liquidity risk management framework in KBC Group and therefore in K&H as well, covers the liquidity funding risk, not the market liquidity risk. During the second half of 2009, a more refined liquidity framework was set up, founded on the following pillars:

- operational liquidity risk management
- structural liquidity risk management
- contingency liquidity risk management

Within the scope of liquidity risk management, KBC's framework focuses on these 3 important complimentary aspects of funding liquidity risk.

Operational liquidity risk management

Operational liquidity management is conducted in the treasury departments, based on estimated funding requirements. Maturities and expected savings and demand account withdrawals are taken into account, as are additional funding needs due to unused credit lines, etc. Operational liquidity management is monitored per entity and on a group-wide basis by the Group Value and Risk Management Directorate.

Structural liquidity risk management

KBC Group's funding structure is managed so as to maintain substantial diversification, to minimise funding concentrations, and to limit the level of reliance on wholesale funding (gross and net of repos). Therefore, the forecast structure of the balance sheet is reviewed regularly and the appropriate funding strategies and options developed and implemented. KBC's liquidity framework applied in K&H as well ensures that net funding collected from non-core sources is at all times limited by the liquidity buffer of government bonds and other eligible collateral.

Contingency liquidity risk management

Contingency liquidity risk is assessed on the basis of several liquidity stress tests, which measure how the liquidity buffer of KBC group banks changes under stressed scenarios. The liquidity buffer is based



on assumptions regarding liquidity outflows (e.g., retail customer behaviour, professional client behaviour, drawing of committed credit lines, etc.), as well as on assumptions regarding inflows resulting from actions to increase liquidity (e.g., ‘repo-ing’ the bond portfolio, reducing unsecured Interbank lending, etc.).

The liquidity buffer should be sufficient to cover liquidity needs (net cash and collateral outflows) over

- (a) a period that is required to restore market confidence in the group following a KBC specific event, and
- (b) a period that is required for markets to stabilise after a general market event.

The overall aim of the liquidity framework of KBC is to remain sufficiently liquid even in stress situations, without resorting to liquidity-enhancing actions which would entail significant costs or which would interfere with the core business of the banking group.

Exposures taken into account

Different from the scope of ALM, liquidity management also covers the trading transactions in the banking entities, and not only the “structural” positions. So for liquidity management purposes, the full group’s (consolidated) balance sheet and off-balance-sheet positions are considered.

It is beyond doubt that in principle all existing transactions have to be taken into account for assessing liquidity risk. Yet, for liquidity risk also future business has to be considered. Structural liquidity risk is assessed by, amongst other things, incorporating expected future events in the current positions. These future events can have liquidity improving (e.g., new long-term funding program) as well as a liquidity worsening impact (decrease of retail deposits, increase of credit volumes ...).

Governance of liquidity risk management in KBC Group

KBC’s approach with regard to liquidity risk management strikes the golden mean between centralization and decentralization. This choice is based on the view that liquidity has specific features that are managed best locally and that some legal limitations make liquidity transfer within the group difficult. To this approach, a central supervision and support is added so that in critical situations, the local entities are supported centrally.

On the one hand, the following important responsibilities are centralized in KBC:

- It’s up to Group VRM in KBC to propose a uniform group-wide liquidity risk management framework (policies, roles & responsibilities, measures, limits);
- Group VRM also continuously monitors and frequently reports KBC Group liquidity risk to the responsible group committees;
- Group RCOC delegated the day-to-day monitoring of the group-wide operational liquidity position to Global Treasury:
 - It manages the long term wholesale funding of the KBC Group centrally;
 - A major part of the liquid collateral in the group is managed at the repo desk in Brussels. More specifically, KBC Bank Group has a vast amount of liquid government bonds which can easily be sold in the market, repo-ed or pledged with the central bank in order to support the other entities in case of a liquidity problem;
 - The insight in the operational liquidity position is improved by making use of an information report which is delivered by the entities to the Global Treasury on a daily basis. This report contains both quantitative (liquidity position and gap for the next week, overview of available marketable assets, etc) and qualitative elements (ad hoc events, borrowing capacity with other banks, etc.).
 - It plays a central role in the contingency liquidity planning and crisis management.

