Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

ANNUAL REPORT

31 December 2020

CONTENT

Statement of the Issuer

K&H Bank Zrt., as the Issuer (represented by David Moucheron, CEO and Attila Gombás, CFO) hereby declare that the Year 2020 Annual Report and the Year 2020 Consolidated Annual Report of K&H Bank Zrt. have been prepared to the best of the Issuer's knowledge, in compliance with the applicable accounting laws and regulations, and the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profitability of K&H Bank Zrt. and the companies involved in the consolidation, and the Management Report and Consolidated Management Report show a true and fair picture of the position, development and performance of K&H Bank Zrt. and the companies involved in the consolidation, including the major risks and uncertainties factors.

Budapest, April 30 2021

David Moucheron	Attila Gombás
Chief Executive Officer	Chief Financial Officer

KERESKEDELMI ÉS HITELBANK ZÁRTKÖRŰEN MŰKÖDŐ RÉSZVÉNYTÁRSASÁG

ANNUAL FINANCIAL STATEMENTS
PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS
AS ADOPTED BY THE EUROPEAN UNION

FOR THE YEAR ENDED 31 DECEMBER 2020

WITH THE REPORT OF INDEPENDENT AUDITOR

INDEPENDENT AUDITOR'S REPORT
(Free translation)

To the shareholder of K&H Bank Zrt.

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of K&H Bank Zrt. (the "Company which comprise the statement of financial position of 31 December 2020 (in which the total assets is MHUF 4,416,727), the income statement, the statement of comprehensive income (in which the total comprehensive income for the year is MHUF 31,186 profit), the statement of changes in equity, the statement of cash flows for the year then ended and the notes to the financial statements comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2020, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and they have been prepared, in all material respects, in accordance with the supplementary requirements of Act C of 2000 on Accounting ("Accounting Act") relevant for the annual financial statements prepared in accordance with IFRS as adopted by the EU.

Our opinion is consistent with our additional report to the audit committee dated x April 2021.

Basis for opinion

We conducted our audit in accordance with Hungarian National Standards on Auditing ("HNSA") and with applicable laws and regulations in force in Hungary. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the financial statements" section of our report.

We are independent of the Company in accordance with the applicable laws of Hungary, with the Hungarian Chamber of Auditors' Rules on ethics and professional conduct of auditors and on disciplinary process and, for matters not regulated in the Rules, with the International Code of Ethics for Professional Accountants (including International Independence Standards) issued by the International Ethics Standards Board for Accountants (IESBA Code) and we also comply with further ethical requirements set out in these.

The non-audit services that we have provided to the Company, in the period from 1 January 2020 to 31 December 2020, are disclosed in note 40 to the financial statements.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Company are in accordance with the applicable laws and regulations in Hungary and that we have not provided non-audit services that are prohibited under Article 5 of Regulation of the European Parliament and Committee No 537/2014 and Subsection (1) and (2) of Section 67/A of Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors].

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach

Overview

Overall materiality	Overall materiality applied was MHUF 2,739
Key Audit Matters	Impairment on loans and advances measured at amortised cost

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which the Company operates.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Materiality	MHUF 2,739
Determination	5% of the average profit before tax of the last 3 years including this current year.
Rationale for the materiality benchmark applied	We chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Company is most commonly measured by users and is a generally accepted benchmark. We believe that the three-year average of profit before tax is less fluctuating and therefore results in a more stable materiality compared to the consideration of current year profit only. We chose 5%, which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	*How our audit addressed the key audit matter*
Impairment on loans and advances measured at amortised cost The net amount of loans and advances to customers (excluding central bank and credit institution, and general government) was MHUF 1,620,846 as at 31 December 2020, representing 37% of the balance sheet total. Impairment recognised in the balance sheet amounted to MHUF 49,357. The management disclosed the related assumptions, balances and estimates in point 2.3.3 of the notes to the financial statements on accounting policy, as well as in notes 15., 20.,23 and 43.4-43.5. Impairment recognised on expected credit losses is determined on the basis of subjective criteria and management is required to apply significant judgement when calculating individual and collective impairment, especially when considering the current uncertain economic environment as a result of COVID-19 pandemic. The first step in the expected credit loss calculation is to identify whether there was significant increase in credit risk, the selected indicators will determine whether a 12-month or a lifetime expected credit loss is calculated. In the calculation of individual impairment, the most significant uncertainty is involved in the estimation of expected future cash flows, and in probability weighting of cash-flow scenarios, where cash flows include recoveries from both collections of contractual cash flows and from collaterals. The Company applies impairment models to calculate collective impairment. These models quantify the probability of default, exposure at	We understood and evaluated the lending process from disbursement to monitoring and to the calculation of impairment, identified the main control points, and tested their operational effectiveness, including management's approval. Thereby the focus was on adaptations of methods and processes introduced to capture the increased uncertainties of the present and future environment due to the COVID-19 pandemic in expected credit losses. We performed credit review for individually significant loans (on a sample basis) and checked the customer's rating by the Bank based on credit application and/or monitoring documents as well as customer-related financial and non-financial information. For a sample of individually impaired loans, we checked whether assumptions, estimations and scenario weightings applied in calculations of the recoverable amount are reasonable and whether the calculations are correct. When assessing the collective impairment, with the support of our internal modelling expert we assessed the applied methodology, assessed, whether it is in accordance with the standard, reviewed the validation documents, recalculated (on a sample basis) selected model parameters and the impairment and assessed the tool used by the Company to calculate impairment. We checked input data (including both data for modelling parameters and for the impairment calculation), indicators used to determine whether there was significant increase in credit risk and analysed the development of impairment. To address increased estimation uncertainty related to Covid-19, we evaluated the adequacy of credit risk parameters and models taking into consideration possible distortions of currently

default and the loss given default as the primary parameters in the estimation of the recoverable amount, taking into account forward looking information – in line with the requirements of IFRS 9.

The modelling methodologies are developed using historical experience, which - in unprecedented economic conditions that currently vary across customer segments and industry sectors - can result in limitations in their reliability to appropriately estimate ECL.

A further limitation is caused by the fact, that, to reduce the economic consequences of the COVID-19 pandemic, the Hungarian government has introduced loan payment support programs, including moratoria on loan repayment transactions available to and used by a significant portion of debtors. These programs complicate a timely reflection of a potential deterioration of the loan portfolio and result in artificially low observed default rates.

To address these limitations, management applied quantitative and qualitative adjustments to ECL that include the following:

- Adjustment of macroeconomic assumptions and the weighting of the applied scenarios
- Management overlay based on expert-based stress migration matrices taking into account sectoral effects and macroeconomic scenarios

We paid considerable attention to this area during our audit due to the significance of the amounts involved and because of the subjective nature of the judgments and assumptions that management is required to make, particularly due the high level of uncertainty that can be experienced in assessing the economic impact of the COVID-19 pandemic.

observed data due to state payment support programs and critically assessed the plausibility of expectations and estimates, that have been introduced due to aforementioned distortions, to identify significant increases in credit risk of single customers or customer groups.

We read points 2.3.3., 15, 20., 23. and 43.4-43.5 of the notes to the financial statements to assess whether disclosures are in line with applicable regulations.

Other information: the business report

Other information comprises the business report of the Company. Management is responsible for the preparation of the business report in accordance with the provisions of the Accounting Act and other relevant regulations. Our opinion on the financial statements expressed in the "Opinion" section of our independent auditor's report does not cover the business report.

In connection with our audit of the financial statements, our responsibility is to read the business report and, in doing so, consider whether the business report is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If based on our work performed we conclude that the business report is materially misstated we are required to report this fact and the nature of the misstatement.

Based on the Accounting Act, it is also our responsibility when reading the business report to consider whether the business report has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any, and to express an opinion on this and on whether the business report is consistent with the financial statements.

As the Company is a public interest entity and the conditions in Paragraph a) and b) of Subsection (1) of Section 95/C of the Accounting Act are met at the balance sheet date, the Company shall publish a non-financial statement required by 95/C in it's business report. In this respect, we shall state whether the business report includes the non-financial statement required by Section 95/C of the Accounting Act.

In our opinion, the 2020 business report of the Company, is consistent with the 2020 financial statements in all material respects, and the business report has been prepared in accordance with the provisions of the Accounting Act. As there is no other regulation prescribing further requirements for the business report, we do not express an opinion in this respect.