Yet, on the other hand, a local first line responsibility remains for liquidity risk monitoring and management (within the centrally defined limits):

- Local management has the best view on the specific characteristics of the local market, products, funding sources and capabilities;



- Day-to-day liquidity management is the responsibility of the individual subsidiaries and branches. Apart from the group framework the local entity can have locally imposed limits (depending on the branch, local regulator, ...);
- The local treasury department takes care that individual cash positions are squared at the end of the day and that the externally and internally imposed liquidity limits are fulfilled at any time;
- The LVRM units perform an independent check to see if the liquidity position complies with the imposed limit. They report to both the local CROC and GVRM (which in turn reports to the Group RCOC);
- All major subsidiaries have a portfolio of liquefiable assets which can be sold in the market, repo-ed or pledged with the central bank in case the normal liquidity measures would not prove sufficient under a stress scenario;
- This way of working sensitizes local management for liquidity risk issues;
- It avoids possible regulatory/legal hurdles (i.e. specific regulation of local Financial Regulators);
- Requirements with regard to liquidity reporting to local Financial Regulators and adhering to their imposed limits can be better followed up thanks to the closer relationship.

Key players in liquidity risk management

In K&H Group, liquidity risk is managed and measured/monitored by Market and Liquidity Risk Department via the ALM function. Yet, it is not managed nor measured in the way like other ALM risk drivers are taken into account. Instead, this risk is managed by a separate set of policies, rules and limits because of its specific nature. Liquidity risk is considered to be a so-called “second order risk”.

Responsible committees

As is the case for the general risk management framework in KBC Group, also for liquidity risk management the following applies:

The highest authority with regard to liquidity risk ultimately remains the Board of Directors (BoD). The BoD is responsible for the approval and periodic review of strategies, key policies and primary limits. The BoD is assisted/informed/advised in these tasks by the Audit Committee (AC), which is a specialized sub-committee of the BoD.

The Executive Committee (EXCO) is responsible for implementing the liquidity strategy as approved by the BoD and proposing appropriate limits in accordance with the risk appetite defined by the BoD.

The Group RCOC in KBC is responsible for proposing an appropriate liquidity management framework, monitoring the KBC Group’s liquidity position and deciding on mitigating/corrective actions if necessary.

Responsible entities for liquidity risk management

Group VRM is responsible for defining the group-wide liquidity risk management framework and appropriate liquidity risk measures. Group VRM is also responsible for making proposals on the overall limit setting, analyzing and frequently reporting on the KBC group’s liquidity risk position to all the external and internal (primarily Group RCOC) stakeholders.

Next to this, local value and risk management (LVRM) is also involved in the process, and is responsible for defining additional local limits, monitoring the local liquidity risk position and reporting it to local stakeholders (local CROC) as well as to GVRM.

Dealing room (under the supervision of the Global Treasurer), as well as local investment functions play an important role in the day to day/intraday liquidity management process.



Process of liquidity risk management

Detect and identify

Liquidity funding risk is not linked to a specific (new) product, but rather a risk that arises from the overall portfolio of funding sources and assets. Liquidity risk is however one of the factors that is taken into account when assessing new commercial strategies or products. This is always done by looking at the impact on the overall liquidity position as discussed below.

Measure

KBC's and K&H's liquidity risk management framework focuses on 3 important aspects of liquidity funding risk. All measures (for operational, structural and contingency liquidity) are based on a combination of "stock" and "flow" assumptions. Concrete assumptions will differ between these different aspects though.

- Stock assumptions: e.g. assets that can be sold or repo-ed (with assumptions on availability of markets and applicable haircuts), or credit lines that can be drawn. It is clear that having a large pool of "marketable" assets (such as NBH eligible collateral) has a positive impact on the liquidity position, while e.g. having a large amount of committed credit lines to clients has a negative impact on the liquidity position because of the potential withdrawal of these lines;
- Cash flow assumptions (according to contractual maturity, as well as modeled for non-defined maturity such as current and savings accounts; taking into account scenario dependent renewal rates etc.)

Operational liquidity risk

The operational liquidity is measured by the (5, 30 and 90 days) liquidity gap. Liquidity gap is to entirely be covered by highly liquefiable core collateral in K&H.

Structural liquidity risk

Structural liquidity is managed via the loan-to-deposit (LTD) ratio, an overall liquidity benchmark. LTD is calculated as the amount of a bank's loans to customers divided by the amount of its customer deposits at any given time. The higher the ratio, the more the bank is relying on borrowed wholesale funds. That is the lower the ratio, the more the credit activity is funded by own sources. Stressed liquidity ratios defined by Basel 3 (LCR, NSFR) are also calculated and reported on a regular basis.

Contingency liquidity risk

Contingency liquidity risk is assessed in the group on the basis of several liquidity stress scenarios. The aim of the stress tests is to measure how the liquidity buffer of the K&H Group evolves under stressed scenarios. For each scenario the evolution of the liquidity buffer is calculated: this is the amount of excess liquidity per time bucket. In essence, there are two different types of stress tests: general market and KBC / K&H specific scenarios. Under both scenarios K&H would achieve the internally set survival period.

Monitor & limit settings

Limits are set on most of the abovementioned measures. As already mentioned previously, the minimum liquidity limits that are applicable in the entities, are driven by KBC guidelines for liquidity risk management. K&H however has additional local limits in place, which give the group some extra safety. It is important to note that local treasury and local risk liquidity departments are responsible for the management of these local limits.



Analyze and advice

In fact, all the previous and next steps in the liquidity risk management process are based on preparatory work of local ALM risk management. This preparatory work often boils down to analyzing (data for methodological development, risk positions, etc.) and advising (on business proposals, etc.), and has to be seen as the most important tasks of local VRM (more specifically local ALM risk management in this case).

Apart from the periodic follow-up of the above-mentioned measures and limits, local ALM Risk Management also considers the liquidity risk when looking at other business developments and commercial actions. It's important to mention that local ALM Risk Management never has the authority to solely decide in any of the steps in the liquidity risk management process, but only gives advice to local CROC regarding the implementation of an adequate framework, the acceptable level of risk, etc.

Reporting

Local liquidity reporting is done daily by Risk Management to Treasury (ALM desk) on operational liquidity limit monitoring; and monthly by Controlling department on the evolution of the Loan-to-Deposit (LTD) ratio. Monthly by Risk Management to Executive Committee (as part of the Integrated Risk Report) presenting the evolution of the operational liquidity and summarizing all liquidity measures. Liquidity stress test scenarios are calculated in KBC based on the input from local Risk Management. Results are also presented to the Audit Committee on a quarterly basis.

Response

When the liquidity risk reporting shows e.g. an overdraft of the operational liquidity risk limits, or a deterioration of the long term liquidity position, it's the responsibility of the (internal) stakeholders (i.e. committees receiving this info) to decide on possible remedial actions.

Chapter IX – Appendix

Appendix

Abbreviations

BCBS	Basel Committee of Banking Supervision
CRD	Capital Requirements Directive (2006/48/EC)
HFSA	Hungarian Financial Supervisory Authority (in Hungarian: PSZÁF)
NBH	National Bank of Hungary
SRP	Supervisory Review Process
ICAAP	Internal Capital Adequacy Assessment Process
SREP	Supervisory Review and Evaluation Process
RWA	Risk Weighted Asset
IFRS	International Financial Reporting Standards
HAS	Hungarian Accounting Standards
ACIFE	Act on Credit Institutions and Financial Enterprises (Act No. CXII of 1996)
STA	Standardized approach (credit risk)
IRB	Internal Ratings Based approach (credit risk)
FIRB	Foundation IRB approach (credit risk)
AIRB	Advanced IRB approach (credit risk)
SMA	Standardized Measurement Approach (market risk)
IMA	Internal Models Approach (market risk)
BIA	Basic Indicator Approach (operational risk)
TSA	Standardized Approach (operational risk)
ASA	Alternative Standardized Approach (operational risk)
AMA	Advanced Measurement Approach (operational risk)
PD	Probability of Default
EAD	Exposure at Default
LGD	Loss Given Default
RAROC	Risk Adjusted Return on Capital
ERM	Enterprise-wide Risk Management
MCEER	Management Committee Eastern Europe and Russia
CT	Country Team
BoD	Board of Directors
EXCO	Executive Committee
CROC	Capital and Risk Oversight Committee
CRC	Credit Risk Council
TRC	Trading Risk Council
ORC	Operational Risk Council
VRM	Value and Risk Management
ARC	Audit Committee
CRO	Chief Risk Officer
RC	Remuneration Committee
CrisCo	Crisis Committee
RCC	Retail Credit Committee
RPC	Retail Product Committee
RCs	Retail Committees
NCC	National Credit Committee
NCSC	National Credit Sub-Committee
CIC	Corporate Institutional Committee