We are not aware of any other material inconsistency or material misstatement in the business report therefore we have nothing to report in this respect.

The business report includes the non-financial statement required by Section 95/C.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with the International Financial Reporting Standards as adopted by the EU and to prepare the financial statements in accordance with the supplementary requirements of the Accounting Act relevant for the annual financial statements prepared in accordance with IFRS as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting in the financial statements unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HNSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with HNSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting in the financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that gives a true and fair view.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

We were first appointed as auditors of the Company on 28 April 2016. Our appointment has been renewed annually by shareholder resolutions representing a total period of uninterrupted engagement appointment of 5 years.

The engagement partner on the audit resulting in this independent auditor's report is Árpád Balázs.

Budapest, 20 April 2021

Árpád Balázs
Partner
Statutory auditor
Licence number: 006931
PricewaterhouseCoopers Könyvvizsgáló Kft.
1055 Budapest, Bajcsy-Zsilinszky út 78.
Licence Number: 001464

Translation note:

Our report has been prepared in Hungarian and in English. In all matters of interpretation of information, views or opinions, the Hungarian version of our report takes precedence over the English version.

CONTENTS OF THE FINANCIAL STATEMENTS

INCOME STATEMENT

	Notes	2020 MHUF	Reclassified 2019 MHUF
Interest and similar income		115 785	100 302
Interest income calculated using the effective interest method	4	99 428	84 640
Other similar income	4	16 357	15 662
Interest and similar expense	4	(27 366)	(20 474)
Net interest and similar income		88 419	79 828
Fee and commission income		86 627	83 645
Fee and commission expense		(22 579)	(21 752)
Net fee and commission income	5	64 048	61 893
Net gains / (losses) from financial instruments at fair value through profit or loss	6	(13 469)	3 896
Foreign exchange differences		32 622	15 743
Net realised gains / (losses) from financial assets at fair value through other comprehensive income	7	215	219
Dividend income	8	2 478	2 676
Gain on the disposal of assets at amortised cost	9	2 685	1 694
Other income	10	1 978	1 302
Other expense	10	(957)	(911)
Total income		178 019	166 340
Operating expenses excluding impairment losses		(105 743)	(105 570)
Staff expenses	11;39	(31 086)	(32 822)
General administrative expenses	11	(55 764)	(55 937)
Depreciation and amortisation of tangible and intangible assets	30;31	(13 185)	(11 282)
Bank tax	12	(5 708)	(5 529)
Impairment on assets:		(27 802)	(2 025)
At amortised cost	23	(23 243)	(1 558)
At fair value through other comprehensive income	22	(11)	24
Other	23	(4 548)	(491)
Modification losses on financial assets at amortized cost	3	(4 400)	-
Profit / (loss) before tax		40 074	58 745
Income tax expense	14	(7 621)	(8 331)
Profit / (loss) after tax		32 453	50 414

Approved by the Board of Directors on 20 April 2021.

David Moucheron	*Attila Gombás*
Chief Executive Officer	*Chief Financial Officer*
Member of the Board	*Member of the Board*

STATEMENT OF COMPREHENSIVE INCOME

	Notes	2020 MHUF	2019 MHUF
Profit / (loss) after tax		32 453	50 414
Other comprehensive income			
Items that may be reclassified to the profit or loss			
Revaluation reserve of debt instruments			
Net gain / (loss) from fair value changes		(470)	2 528
Deferred tax impact on fair value changes	27	51	(274)
Transfer from revaluation reserve to net profit:			
(Losses)/gains on impairment	22	11	(24)
(Losses)/ gains on disposal	7	(215)	(219)
Amortisation of reclassified assets	27	22	26
Deferred income tax			
Cash flow hedge			
Net gain / (loss) from fair value changes	6	(1 398)	4 653
Deferred tax impact on fair value changes	27	126	(419)
Transfer from cash flow hedge reserve to net profit:			
Ineffective part	6;24	115	154
Gross amount	6;24	(385)	(529)
Deferred income tax	27	24	34
Items that will not be reclassified to the profit or loss			
Revaluation reserve of equity instruments			
Net gain / (loss) from fair value changes		812	853
Deferred tax impact on fair value changes	27	43	(92)
Actuarial result on defined benefit plans	39	(3)	8
Deferred income tax	27	-	(1)
Total other comprehensive income / (loss)		(1 267)	6 698
Total comprehensive income		31 186	57 112

Approved by the Board of Directors on 20 April 2021.

David Moucheron *Chief Executive Officer* *Member of the Board*	*Attila Gombás* *Chief Financial Officer* *Member of the Board*

STATEMENT OF FINANCIAL POSITION

	Notes	2020	Reclassified 2019
		MHUF	MHUF
ASSETS			
Cash and cash balances with central banks and other demand deposits with credit institutions		391 045	413 502
Cash		71 154	54 226
Cash balances with central banks	15;18;20	184 099	272 000
Other demand deposit with credit institutions	15;18;20	135 792	87 276
Financial assets		3 872 717	3 004 660
Held for trading	15;18;20;24	67 202	77 026
of which assets pledged as collateral	*15*	*1 802*	-
Mandatorily at fair value through profit or loss	15;18-20	139 570	67 016
At fair value through other comprehensive income	15;18;20	112 299	93 040
of which assets pledged as collateral	*15*	*24 226*	*21 599*
At amortised cost	15;18;20	3 528 181	2 738 071
of which assets pledged as collateral	*15*	*432 482*	*279 115*
Hedging derivatives	24	25 465	29 507
Fair value changes of hedged item under portfolio hedge of interest rate risk	24	17 841	19 042
Tax assets		3 058	2 505
Current tax assets		3 058	2 505
Deferred tax assets	27	-	-
Investments in subsidiaries and associated companies	28	12 410	12 202
Investment property	29	1 536	1 874
Property, plant and equipment	30	47 458	50 556
Intangible assets	31	46 441	30 422
Non-current assets held for sale and disposal groups	25	1 474	-
Other assets	26	22 747	19 416
Total assets		4 416 727	3 554 179
LIABILITIES AND EQUITY			
Financial liabilities	15;18;20	3 949 854	3 118 453
Held for trading	15;18;20	64 168	61 193
Designated at fair value through profit or loss	15;18;20	33 051	52 614
Measured at amortised cost	15;18;20	3 828 270	2 979 625
Hedging derivatives	24	24 365	25 021
Fair value changes of hedged item under portfolio hedge of interest rate risk	24	14 614	15 827
Tax liabilities		1 184	1 226
Current tax liabilities		991	401
Deferred tax liabilities	27	193	825
Provisions for risks and charges and credit commitments	32	2 844	1 851
Other liabilities	33	60 138	59 915
Total liabilities		4 028 634	3 197 272
Share capital	34	140 978	140 978
Share premium		48 775	48 775
Accumulated profit		156 362	125 945
Other reserves		41 978	41 209
Total equity	44	388 093	356 907
Total liabilities and equity		4 416 727	3 554 179

Approved by the Board of Directors on 20 April 2021.

David Moucheron
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer
Member of the Board

STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory risk reserve	Revaluation reserve of securities	Cash flow reserve	Other revalu-ation reserves	Retained earnings	Total equity
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
2019								
Balance at the beginning of the period	140 978	48 775	23 335	3 919	2 157	59	83 572	302 795
Net profit for the year	-	-	-	-	-	-	50 414	50 414
Other comprehensive income for the period (Note 6)	-	-	-	2 798	3 893	7	-	6 698
Total comprehensive income	-	-	-	2 798	3 893	7	50 414	57 112
Dividend paid	-	-	-	-	-	-	(3 000)	(3 000)
Transfer from retained earnings to statutory risk reserve (Note 44)	-	-	5 041	-	-	-	(5 041)	-
Total change	-	-	5 041	2 798	3 893	7	42 373	54 112
Balance at the end of the period	140 978	48 775	28 376	6 717	6 050	66	125 945	356 907
of which revaluation reserve for shares (Note 15)	-	-	-	*1 416*	-	-	-	
of which revaluation reserve for bonds (Note 15)	-	-	-	*5 301*	-	-	-	
2020								
Balance at the beginning of the period	140 978	48 775	28 376	6 717	6 050	66	125 945	356 907
Net profit for the year	-	-	-	-	-	-	32 453	32 453
Other comprehensive income for the period (Note 6)	-	-	-	254	(1 518)	(3)	-	(1 267)
Total comprehensive income	-	-	-	254	(1 518)	(3)	32 453	31 186
VISA conversion (Note 7)	-	-	-	(1 209)	-	-	1 209	-
Transfer from retained earnings to statutory risk reserve (Note 44)	-	-	3 245	-	-	-	(3 245)	-
Total change	-	-	3 245	(955)	(1 518)	(3)	30 417	31 186
Balance at the end of the period	140 978	48 775	31 621	5 762	4 532	63	156 362	388 093
of which revaluation reserve for shares (Note 15)	-	-	-	*1 062*	-	-	-	*1 062*
of which revaluation reserve for bonds (Note 15)	-	-	-	*4 700*	-	-	-	*4 700*

Other revaluation reserves include own credit risk adjustments and the actuarial result on defined benefit plans. No dividend was paid on ordinary shares in 2020 (HUF 3 000 million dividend - 0.021280 HUF/share - was paid in 2019. See Note 44 for dividend proposed on ordinary shares in 2020.

Approved by the Board of Directors on 20 April 2021

David Moucheron
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer
Member of the Board

NOTES TO THE FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS

	Notes	2020	Reclassified 2019
		MHUF	MHUF
OPERATING ACTIVITIES			
Profit / (loss) before tax		40 074	58 745
Adjustments for:			
Interest and similar income	4	(115 785)	(100 302)
Interest and similar expense	4	27 366	20 474
Net transfer from revaluation reserve of securities	7	204	243
Net transfer from cash flow hedge reserve	6	270	375
Depreciation and impairment of property, plant and equipment, intangible assets, financial assets at fair value through other comprehensive income and other assets	30;31	17 732	11 774
(Profit)/Loss on the disposal of property, plant and equipment	9	(121)	(102)
(Profit)/Loss on the disposal of investment property	9	(403)	(352)
Change in impairment on financial assets values at amortised cost*	23	23 243	1 558
Change of modification result on financial assets at amortized cost		4 400	-
Change in other provisions	32	1 063	382
Unrealised valuation differences	6	(3 861)	3 639
Cash flows from operating profit / (loss) before tax and before changes in operating assets and liabilities		(5 818)	(3 566)
Changes in financial assets held for trading		15 522	(16 610)
Changes in financial assets mandatorily valued at fair value through profit or loss		(66 123)	(48 018)
Changes in financial assets valued at fair value through other comprehensive income		(19 907)	5 751
Changes in financial assets valued at amortised cost		110 796	(166 162)
Changes in other assets		900	(7 590)
Changes in operating assets		41 188	(232 629)
Changes in financial liabilities held for trading		(6 478)	9 035
Changes in financial liabilities designated at fair value through profit or loss		(18 665)	(22 917)
Changes in financial liabilities measured at amortised cost		682 017	306 815
Changes in other liabilities		(217)	(24 875)
Changes in operating liabilities		656 657	268 058
Income taxes paid		(7 987)	(7 855)
Interest received		98 460	103 267
Interest paid		(27 529)	(21 667)
Net cash from/(used in) operating activities		754 972	105 608

* Including impairments on loan commitments.

STATEMENT OF CASH FLOWS (continued)

	Notes	2020 MHUF	2019 MHUF
INVESTING ACTIVITIES			
Purchase of securities at amortised cost		(253 300)	(252 787)
Proceeds from the repayment at maturity of securities at amortised cost		58 609	68 778
Capital increase in subsidiary		-	(1 000)
Proceeds from the disposal of a subsidiary or business unit, net of cash disposed		-	11
Dividends received		2 478	2 676
Purchase of intangible assets	31	(24 294)	(14 944)
Purchase of property, plant and equipment	30	(9 457)	(21 556)
Proceeds from the sale of property, plant and equipment	30	362	210
Proceeds from the sale of Non-current assets held for sale and disposal groups		-	-
Purchase of investment property	29	(376)	(804)
Proceeds from the sale of investment property	29	1 353	1 012
Net cash from/(used in) investing activities		(224 625)	(218 404)
FINANCING ACTIVITIES			
Repayment of principal of lease liabilities		(2 827)	(1 699)
Dividend paid		-	(3 000)
Net cash from/(used in) financing activities		(2 827)	(4 699)
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents		527 519	(117 495)
Net foreign exchange difference		642	(4 957)
Cash and cash equivalents at beginning of the period		289 788	412 240
Cash and cash equivalents at end of the period		817 949	289 788

STATEMENT OF CASH FLOWS (continued)

	Notes	2020 MHUF	2019 MHUF
OPERATING CASH FLOWS FROM DIVIDENDS			
Dividends received	8	2 478	2 676
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash and cash balances with central banks and other demand deposits with credit institutions		391 045	413 502
Loans and advances to banks repayable on demand and term loans to banks < 3 months	15	721 305	1 639
Deposits from banks repayable on demand and redeemable at notice	15	(294 401)	(125 353)
Total cash and cash equivalents		817 949	289 788

Loans and advances to banks repayable on demand and term loans to banks < 3 months are recorded as Financial assets at amortised cost in the statement of financial position. Deposits from banks repayable on demand and redeemable at notice are presented as financial liabilities measured at amortised cost.

The Bank uses the indirect method for presentation of cash flows resulting from operating activities.

Approved by the Board of Directors on 20 April 2021.

David Moucheron	*Attila Gombás*
Chief Executive Officer	*Chief Financial Officer*
Member of the Board	*Member of the Board*

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – GENERAL

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság ("K&H Bank Zrt." or "the Bank") is a limited liability company incorporated in Hungary. The Bank provide banking services through a nation-wide network of 204 branches. As at 31 December 2020 the Bank's registered office was at Lechner Ödön fasor 9, Budapest. Website: www.kh.hu.

The parent company of the Bank is KBC Bank N.V. The ultimate parent is KBC Group N.V.

David Moucheron Chief Executive Officer (Budapest) and Attila Gombás Chief Financial Officer (Budapest) are obliged to sign these financial statements.

The Bank is required to have its accounts audited under applicable law.

Person in charge of accounting tasks: Ecsedi Paula (Budapest), registration number: 140573.

NOTE 2 – ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of these financial statements are summarised below.

2.1 Basis of presentation

The financial statements have been prepared under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of financial instruments categorised at fair value through profit or loss ("FVTPL") and at fair value through other comprehensive income ("FVOCI"). The carrying values of recognized assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortised cost, are adjusted to record changes in fair value attributable to the risk that are being hedged.

The Bank maintains its accounting records and prepares its statutory accounts in accordance with commercial banking and fiscal regulations prevailing in Hungary. The Bank's functional currency is the Hungarian Forint ("HUF"). All balances are presented in millions of Hungarian Forints ("MHUF") unless otherwise stated. The tables in this report may contain rounding differences.

The accounting policies are consistent with those applied in prior year.

2.1.1 Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and all applicable IFRSs that have been adopted by the EU.

The Bank prepares consolidated annual financial statements according to the same accounting framework as the separate annual financial statements. The Bank's separate and consolidated annual financial statements are approved and published on the same day.

2.2 Significant accounting judgements and estimates

In the process of applying the Banks' accounting policies, Management has used its judgements and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgements and estimates are as follows:

<u>Fair value of financial instruments</u>

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. An imbalance between supply and demand (e.g. fewer buyers than sellers, thereby forcing prices down) is not the same as a forced transaction or distress sale.

NOTE 2 – ACCOUNTING POLICIES (continued)

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The judgements include considerations of liquidity and model inputs such as correlation and volatility for longer dated derivatives. For the sensitivity of the judgements used for fair value calculation see Note 18 and Note 43.3.

Allowance for impairment of loans and advances, loss allowances of contingent liabilities and provision for commitments

The impairment allowances of loans and advances and loss allowances of contingent liabilities are determined based on the expected credit losses (ECL). Calculating ECL requires significant judgments on different aspects for example, but not limited to, the borrowers' financial position and repayment capabilities, the value and recoverability of collaterals, forward looking and macroeconomic information. The Bank applies neutral and free from bias approach when dealing with uncertainties and making decisions based on significant judgments.

The Bank regularly reviews its loans and advances, contingent liabilities and its commitments to assess impairment and provision. The Bank applies its judgement on the basis of experience to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and where there is little available historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of amortised cost assets. Refer to Note 23 for further details.

In cases when the historical loss experience is not able to capture all the specific risks (e.g.: COVID-19 related crisis) expert-based calculation at portfolio level is performed via a management overlay. For further details of the effect of the Covid-19 crises see Note 3.