Scope of consolidation and participations

Enterprise	Owner "A"	Owner "B"	Direct investment of owner "A"	Direct investment of owner "B"	Total direct and indirect investment	Planning unit?	Status of operation	Classification according to ACIFE
K&H Pannonlizing ZRt.	K&H Bank ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Faktor Zrt.	K&H Bank ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Befektetési Alapkezelő ZRt.	K&H Bank ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Csportszolgáltató Kft.	K&H Bank ZRt.		100,00%		100,00%	yes	active	additional
K&H Equities ZRt.	K&H Bank ZRt.		100,00%		100,00%	yes	active	other
K&H Autópark Kft.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	operative leasing
K&H Autófinanszírozó ZRt.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Eszközfinanszírozó ZRt.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Eszközlizing Kft.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	operative leasing
K&H Lizing ZRt.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Ingatlanlizing ZRt.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	PIBB
K&H Alkusz Kft.	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	active	other
K&H Lizingház ZRt. V.a	K&H Pannonlizing ZRt.		100,00%		100,00%	yes	under dissolution	operative leasing
Kvantum KK Rt. v.a.	K&H Bank ZRt.		100,00%		100,00%	yes	under dissolution	other
GIRO Elszámolásforgalmi ZRt.	K&H Bank ZRt.		20,99%		20,99%	yes	active	PIBB
Risk Kft. f.a.	K&H Bank ZRt.		100,00%		100,00%	no	under liquidation	other
HAGE Hajdúsági Agrárpari ZRt.	K&H Bank ZRt.		25,00%		25,00%	yes	active	other
Bankközi Informatika Szolgáltató ZRt.	GIRO Elszámolásforgalmi ZRt.		100,00%		0,00%	-	-	-
Árpád Üzletház Egyesülés	K&H Bank ZRt.		7,52%		7,52%	-	-	-
SWIFT S.C.	K&H Bank ZRt.		0,024%		0,00%	-	-	-
VISA Inc.	K&H Bank ZRt.		0,043%		0,00%	-	-	-
VISA Europe Limited	K&H Bank ZRt.		0,022%		0,00%	-	-	-
Hitelgarancia ZRt.	K&H Bank ZRt.		13,30%		13,30%	-	-	-
Kisvállalkozás-fejlesztő pénzügyi ZRt.	Hitelgarancia ZRt.		1,47%		0,00%	-	-	-
Garantiqa Pont Zrt.	Hitelgarancia ZRt.		100,00%		0,00%	-	-	-
KA-VOSZ - Garantiqa Zrt	Hitelgarancia Zrt.		6,52%		0,00%	-	-	-
Gyulai Húskombinát ZRt.	HAGE Hajdúsági Agrárpari ZRt.	HAGE Invest Kft.	49,72%	0,76%	0,00%	-	-	-
HAGE Invest Kft.	HAGE Hajdúsági Agrárpari ZRt.	NAGISZ Zrt	95,56%	4,44%	0,00%	-	-	-
NAGISZ ZRt.	HAGE Hajdúsági Agrárpari ZRt.		24,85%		0,00%	-	-	-
BIG-PIG Kft.	HAGE Hajdúsági Agrárpari ZRt.	NAGISZ Zrt	27,95%	49,58%	0,00%	-	-	-
Terményfeltáró Kft.	HAGE Hajdúsági Agrárpari ZRt.		100,00%		0,00%	-	-	-
Nádudvari Élelmiszer Kft.	HAGE Hajdúsági Agrárpari ZRt.	NAGISZ Zrt	47,99%	51,96%	0,00%	-	-	-
Pannon Lúd Kft.	HAGE Hajdúsági Agrárpari ZRt.		4,26%		0,00%	-	-	-
Mastercard	K&H Bank ZRt.		0,054%		0,054%	-	-	-

Table 20: Scope of consolidation and participations (part 1)