Provision for litigations and claims

The amount of provision required to meet losses incurred as a result of litigations and claims is another principal area of estimation uncertainty in these financial statements. Refer to Note 32 for further details.

2.3 Significant accounting policies

2.3.1 Foreign currency translation

The functional and presentational currency of the Bank is HUF. Monetary assets and liabilities denominated in foreign currencies are translated into HUF at exchange rates quoted by the National Bank of Hungary as at the date of the statement of financial position. Negative and positive exchange rate differences are recognized in the income statement. Exceptions to the above general rule are the cases when a monetary asset or liability is involved in a cash flow hedge relationship as a hedging instrument and in accordance with the hedging documentation the foreign exchange translation difference of the hedging instrument is recognized as other comprehensive income. Non-monetary items are translated into the functional currency at a historical exchange rate as at the date of transaction. Non-monetary items measured at FV through OCI, which are denominated in foreign currencies, are translated into HUF at exchange rates quoted by the National Bank of Hungary as at the date of the statement of financial position and recorded as foreign exchange differences in the income statement. Income and expenses arising in foreign currencies are converted at the rate of exchange on the transaction date. Resulting foreign exchange gains or losses are recorded in the income statement on line foreign exchange differences.

2.3.2 Financial assets

The Bank applies all the requirements of IFRS 9 as from 1 January 2018, except for the hedge accounting transactions which continued to be accounted for in accordance with IAS 39.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.2.1 Financial assets – recognition and derecognition

2.3.2.1.1 Recognition

Financial assets and liabilities are recognised in the statement of financial position when the Bank becomes a party to the contractual provisions of the instruments. Regular-way purchases or sales of financial assets are recognised using settlement date accounting. All financial assets are measured initially at fair value plus transaction costs that are directly attributable to its acquisition; with the exception of financial assets measured at fair value through profit or loss.

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the Bank recognises the difference as follows:

- When the transaction price in a non-active market differs from the fair value of other observable market transactions in the same instrument or from the fair value based on a valuation technique whose variables include only data from observable markets, the difference between the transaction price and the fair value (day 1 profit) is taken to profit or loss.
- If this is not the case (i.e. the variables do not include only data from observable markets), day 1 profit is deferred and is released in profit or loss during the life and until the maturity of the financial instrument.

2.3.2.1.2 Derecognition and modification

The Bank derecognises a financial asset when the contractual cash flows from the asset expire or the Bank transfers its rights to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred.
In specific transactions like repurchase agreements and securities lending and borrowing the Bank assesses the transfer of the risks and rewards based on the applicable facts and circumstances and on the predetermined repurchase price. When this indicates that the Bank has retained substantially all risks and rewards then financial assets and liabilities are not derecognised but the relating consideration or financial assets received/paid are presented as separate financial liability/asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Repo and reverse repo agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognized in the statement of financial position and are measured in accordance with accounting policies for trading securities or investment securities if the repurchase price is not fair value at the time of reacquisition. The counterparty liability for amounts received under these agreements is included in financial liabilities measured at amortised cost. The difference between sale and repurchase price is treated as interest expense and accrued over the life of the repo agreement. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognized in the statement of financial position, as the Bank does not obtain control over the assets. Amounts paid under these agreements are included in financial assets at amortised cost. The difference between purchase and resale price is treated as interest income and accrued over the life of the reverse repo agreement.

Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Securities borrowed are not recognized on the statement of financial position, unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gain or losses included in Net gains / (losses) from financial instruments at fair value through profit or loss.

NOTE 2 – ACCOUNTING POLICIES (continued)

When during the term of a financial asset there is a change in the terms and conditions, then the Bank assesses whether the new terms are substantially different to the original terms indicating that the rights to the cash flows of the initial instruments have expired. In case the conclusion is that the terms are substantially different then the transaction is accounted for as financial asset derecognition, which requires derecognising the existing financial asset and recognising a new financial asset based on the revised terms. Conversely, when the Bank assesses that the terms are not substantially different than the transaction is accounted for as financial asset modification.

Renegotiated loans

Where possible, the Bank seeks to renegotiate loans rather than to take possession of collateral.

The Bank considers a loan (receivable) renegotiated if the loan or credit arrangements are renegotiated, rescheduled (prolonged) and renegotiated upon the debtor's or the financial institution's initiative, within the framework of the amendment of the underlying contract, where the underlying contract is amended with a view to avoiding default because of the considerable deterioration in the financial condition or solvency of the borrower, on account of which he is unable to meet the obligations of repayment as originally contracted. Such amendments result in significant changes in the terms and conditions of the underlying contract, bringing considerably more favourable terms for the client - by way of derogation from the market conditions pertaining to contracts of the same type bearing similar terms and conditions.

The assessment of the substantially different terms is made when loans to customers are renegotiated or otherwise modified. In considering the substantially different terms, the Bank evaluates whether:

- The borrower has changed;
- The loan has been partially written off because the Bank estimates that the part or entirety of the loan became irrecoverable;
- Changes made to a loan or loans of the same borrower resulted in refinancing or consolidation of the loans into a new loan;
- Due to significant financial difficulty of the borrower, the Bank has granted more than one concession;
- Substantial new terms have been introduced, such as profit share/equity-based return significantly modifying the risk profile of the loan;
- The nature of the interest rate or the reference rate has significantly changed;
- The currency of the contract has changed.

The amendments are representing, among others, the deferral of repayments (interest and/or principal) temporarily for a specific period (grace period), payment by instalments, modification of interest rates (for example repricing in the form of discount rates), capitalization of interest, changing the type of currency of denomination, extending the term of the loan, rescheduling instalment payments, reducing the level of collateralization or the level of security requested, or allowing other form of collateral or security, waiving the collateral or security requirement (non-collateralization), introducing new contract terms and conditions or eliminating certain existing terms and conditions. Furthermore a supplementary agreement or a new contract may be concluded between the debtor and the Bank, or between the borrower and an affiliate of the original lender, for a new loan for refinancing the debts (interest and principal) outstanding on account of the existing contract, or for undertaking additional commitments with a view to avoiding any further increase in risk exposure or to cutting losses, upon which the claims of the Bank (including the financial institution participating as the affiliate of the original lender) arising on account of the aforesaid supplementary agreement or new contract are also recognized as renegotiated loans (receivables).

The terms are considered as substantially different in any case if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial asset.

NOTE 2 – ACCOUNTING POLICIES (continued)

The process of financial asset modification requires adjusting the carrying amount of the previously recognised financial asset in order to reflect the changed terms on the contractual cash flows. In doing that the Bank recalculates the gross carrying amount of the financial asset and recognises a modification gain or loss presented separately in the income statement. The carrying amount of the financial asset is recalculated as the present value of the estimated future cash payments through the expected life of the changed terms that are discounted at the financial asset's original effective interest rate. Any costs or fees incurred as part of the modification shall adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Loans where the relevant contract had to be amended due to changes in market conditions are not considered as renegotiated loans (receivables), furthermore, where the parties agree in market conditions pertaining to similar agreements and where the solvency of the debtor is such as to ascertain his ability to comply with his ensuing contractual obligations.

If the renegotiation does not result in derecognition, the impact of modification will be presented as change in the assets' effective interest rate or change in gross carrying amount. The effect of contract modification on gross carrying amount is presented as modification losses on financial assets at amortized cost in the income statement (see Note 3).

Derecognition of renegotiated loans

For derecognition of the renegotiated loans the Bank applies the following criteria. An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial asset and the recognition of a new financial asset. A substantial modification of the terms of an existing financial asset or a part of it is accounted for as an extinguishment of the original financial asset and the recognition of a new financial asset.

If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the asset and are amortised over the remaining term of the modified liability.

2.3.2.1.3 Write-offs

A write-off is a direct reduction of the gross carrying amount of a financial asset when the Bank has no reasonable expectations of recovering the financial asset on its entirety or a portion thereof. A write-off constitutes a derecognition event.
Write-offs do not constitute a debt forgiveness and the Bank retains its legal enforceable rights towards the borrower until the official legal proceedings have concluded otherwise.