K&H Value and Risk Management Division
Basel II – Pillar 3 disclosure
Public



Enterprise	Under the scope of consolidated supervision	Gross direct and indirect investments	Consolidation method according to IAS	Consolidation method according to PSZAF	Cause of exemption/comments	Credit-Capital conversion?	Supervised by corporate?
K&H Pannonzing ZRt.	yes	4 484 844 000	full consolidation	full consolidation		no	
K&H Faktor Zrt.	yes	250 000 000	full consolidation	full consolidation		no	yes
K&H Befektetési Alapkezelő ZRt.	yes	850 000 000	full consolidation	full consolidation		no	
K&H Csportszolgáltató Kft.	yes	60 000 000	full consolidation	full consolidation		no	
K&H Equities ZRt.	yes	25 121 608 177	full consolidation	full consolidation		no	
K&H Autópark Kft.	yes	10 000 000	full consolidation	full consolidation		no	
K&H Autófinanszírozó ZRt.	yes	50 000 000	full consolidation	full consolidation		no	
K&H Eszközfinanszírozó ZRt.	yes	100 000 000	full consolidation	full consolidation		no	
K&H Eszközüzlet Kft.	yes	50 000 000	full consolidation	full consolidation		no	
K&H Lízing ZRt.	yes	50 000 000	full consolidation	full consolidation		no	
K&H Ingatlanlízing ZRt.	yes	50 000 000	full consolidation	full consolidation		no	
K&H Alkusz Kft.	no	22 933 000	full consolidation	not in scope		no	
K&H Lízingház ZRt. V.a	yes	20 000 000	equity method	equity method	Liquidation started in May, 2010	no	
Kvantum KK Rt. v.a.	yes	351 098 462	equity method	equity method	Dissolution is prolonged due to tax dispute	no	
GIRO Elszámolószolgálati ZRt.	no	247 086 667	equity method	not in scope	Pursuant to E-I 59/2005. resolution exempted from consolidated supervision	no	
Risk Kft. f.a.	no	512 940 512	not in scope	not in scope	SzTV 119.par.(1) c.; under liquidation thus the Bank cannot practice its ownership rights; provisioned in 100% (book value:512.942.512 Ft, nominal value: 444.000.000 Ft)	no	
HAGE Hajdúsági Agrárpari ZRt.	no	542 020 693	equity method	not in scope	Bank does not have 25% voting power on parity base	no	yes
Bankközi Informatika Szolgáltató ZRt.	-	-	not in scope	not in scope	participation only through affiliated company	no	
Árpád Üzletház Egyesülés	-	-	not in scope	not in scope	participation below 20%		
SWIFT S.C.	-	-	not in scope	not in scope	participation below 20%	no	
VISA Inc.	-	-	not in scope	not in scope	participation below 20%		
VISA Europe Limited	-	-	not in scope	not in scope	participation below 20%		
Hitelgarancia ZRt.	-	-	not in scope	not in scope	participation below 20%	no	
Kisvállalkozás-fejlesztő pénzügyi ZRt.	-	-	not in scope	not in scope	participation only through affiliated company	no	
Garantiqa Pont Zrt.	-	-	not in scope	not in scope	participation only through affiliated company	no	
KA-VOSZ - Garantiqa Zrt	-	-	not in scope	not in scope	participation only through affiliated company		
Gyulai Húskombinat ZRt.	-	-	not in scope	not in scope	participation only through affiliated company		
HAGE Invest Kft.	-	-	not in scope	not in scope	participation only through affiliated company		
NAGISZ ZRt.	-	-	not in scope	not in scope	participation only through affiliated company		
BIG-PIG Kft.	-	-	not in scope	not in scope	participation only through affiliated company		
Terményfeltáró Kft.	-	-	not in scope	not in scope	participation only through affiliated company		
Nádudvari Élelmiszer Kft.	-	-	not in scope	not in scope	participation only through affiliated company		
Pannon Lúd Kft.	-	-	not in scope	not in scope	participation only through affiliated company		
Mastercard	-	-	not in scope	not in scope	participation below 20% Not booked in GL of the Bank.		

Table 21: Scope of consolidation and participations (part 2)



Detailed breakdown of the total lending portfolio of K&H Bank

Maturity (mln HUF)	CGCB	RGLA	PSE	INST	CORP	RETAIL	SECRE	PDUE	OTHER	TOTAL
<1 year	58 200	9 749	78	47 361	569 781	15 621	1 117	7 546	0	709 453
1 <= to <5 years	0	21 128	1 169	29 882	491 095	8 812	25 648	1 720	0	579 454
5 <= to <10 years	0	7 642	0	9 852	112 655	336	87 008	2 234	0	219 727
10 <= years	1 078 733	84 281	7	66 365	92 031	12 420	570 301	32 469	0	1 936 607
UFN	0	0	0	26 636	12 831	104	0	5 052	94 885	139 507
TOTAL	1 136 933	122 800	1 254	180 096	1 278 393	37 293	684 074	49 021	94 885	3 584 748

Table 22: Breakdown of the lending portfolio of K&H Bank by maturity and asset classes

Code	Continent (mln HUF)	CGCB	RGLA	PSE	INST	CORP	RETAIL	SECRE	PDUE	OTHER	TOTAL
CEE	Central Eastern Europe	1 136 933	122 800	1 254	69 490	1 226 563	37 293	684 074	49 021	94 885	3 422 312
WEU	Western Europe	0	0	0	108 661	46 401	0	0	0	0	155 062
ASIA	Asia	0	0	0	749	5 330	0	0	0	0	6 079
NAM	North America	0	0	0	516	67	0	0	0	0	583
LAM	Latin America	0	0	0	0	0	0	0	0	0	0
MEA	Middle East	0	0	0	10	32	0	0	0	0	42
AFR	Africa	0	0	0	594	0	0	0	0	0	594
AUO	Australia & Oceania	0	0	0	76	0	0	0	0	0	76
TOT	TOTAL	1 136 933	122 800	1 254	180 096	1 278 393	37 293	684 074	49 021	94 885	3 584 748

Table 23: Breakdown of the lending portfolio of K&H Bank by continents and asset classes

Code	Country (mln HUF)	CGCB	RGLA	PSE	INST	CORP	RETAIL	SECRE	PDUE	OTHER	TOTAL
CEE	HUNGARY	1 136 933	115 911	1 086	66 519	1 214 733	37 293	684 074	49 021	94 885	3 400 455
CEE	BELARUS	0	0	0	26	0	0	0	0	0	26
CEE	CROATIA	0	0	0	0	0	0	0	0	0	0
CEE	CZECH REPUBLIC	0	0	0	33	497	0	0	0	0	530
CEE	KAZAKHSTAN	0	0	0	0	0	0	0	0	0	0
CEE	POLAND	0	0	0	97	410	0	0	0	0	507
CEE	ROMANIA	0	0	0	84	10 922	0	0	0	0	11 006
CEE	RUSSIAN FEDERATION	0	6 889	167	550	0	0	0	0	0	7 607
CEE	SERBIA	0	0	0	0	0	0	0	0	0	0
CEE	SLOVAK REPUBLIC	0	0	0	607	0	0	0	0	0	608
CEE	SLOVENIA	0	0	0	1 573	0	0	0	0	0	1 573
CEE	UKRAINE	0	0	0	0	0	0	0	0	0	0

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WEU	AUSTRIA	0	0	0	1 224	0	0	0	0	0	1 224
WEU	BELGIUM	0	0	0	67 131	20 427	0	0	0	0	87 558
WEU	CYPRUS	0	0	0	0	1	0	0	0	0	1
WEU	DENMARK	0	0	0	719	0	0	0	0	0	719
WEU	FRANCE	0	0	0	2 165	852	0	0	0	0	3 017
WEU	GERMANY	0	0	0	5 824	10 402	0	0	0	0	16 227
WEU	GIBRALTAR	0	0	0	0	0	0	0	0	0	0
WEU	IRELAND	0	0	0	0	6 352	0	0	0	0	6 352
WEU	ITALY	0	0	0	0	2 175	0	0	0	0	2 175
WEU	JERSEY	0	0	0	0	0	0	0	0	0	0
WEU	LUXEMBOURG	0	0	0	1 588	0	0	0	0	0	1 588
WEU	MALTA	0	0	0	0	0	0	0	0	0	0
WEU	NETHERLANDS	0	0	0	510	6 192	0	0	0	0	6 702
WEU	NORWAY	0	0	0	265	0	0	0	0	0	265
WEU	SPAIN	0	0	0	114	0	0	0	0	0	114
WEU	SWEDEN	0	0	0	131	0	0	0	0	0	131
WEU	SWITZERLAND	0	0	0	4 947	0	0	0	0	0	4 947
WEU	UNITED KINGDOM	0	0	0	24 043	0	0	0	0	0	24 043
WEU	BRITISH VIRGIN ISL.	0	0	0	0	0	0	0	0	0	0
ASIA	JAPAN	0	0	0	749	0	0	0	0	0	749
ASIA	SINGAPORE	0	0	0	0	5 330	0	0	0	0	5 330
NAM	CANADA	0	0	0	250	0	0	0	0	0	250
NAM	UNITED STATES of AM.	0	0	0	266	67	0	0	0	0	332
NAM	US VIRGIN ISLANDS	0	0	0	0	0	0	0	0	0	0
LAM	BAHAMAS	0	0	0	0	0	0	0	0	0	0
LAM	BELIZE	0	0	0	0	0	0	0	0	0	0
LAM	DOMINICAN REPUBLIC	0	0	0	0	0	0	0	0	0	0
LAM	PANAMA	0	0	0	0	0	0	0	0	0	0
MEA	TURKEY	0	0	0	10	32	0	0	0	0	42
AFR	EGYPT	0	0	0	0	0	0	0	0	0	0
AFR	MOROCCO	0	0	0	558	0	0	0	0	0	0
AFR	NIGERIA	0	0	0	0	0	0	0	0	0	0
AFR	SEYCHELLES	0	0	0	0	0	0	0	0	0	0
AFR	TUNISIA	0	0	0	36	0	0	0	0	0	36
AUO	AUSTRALIA	0	0	0	76	0	0	0	0	0	76
TOT	TOTAL	1 136 933	122 800	1 254	179 538	1 278 393	37 293	684 074	49 021	94 885	3 584 748