2.3.2.2 Equity and debt instruments classification

On initial recognition of a financial asset, the Bank first assesses the contractual terms of the instrument in order to classify it as an equity or debt instrument. An equity instrument is defined as any contract that evidences a residual interest in another entity's net assets. In order to satisfy this condition, the Bank reviews whether the instrument includes no contractual obligation for the issuer to deliver cash or exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
Any instruments which do not meet the criteria of equity instruments are classified as debt instruments by the Bank.

2.3.2.2.1 Classification and measurement – debt instruments

When the Bank concludes that the financial asset is a debt instrument then on initial recognition, it can be categorised in one of the following categories:

- Mandatorily measured at fair value through profit or loss (FVPL);
- Designated at initial recognition at fair value through profit or loss (FVO);
- Fair value through other comprehensive income (FVOCI);
- Amortised cost (AC)

NOTE 2 – ACCOUNTING POLICIES (continued)

Debt instruments have to be classified in the FVPL category when (i) they are not held in business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets or alternatively (ii) they are held in such business model but the contractual terms of the instrument give rise on specified dates to cash flows that are not solely payments of principal and interest on the principal amount outstanding.

Further, the Bank may in some cases, on initial recognition, irrevocably designate a financial asset that otherwise meets the requirements to be measured at AC or at FVOCI as at fair value (FVO) if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVO:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets;
- and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument is measured at AC only if it meets both of the following conditions and is not designated as at FVO:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows;
- and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

2.3.2.2.2 Business model assessment

The business model assessment is relevant for debt instruments to assess whether they are allowed to be measured at AC and FVOCI. In performing the assessment, the Bank reviews the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to key management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or whose performance is evaluated on a fair value basis are measured at FVPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

2.3.2.2.3 Assessment whether contractual cash flows are solely payments of principal and interest (SPPI)

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

NOTE 2 – ACCOUNTING POLICIES (continued)

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

2.3.2.2.4 Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets which could occur when the Bank begins or ceases to perform an activity that is significant to its operations (e.g.: when the Bank acquires, disposes of, or terminates a business line). The reclassification takes place from the start of the first reporting period following the change.

2.3.2.2.5 Classification and measurement – Equity instruments

Financial equity instruments are categorised in one of the following categories:

- Mandatorily measured at fair value through profit or loss (FVPL);
- Equity instruments elected for fair value through other comprehensive income (FVOCI).

For investments in subsidiaries and affiliated undertakings the rules defined in Section "Participations" apply.

In the banking activity all equity instruments is included in the FVOCI category when the investment is not held for trading. This is a specific designation that is be made on a case-by-case basis, applicable to strategic investments. The election to include equity instruments in the FVOCI category is irrevocable on initial recognition and can be done on an investment-by-investment basis which is interpreted by the Bank as share-by-share basis. Equity categorised in the FVOCI category is subsequently measured at fair value with all changes recognised in other comprehensive income and without any recycling into the income statement even when the investments is disposed. The only exception applies to the dividend income which are recognised in the income statement.

2.3.2.2.6 Classification and measurement - Derivatives

The Bank can recognise derivative instruments either for trading purpose or as hedging derivatives. Derivatives can have asset or liability positions depending on their actual market value.

Trading derivatives

Derivative instruments are always measured at fair value and the Bank makes a distinction as follows:

- Derivatives that are held with a hedging intent but for which hedge accounting cannot be or is not applied (economic hedge): hedging instruments can be acquired with the intention of economically hedging an external exposure but without the application of hedge accounting. The interest component of these derivatives is recognised under 'Net interest income', while all other fair value changes are recognised under 'Net result from financial instruments at fair value through profit or loss'.
- Derivatives held without hedging intent (trading derivative): the Bank can also enter into a derivative position without any intention to hedge economically a position. Such activity can relate to closing / selling an external position in the near term or for short-term profit taking purposes. All fair value changes on such derivatives are recognised under 'Net result from financial instruments at fair value through profit or loss'.

NOTE 2 – ACCOUNTING POLICIES (continued)

Hedging derivatives

Hedging derivatives are derivatives which are specifically designated in a hedge relationship. The accounting process of such derivatives are detailed in the section "Hedge Accounting".

2.3.2.3 Fair value hierarchy of financial instruments

The fair value measurements are classified into the levels of fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1	quoted prices (unadjusted) in active markets for identical assets or liabilities
Level 2	inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
Level 3	inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement.

The Bank assesses the significance of fair value adjustments at portfolio level in function of the proportion of the fair value adjustment relative to the size of the underlying portfolio. A fair value adjustment related to the unobservable input is considered to be material for the Bank if this fair value adjustment makes up at least 5% of the nominal exposure of the underlying portfolio.

The amount of the fair value which is calculated on transaction level is adjusted (MVA - Market Value Adjustment) by the Bank taking into account the elements listed below. The adjustment according to the following elements is calculated by instrument / transaction types or on customer level:
- close-out cost of the transactions,
- funding value adjustment,
- illiquidity of the markets,
- counterparty risk.

Changes to the fair value classification

The classification of a financial instrument into the fair value hierarchy is not static. Financial instruments can shift between different fair value levels for various reasons, for instance:

- Market changes: The market can become inactive. As a result, previously observable parameters can become unobservable (possible shift from level 1 to level 2 or 3);
- Model changes: The application of a new refined model that takes more observable input factors into account or reduces the fair value impact of unobservable inputs (possible shift from level 3 to level 2);
- Change in sensitivity: The sensitivity of a valuation input to the entire fair value may change over time. An unobservable input that used to be significant to the entire fair value measurement may become insignificant (or vice versa). The fair value classification in the hierarchy would consequently change from level 3 to level 2 (or vice versa).

Defining the fair value classification of a financial instrument can only be made taking into account changing market circumstances, upgraded models and the sensitivity of the valuation inputs. With this regard, the fair value classification per instrument/portfolio is reassessed by the Bank on a regular basis.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.3 Financial assets - Impairment

2.3.3.1 Definition of default

The Bank uses the definition for defaulted financial assets which is used for internal risk management purposes and it is in line with guidance and standards of the financial industry regulators. A financial asset is considered as defaulted if one or more of the following conditions are fulfilled:

- A significant deterioration in creditworthiness
- The asset is flagged as non-accrual
- The asset is flagged as a forborne asset in line with the internal policies for forbearance specified as stage 3 forborne
- Liquidation proceedings have been initiated against the client
- The counterparty has filed for bankruptcy or sought similar protection measures.
- The credit facility towards the customer is terminated.

The Bank applies a backstop for facilities that have at least 90 days past due status. In this context a backstop is used as a final control to ensure that all the assets that should have been designated as defaulted, are properly identified.

2.3.3.2 Expected credit loss model

The model for impairment of financial assets is called the Expected Credit Loss model (ECL). The scope of the ECL model is based on the classification of financial assets. The ECL model is applicable to the following financial assets:

- Financial assets measured at amortised cost;
- Debt instruments measured at fair value through the other comprehensive income;
- Loan commitments and financial guarantees;
- Finance lease receivables; and
- Trade and other receivables.

No ECL are calculated for equity investments. Financial assets that are in scope for the ECL carry an amount of impairments equal to the life-time ECL if the credit risk has increased significantly since initial recognition. If the credit risk has not increased significantly since initial recognition, the loss allowance equals to an amount of 12 month ECL (see below for the references to the significant increase in credit risk).
To distinguish between the different stages with regards the amount of ECL, the Bank uses the internationally accepted terminology for stage 1, stage 2 and stage 3 financial assets.

All financial assets at initial recognition, unless they are already credit impaired, are classified at stage 1 and carry 12 month ECL. Once a significant increase in credit risk since initial recognition occurs, the asset migrates to stage 2 and carries life-time ECL. Once an asset meets the definition of default it migrates to stage 3.

IFRS 9 allows for a practical expedient for leasing and trade receivables. The ECL for trade receivable are measured in an amount equal to the life-time ECL. The Bank applies this practical expedient for trade receivables.

Impairment gains and losses on financial assets are recognised under the heading “Impairments” in the income statement.

Financial assets that are measured at amortised cost are presented on the statement of financial position at their carrying amount being the gross carrying amount minus loss allowances. Debt instruments measured at fair value through other comprehensive income are presented on the statement of financial position at their carrying amount being the fair value at the reporting date. The adjustment for the ECL is recognised as a reclassification adjustment between the income statement and the other comprehensive income. For loan commitments and financial guarantees a provision for ECL is recognized as liability.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.3.3 Significant increase in credit risk since initial recognition

In accordance to the ECL model, a financial assets attracts life-time ECL once the credit risk has increased significantly since initial recognition; therefore the assessment of the significant increase in credit risk defines the staging of financial assets. The assessment of a significant increase in credit risk is a relative assessment based on the credit risk that was assigned at initial recognition. This is a multi-factor assessment, and, thus the Bank has developed a multi-tier approach (MTA).

2.3.3.3.1 Multi-Tier Approach – Bond portfolio

For the bond portfolio the MTA consists of three tiers:

- Low credit exception: Bonds always carry 12-months ECL if they have a low credit risk at the reporting date (i.e. stage 1). The Bank uses the low credit risk exception for bonds which are graded as investment grade.
- Internal rating: only applicable if the first tier is not met. This is a relative assessment comparing the Probability of Default (PD) at initial recognition to the PD at the reporting date. The Bank makes the assessment on a facility level at each reporting period.
- Management assessment: Finally management reviews and assesses the significant increase in credit risk for financial assets at an individual and a portfolio level.

If none of these triggers results in a migration to stage 2, then the bond remains in stage 1. A financial asset is considered impaired (i.e. stage 3) as soon as it meets the definition of default. The MTA is symmetrical, i.e. a credit that has migrated to stage 2 or 3 can return to stage 2 or 1 if the Tier that triggered the migration is not present in a subsequent reporting date.

2.3.3.3.2 Multi-tier approach – Loan portfolio

For the loan portfolio the Bank uses a five-tier approach. This MTA is a waterfall approach, i.e. if after assessing the first Tier, doesn't result in migrating to stage 2, then the second Tier is assessed and so on. At the end, if all Tiers are being assessed without triggering a migrations to stage 2, then the financial asset remains in stage 1.

- Internal rating: the internal rating is used as the main criterion for assessing the increase in credit risk. This is a relative assessment comparing the PD at initial recognition to the PD at the reporting date. The Bank makes the assessment on a facility level at each reporting period.
- Forbearance: Forborne financial assets are always considered as stage 2, unless they are already impaired. In the latter case, they migrate to stage 3.
- Days past due: the Bank uses the backstop described in the standard. A financial asset that has more than 30 days past due, migrates to stage 2.
- Internal rating backstop: the Bank uses an absolute level of PD as a backstop for financial assets to migrate to stage 2. This backstop corresponds to the highest PD (i.e. PD9 based on the Bank internal rating) before a financial asset is considered to be impaired.
- Management assessment: Finally management reviews and assesses the significant increase in credit risk for financial assets at an individual and a portfolio level.

A financial asset is considered impaired (i.e. stage 3) as soon as it meets the definition of default. The MTA is symmetrical, i.e. a credit that has migrated to stage 2 or 3 can return to stage 2 or 1 if the Tier that triggered the migration is not met at the reporting date. For Covid-19 related details, please refer to Note 3.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.3.4 Measurement of ECL

The ECL is calculated as the product of the probability of default (PD), the estimated exposure at default (EAD) and the loss given default (LGD).

The ECL are calculated in a way that reflect:
- an unbiased, probability weighted amount;
- the time value of money; and
- information about the past events, current conditions and forecast economic conditions.

The life-time ECL represents the sum of the ECL over the life time of the financial asset discounted at the original effective interest. The 12 months ECL represent the portion of the life time ECL that results from a default in 12-month period after the reporting date.

The Bank uses specific IFRS 9 models for PD, EAD and LGD to calculate ECL. To the extent possible the Bank uses similar modelling techniques that have been developed for prudential purposes (i.e. Basel models) for efficiency purposes. Having said that, the Bank ensures that the Basel models are adapted to be in compliance with IFRS 9, for example:
- the Bank removes the conservatism which is required by the regulator for Basel models
- the Bank adjusts the way that macroeconomic parameters affect the outcome to ensure that the IFRS 9 models reflect a “point-in-time” rather than “through-the-cycle” estimate (the latter is required by the regulator).
- the Bank applies forward looking macroeconomic information in the models.

The Bank also considers three different forward looking macro-economic scenarios with different weights in the calculation of ECL. The base case macro-economic scenario represents the Bank’s estimations for the most probable outcome and it also serves as a primary input for other internal and external purposes.
The maximum period for measurement of the ECL is the maximum contractual period (including extensions) with the exception of specific financial assets which include a drawn and an undrawn amount available on demand which is not limited the exposure to the contractual period. Only for such assets a measurement period can extend beyond the contractual period.

2.3.3.5 Purchased or originated credit impaired (POCI)

The Bank defines POCI assets as financial assets in scope of the IFRS 9 impairment which at origination are already defaulted (i.e. meet the definition of default).
POCI assets are recognised initially at an amount net of impairments and are measured at amortised cost using a credit adjusted effective interest rate. In subsequent period any changes to the estimated lifetime ECL are recognised in the income statement. Favourable changes are recognised as an impairment gain even if the lifetime ECL at the reporting date is lower than the estimated lifetime ECL at origination.

2.3.4 Cash, cash balances with central banks and other demand deposits

Cash comprises cash on hand and demand deposits, e.g. cheques, petty cash and central bank balances as well as other bank balances. For the purposes of reporting cash flows, cash and cash equivalents comprise balances with an original maturity less than 90 days, including cash, balances due from banks and balances with the National Bank of Hungary (including obligatory reserves) decreased with deposits from banks repayable on demand.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.5 Financial liabilities

Financial instruments or their component parts are classified as liabilities or as equity in accordance with the substance of the contractual arrangements on initial recognition and the definitions of financial liabilities and equity instruments. A financial instrument is classified as a liability if:

- the Bank has a contractual obligation to deliver cash or another financial asset to the holder or to exchange another financial instrument with the holder under conditions that are potentially unfavourable to the Bank; or
- the Bank has a contractual obligation to settle the financial instrument in a variable number of its own equity instruments.

A financial instrument is classified as an equity instrument if both of the conditions are not met and in that case is covered under the section “Equity”.

2.3.5.1 Financial liabilities – recognition and derecognition

The Bank recognises a financial liability when it becomes a party to the contractual provisions of the instrument which is typically the date when the consideration received in the form of cash or other financial asset has been received. At initial recognition the financial liability is recognised at fair value and less transaction costs that are directly attributable to its issuance, except for financial liabilities at fair value through profit or loss.

Financial liabilities are derecognised when they are extinguished, i.e. when the obligation specified in the contract is discharged, cancelled or expires. The Bank can also derecognise the financial liability and recognise a new one when there is an exchange between the Bank and the lenders of the financial liability with substantially different terms, as well as substantial modifications of the terms of the existing financial liabilities. In assessing whether terms are different, the Bank compares the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, and the discounted present value of the remaining cash flows of the original financial liability. If the difference is at least 10% or more then the Bank derecognises the original financial liabilities and recognises a new one. When the exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment.

Financial liabilities held for trading

Held-for-trading liabilities are those incurred principally for the purpose of generating a profit from short-term fluctuations in price or dealer’s margin. A liability also qualifies as a trading liability if it belongs to a portfolio of financial instruments held for trading separately by the trading desk and for which there is a recent pattern of short-term profit-taking.

Trading liabilities can include derivative liabilities, short positions in debt and equity instruments, time deposits and debt certificates. In connection with derivative liabilities the Bank makes similarly distinction between trading and hedging derivatives as in case for derivative assets.
Initially, held-for-trading liabilities are measured at fair value. At the end of the reporting date, trading liabilities are measured at fair value. Fair value adjustments are always recorded in the income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

Financial liabilities upon initial recognition designated by the entity at fair value through profit or loss

IFRS 9 allows measuring a (group of) financial liability(s) on initial recognition at fair value, whereby fair value changes are recognized in profit or loss except for fair value changes related to the changes in own credit risk which are presented separately in OCI. The fair value designation is used by the Bank for the following reasons:

- the Bank designates a financial liability or group of financial liabilities at fair value when these are managed and their performance are evaluated on a fair value basis.
- Fair value option can be used when the use eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.
- A financial instrument is regarded as a hybrid instrument when it contains one or more embedded derivatives that are not closely related to the host contract. The fair value option can be used when it is not possible to separate the non-closely related embedded derivative from the host contract and then the entire hybrid instrument can be designated at fair value. This results that both the embedded derivative and the host contract are measured at fair value. the Bank uses this option when, for example, structured products contain non closely related embedded derivatives, in which case both the host contract and the embedded derivative are measured at fair value.