Table 24: Breakdown of the lending portfolio of K&H Bank by countries and asset classes



Sector (mln HUF)	CGCB	RGLA	PSE	INST	CORP	RETAIL	SECRE	PDUE	OTHER	TOTAL
Agriculture, Farming & Fishing	0	0	0	0	71 562	0	136	575	0	72 273
Authorities	1 136 933	122 800	1 254	9 006	52 394	0	0	4 678	0	1 327 064
Automotive	0	0	0	0	57 384	0	31	350	0	57 765
Aviation	0	0	0	0	14 568	0	29	0	0	14 596
Beverages	0	0	0	0	11 161	0	0	0	0	11 161
Building & Construction	0	0	0	0	89 392	0	42	475	0	89 908
Chemicals	0	0	0	0	69 646	0	14	120	0	69 780
Commercial Real Estate	0	0	0	0	46 822	0	0	2 067	0	48 889
Consumer Products	0	0	0	0	1 462	0	0	5	0	1 467
Distribution	0	0	0	0	119 525	0	66	2 375	0	121 966
Electricity	0	0	0	0	46 337	0	0	338	0	46 675
Electrotechnics	0	0	0	0	27 695	0	3	16	0	27 713
Finance & Insurance	0	0	0	144 454	283 653	0	0	1	0	428 109
Food Producers	0	0	0	0	47 383	0	0	219	0	47 603
Horeca	0	0	0	0	28 029	0	0	147	0	28 176
IT	0	0	0	0	890	0	0	9	0	899
Machinery & Heavy Equipment	0	0	0	0	13 533	0	0	328	0	13 861
Media	0	0	0	0	1 084	0	17	132	0	1 232
Metals	0	0	0	0	30 935	0	36	72	0	31 043
Oil, Gas & Other Fuels	0	0	0	0	50 912	0	0	2	0	50 914
Paper & Pulp	0	0	0	0	18 428	0	0	0	0	18 428
Privat Individuals	0	1	0	0	94 805	0	17	566	0	95 389
Services	0	0	0	0	1 997	0	0	534	0	2 531
Shipping	0	0	0	0	36 181	0	0	61	0	36 242
Telecom	0	0	0	0	1 848	0	0	29	0	1 876
Textile & Apparel	0	0	0	0	3 094	0	0	72	0	3 166
Timber & Wooden Furniture	0	0	0	0	705	0	0	0	0	705
Tobacco	0	0	0	0	22 441	0	18	95	0	22 554
Traders	0	0	0	0	6 625	0	0	2	0	6 627
Water	0	0	0	0	0	37 189	683 666	30 700	0	751 555
OTHERS	0	0	0	26 636	27 903	104	0	5 052	94 885	154 579
TOTAL	1 136 933	122 800	1 254	180 096	1 278 393	37 293	684 074	49 021	94 885	3 584 748

Table 25: Breakdown of the lending portfolio of K&H Bank by sectors and asset classes



(return)

Detailed breakdown of the lending portfolio of K&H Bank affected by loan loss allowances