Financial liabilities measured at amortised cost

The Bank classifies most of its financial liabilities under this category, also those used to fund trading activities, when the trading intent is not present in the financial liabilities (e.g.: issued bonds). These financial liabilities are initially measured at cost, which is the fair value of the consideration received including transaction costs. Subsequently they are measured at amortised cost, which is the amount at which the funding liability was initially recognised minus principal repayments and plus or minus the cumulative amortisation of any difference between that initial amount and the maturity amount. The difference between the amount made available and the nominal value is recorded on an accruals basis as an interest expense. Interest expenses accrued, but not yet paid, are recorded under accruals and deferrals.

2.3.5.2 Financial liabilities – own credit risk

For financial liabilities designated at fair value, IFRS 9 requires measuring the financial liability on initial recognition at fair value. Thereafter fair value changes are recognized in the income statement, except for fair value changes related to the changes in own credit risk which are presented separately in OCI.

Accordingly, the fair value movement of the liability is presented in different parts: changes in own credit risk are presented in OCI and all other fair value changes are presented in the income statement under the line item “Net result from financial instruments at fair value through profit or loss”. The amounts recognized in OCI relating to the own credit risk are not recycled to the income statement even when the liability is derecognized and the amounts are realized. Although recycling is prohibited, the Bank transfers the amounts in OCI to other reserves within equity at derecognition. The only situation when the presentation of the own credit risk in OCI is not applied when this would create an accounting mismatch in the income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.5.3 Financial liability – financial guarantee contract

A financial guarantee contract is a contract that requires the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Such a contract is initially recognised at fair value and is subsequently measured at the higher of

- the amount determined in accordance with impairment provisions of IFRS 9 (see section "Financial Assets – Impairment") and
- the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with the revenue recognition principle of IFRS 15.

2.3.6 Offsetting

The Bank offsets and presents only a net amount in the statement of financial position of a financial asset and financial liability when and only when it has currently a legally enforceable right to set off the recognized amounts and intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

2.3.7 Hedge accounting

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognized asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction.

At inception of the hedge relationship, the Bank formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship.

Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed regularly. The frequency is defined in the hedging document. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%. For situations where that hedged item is a forecast transaction, the Bank assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the income statement.

Fair value micro hedging: In relation to fair value hedges which meet the conditions for hedge accounting, any gains or losses from the changes in fair value of the derivative are recognized immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk. Accrued interest income from interest rate swaps is recognized in net interest and similar income. If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then the hedge accounting is discontinued prospectively. Any adjustment up to the point of discontinuation that is made to a hedged item for which the effective interest method is used is amortised to the income statement over its remaining life or recognized directly when the hedged item is derecognized.

Fair value macro hedging: a group of derivatives can be viewed in combination and jointly designated as a hedging instrument. The Bank uses interest rate swaps to hedge the interest rate risk for a portfolio of financial instruments (loans, deposits, securities). Interest rate swaps are measured at fair value, with fair-value changes being reported in the income statement. Accrued interest income from interest rate swaps is recognized in net interest and similar income. The hedged amount of loans is measured in fair value as well, with fair value changes being reported in the income statement. If a hedge is ineffective, the cumulative fair value change in the hedged amount will be amortised to the income statement over the remaining lifetime of the hedged assets or will be immediately removed from the statement of financial position if ineffectiveness is due to derecognition of the corresponding loans.

NOTE 2 – ACCOUNTING POLICIES (continued)

Cash flow hedges: In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized initially in the other comprehensive income in the cash flow hedge reserve. Any ineffective portion of changes in the fair value of a derivative is immediately recognized in the income statement. The amount recognized in OCI is reclassified to the income statement as a reclassification adjustment in the same period as the hedged cash flows affect the income statement. Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, the cumulative gain or loss on a cash flow hedge recognized in the other comprehensive income remains in the other comprehensive income until the forecasted transaction occurs, when it is then transferred to the income statement for the period.

For hedges which do not qualify for hedge accounting and trading derivatives, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the income statement for the period.

2.3.8 Participations

In the separate financial statement of the Bank, participations in subsidiaries and affiliated undertakings are measured at cost based on IAS 27, reduced by impairment determined in accordance with IAS 36. The carrying amount of other equity instruments with participating nature is determined in accordance with IFRS 9, such equity instruments are measured at fair value and impairment is not applied.

The Bank considers a participation in a subsidiary or in affiliated undertakings impaired, if there is a significant and permanent decrease in the fair value (and therefore the value of the participation decreases under the purchase value), or there is any objective evidence that the participation is impaired. Determining “Significant” and „permanent” requires a decision. „Significant” means generally 15% or more and “permanent” means more than 1 year.

2.3.9 Leasing

This classification is crucial for lessor positions; for lessee positions, this classification is of lesser importance since both classifications result in a similar recognition and measurement of the lease in the statement of financial position and profit or loss.

2.3.9.1 The Bank, as a lessee

On initial recognition the Bank recognises a right-of-use (ROU) asset and a lease liability which are both measured - in most cases - at the present value of the lease payments. The ROU asset will be recognized in the Bank’s statement of financial position similarly as to where the leased assets would be recognized if it were subject to a finance lease. The lease liability will be recognized as “Financial liabilities at amortised cost – other liabilities”.
The ROU asset is measured at cost, less any accumulated depreciation and any accumulated impairment losses; and adjusted for any remeasurement of the lease liability. The depreciation requirements follow IAS 16, the impairment requirements follow IAS 36. The lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term.
The Bank recognises a financial cost on the lease. The cost represents the unwinding of the discount rate of the lease. The Bank uses the incremental borrowing rate for discounting the lease payments when and if the rate implicit in the lease is not readily determinable.
The lease term is determined as the non-cancellable period of the lease, taking into account the periods covered by an option to extend or terminate the lease. For assessing these options, the Bank uses all economic facts and circumstances, including the factors listed in IFRS 16 B37 to determine the lease term.
The lease liability is remeasured when there is a lease modification or a reassessment such as an indexation of the rent payment or at the reassessment of the lease term. The lease liability shall be remeasured using a revised discount rate, whereby the revised rate is determined at the date of the remeasurement in case of a change in the lease term. The remeasurement shall occur when there are changes to the lease term or in case of other

NOTE 2 – ACCOUNTING POLICIES (continued)

reassessments. The lease liability shall be remeasured using an unchanged discount rate when there are change in index or rate affecting payments.

The Bank opts to apply the following practical expedients foreseen in the standard: the Bank applies a single discount rate to a portfolio of leases with reasonably similar characteristics (‘portfolio approach’). The Bank applies the recognition exemption for both leases with a low value (< 5.000 EUR) and short-term leases (< 12 months). The Bank does not recognise contracts of intangibles as leasing agreement.

IFRS 16 requires that an lease should be recorded in the lessee's balance sheet both as an asset and as an obligation to pay future rentals. The derecognition requirements for finance lease liabilities are based on IFRS 9 rules.

At the commencement of the lease term, the sum to be recognised both as an asset and as a liability is the present value of the minimum lease payments each determined at the inception of the lease. In calculating the present value of the minimum lease payments, the discount factor is the interest rate implicit in the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset.

2.3.9.2 The Bank, as a lessor

All leases need to be classified as either finance leases or operating leases. The classification under IFRS 16 is based on the extent to which risk and rewards incidental to ownership of leased assets lie with the lessor or the lessee. A finance lease transfers substantially all the risks and rewards incidental to ownership of an asset.

The amount due from the lessee under a finance lease is recognised in the Bank’s statement of financial position as claims from customers at an amount equal to the Bank’s net investment in the lease in the financial statement line item of financial assets at amortised cost. Over the lease term, rentals are apportioned between a reduction in the net investment in the lease and income. The net investment in a lease is its gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is equal to the minimum lease payments plus any unguaranteed residual accruing to the lessor.

During the lease term, the net investment in the lease will represent the remaining minimum lease payments, less that part of the minimum lease payments that is attributable to future gross earnings (i.e. interest) and it will also include the unguaranteed residual value. The unguaranteed residual value, which is expected to be small in a finance lease (even in a property lease), represent the amount the lessor expects to recover from the value of the leased asset at the end of the lease term that is not guaranteed in any way by either the lessee or third parties.

The requirements on subsequent measurement are based on IFRS 16, but for the impairment and derecognition of finance lease assets IFRS 9 rules must be applied.