Sector (mln HUF)	CGCB	RGLA	PSE	INST	CORP	RETAIL	SECRE	PDUE	OTHER	TOTAL
Agriculture, Farming & Fishing	0	0	0	0	12 035	0	0	1 894	0	13 929
Authorities	0	0	0	0	3 973	0	0	619	0	4 592
Automotive	0	0	0	0	1 326	0	0	0	0	1 326
Aviation	0	0	0	0	2	0	0	0	0	2
Beverages	0	0	0	0	9 075	0	0	8 239	0	17 314
Building & Construction	0	0	0	0	12 534	0	0	309	0	12 844
Chemicals	0	0	0	0	21 962	0	0	5 119	0	27 081
Commercial Real Estate	0	0	0	0	8	0	0	25	0	34
Consumer Products	0	0	0	0	20 688	0	0	8 803	0	29 491
Distribution	0	0	0	0	919	0	0	0	0	919
Electricity	0	0	0	0	316	0	0	407	0	723
Electrotechnics	0	0	0	2 899	0	0	0	769	0	3 669
Finance & Insurance	0	0	0	0	3 618	0	0	758	0	4 376
Food Producers	0	0	0	0	9 561	0	0	236	0	9 797
Horeca	0	0	0	0	0	0	0	18	0	18
IT	0	0	0	0	392	0	0	1 680	0	2 072
Machinery & Heavy Equipment	0	0	0	0	102	0	0	210	0	313
Media	0	0	0	0	7 105	0	0	1 451	0	8 556
Metals	0	0	0	0	0	0	0	4	0	4
Paper & Pulp	0	0	0	0	0	0	0	262	0	262
Privat Individuals	0	0	0	0	0	503	69 951	48 516	0	118 970
Services	0	0	0	0	12 182	0	0	2 308	0	14 490
Shipping	0	0	0	0	303	0	0	269	0	572
Telecom	0	0	0	0	0	0	0	282	0	282
Textile & Apparel	0	0	0	0	90	0	0	106	0	195
Timber & Wooden Furniture	0	0	0	0	465	0	0	289	0	754
Traders	0	0	0	0	210	0	0	244	0	455
OTHERS	0	0	0	0	135	0	0	9 380	34 425	43 940
TOTAL	0	0	0	2 899	117 002	503	69 951	92 199	34 425	316 979

Table 26: Breakdown of the lending portfolio of K&H Bank affected by loan loss allowances by sectors and asset classes (exposures pre credit conversion factors)



Sector (mln HUF)	CGCB	RGLA	PSE	INST	CORP	RETAIL	SECRE	PDUE	OTHER	TOTAL
Agriculture, Farming & Fishing	0	0	0	0	2 725	0	0	1 343	0	4 067
Authorities	0	0	0	0	20	0	0	281	0	301
Automotive	0	0	0	0	135	0	0	0	0	135
Aviation	0	0	0	0	0	0	0	0	0	0
Beverages	0	0	0	0	1 395	0	0	7 826	0	9 221
Building & Construction	0	0	0	0	2 509	0	0	193	0	2 702
Chemicals	0	0	0	0	1 519	0	0	3 316	0	4 836
Commercial Real Estate	0	0	0	0	1	0	0	20	0	21
Consumer Products	0	0	0	0	1 092	0	0	6 519	0	7 611
Distribution	0	0	0	0	533	0	0	0	0	533
Electricity	0	0	0	0	21	0	0	391	0	413
Electrotechnics	0	0	0	522	0	0	0	769	0	1 291
Finance & Insurance	0	0	0	0	911	0	0	549	0	1 460
Food Producers	0	0	0	0	591	0	0	102	0	693
Horeca	0	0	0	0	0	0	0	9	0	9
IT	0	0	0	0	17	0	0	1 359	0	1 376
Machinery & Heavy Equipment	0	0	0	0	1	0	0	80	0	81
Media	0	0	0	0	1 998	0	0	1 397	0	3 395
Metals	0	0	0	0	0	0	0	2	0	2
Paper & Pulp	0	0	0	0	0	0	0	262	0	262
Privat Individuals	0	0	0	0	0	314	5 425	17 996	0	23 736
Services	0	0	0	0	1 765	0	0	1 779	0	3 544
Shipping	0	0	0	0	3	0	0	119	0	121
Telecom	0	0	0	0	0	0	0	221	0	221
Textile & Apparel	0	0	0	0	2	0	0	79	0	81
Timber & Wooden Furniture	0	0	0	0	24	0	0	248	0	272
Traders	0	0	0	0	15	0	0	181	0	195
OTHERS	0	0	0	0	135	0	0	9 379	34 425	43 938
TOTAL	0	0	0	522	15 413	314	5 425	54 421	34 425	110 519

Table 27: Breakdown of the lending portfolio of K&H Bank affected by loan loss allowances by sectors and asset classes (value adjustments and provisions)