Assets subject to operating leases are included in bank premises and equipment in the statement of financial position and lease payments received are presented as income in the income statement. When the Bank provides lease incentive to the lessee, the aggregate cost of incentives are treated as a reduction of rental income over the lease term.

In case of financing the purchase of a vehicle or other equipment, the main collateral is the vehicle or the other equipment, on which the Bank has got the right to buy. When the contract is extraordinarily terminated the assets received in the debt settlement are measured at cost which is defined as the fair value of the vehicle or other the equipment. If the carrying amount of the received asset differs from the value defined at the subsequent valuation of the asset then impairment is accounted for or the formerly booked impairment is fully or partially released.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.10 Equity (Reserves)

Reserves in the financial statements of the Bank contains the following:

- In Other Comprehensive Income
  - revaluation reserve of financial instruments measured through other comprehensive income, where the fair value changes of FVOCI financial instruments are recognised.
  - accumulated amount of financial liabilities designated at fair value through profit or loss that is attributable only to the own credit changes of the Bank
  - hedging reserve, which is the gain or loss on the hedging instrument included in a cash flow hedge that is determined to be an effective hedge.
  - remeasurement of defined benefit plans: the actuarial gains and losses recognised as remeasurements of the net defined benefit (e.g. effect of change in yield curves applied for estimating or discounting, or changes in tax rates related to the benefit)
- Statutory risk reserve which is set aside as 10% of the profit calculated in accordance with Hungarian Accounting Regulations for use against future losses.
- Share premium which is the excess amount received by the Bank over the par value of its shares at the time of capital increase.

2.3.11 Dividend on ordinary shares

Dividends on ordinary shares are recognized as a liability and deducted from equity when they are approved by the shareholders. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

2.3.12 Share based payment transactions

A number of employees of the Bank receive remuneration in the form of share-based payment transactions. They are granted share appreciation rights, which can only be settled in cash (“cash-settled transactions”). The cost of cash-settled transactions is measured at fair value at the grant date, using the KBC share price determining the fair value. The value of the share-based payment is expensed in the year of the remunerated performance with recognition of a corresponding liability. The liability is valued at the closing price of the underlying share at the end of the period. The liability is released at the date of pay-out.

2.3.13 Investment property

Investment property is defined as a real estate property either built, purchased or acquired under a finance lease by the Bank, which is held to earn rentals or capital appreciations rather than used by the Bank for the supply of services or for administrative purposes.
The Bank subsequently measures investment property at initial cost minus accumulated depreciation and impairment losses.

Depreciation is provided on a straight-line basis during the useful life of the asset. The useful life of investment property is generally 33 years, except if the consideration of certain special circumstances results different useful lifetime.

2.3.14 Property, plant and equipment

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and are expected to be used during more than one period. An item of property, plant and equipment is recognized as an asset only when it is probable that future economic benefits associated with the asset will flow to the entity and the cost of the asset can be measured reliably.

The Bank considers movables as tangible asset only above HUF 100,000 initial cost. Items under this amount – including decorative elements, art works with low value – are accounted for as material cost.

NOTE 2 – ACCOUNTING POLICIES (continued)

Property, plant and equipment is initially measured at cost. Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction.

After initial recognition subsequent cost can increase the carrying amount of an asset or can be recognized as a separate asset, if it is probable that future economic benefits associated with the asset will flow to the Bank and the cost can be measured reliably. The carrying amount of replaced components are derecognized. Repairs and maintenance are charged to the income statement as incurred

In case of compound assets, main components of these can differ regarding the economic characteristics. In this case the initial cost is divided among main components. Useful life, residual value and depreciation method is determined individually for every main components.

The subsequent measurement of property, plant and equipment is based on the cost model, i.e. property, plant and equipment are carried at initial cost less accumulated depreciation and any accumulated impairment losses.

Every part of property, plant and equipment, which represents significant value compared to the total initial cost of the asset is depreciated separately. Depreciation is calculated on a straight-line basis under the estimated useful life of the asset. Land, art works have unlimited useful lives, therefore are not depreciated.

The estimated useful lives of property, plant and equipment are the following:

Buildings	10-50 years
Leasehold rights	10-50 years
Leasehold improvements	3-20 years
Right-of-use assets (leases)	3-20 years
Furniture, fixtures and equipment	3-7 years
System software	5 years

System software (operating systems) are initial software linked to the purchase of hardware, without whose installation the hardware will not function or operate. Such software regulates the internal operation of the computer and ensures communication with the configuration or the network, and thus includes operating systems, support software and compilers, therefore system software forms an integral part of related hardware.

The Bank prepares reassessment for the useful lives and the residual values at least on a yearly basis.

2.3.15 Intangible assets

An intangible asset shall be recognised if, and only if it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

Intangible assets can have a finite or indefinite useful life. The Bank owns intangible assets with finite useful life.

Intangible assets with finite lives are amortised over the useful economic life; the amortisation expense is recorded as operating expense in the income statement. The impairment assessment of intangible assets with finite lives is the same as tangible assets. Intangible assets with finite lives have no residual value, as the Bank does not intend to dispose the intangible assets before their economic useful lives.

NOTE 2 – ACCOUNTING POLICIES (continued)

The subsequent measurement of intangible assets is based on the cost model i.e. are carried at initial cost less accumulated amortisation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis under the estimated useful life of the asset:

Standard software and other intangibles	5 years
Core banking software	8 years

Core banking systems are software handling back-end data processing applications for processing all transactions that have occurred during the day and posting updated data on account balances to the mainframe. Core systems typically include deposit account processing, loan and credit processing, interfaces to the general ledger and reporting tools.

The Bank owns purchased trademarks, the depreciation is based on the useful life determined in the purchase agreement.

2.3.16 Impairment of non-financial assets

When the Bank prepares financial statements it ensures that the carrying amount of the non-financial asset does not exceed the amount what could be obtained from either using or selling it ("recoverable amount"). Property, plant and equipment, investment property and software are subject to the impairment review only when an objective evidence of impairment indicator exists. The Bank reviews at least annually whether there are any indicators of impairment.

When an impairment indicator is present, or the impairment test of an asset must be prepared, the Bank estimates the asset's recoverable amount. The recoverable amount is defined as the higher of fair value less cost to sell or the value in use, determined individually by assets, except if the economic benefits realized on the asset can not be separated from economic benefits realized on other assets or group of assets. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.
Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

2.3.17 Contingent liabilities

In the ordinary course of its business, the Bank enters into off-statement of financial position commitments such as guarantees, commitments to extend credit, letters of credit, warranties and transactions with financial instruments. These commitments are recorded in the financial statements if and when they become payable.

Taking into account that IFRS 9 and IAS 37 do not contain specific requirements related to the accounting treatment of commitments for issuing non-financial guarantees, the Bank treats them in the same way as financial guarantees.

To determine the allowance for losses on contingent liabilities the Bank uses the Expected Credit Loss model (ECL) (for details see Note 2.3.3 Financial assets – Impairment).

2.3.18 Provisions

Provisions are recognised at the reporting date if and only if there is a present obligation (legal or constructive) due to a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.
When the timing effect is material, the amount recognised as a provision is the net present value of the best estimate.

NOTE 2 – ACCOUNTING POLICIES (continued)

Any compensation that arises in relation to provisions for operational losses from claims and legal disputes regarding commercial activity are presented in other income / (expense) when they become virtually certain.
When it is virtually certain that another party will repay the expenditure of the provisions, the reimbursement is treated as a separate asset.

2.3.19 Revenue recognition

2.3.19.1 Net interest and similar income

Net Interest Income falls under the scope of IFRS 9. Interest income and expense are calculated and recognised based on the effective interest rate method, or, if considered appropriate, based on a method that results in an interest income or interest expense that is a reasonable approximation of using the effective interest rate method as basis for the calculation. The effective interest includes fees considered to be part of the effective interest rate of a financial instrument (generally fees received as compensation for risk or origination fees).). Prepayment fees are also presented as interest income.

Interest income calculated using effective interest method is presented as a separate line item on the face of the income statement. Interest income related to assets held for trading, mandatorily at fair value through profit or loss and hedging derivatives are presented in a separate line item as “other similar income”.

Interest income and expenses from financial instruments are, with the exceptions described below classified as “Net Interest Income”.

For financial assets measured at amortised cost or debt instruments measured at fair value through other comprehensive income, the calculation of the interest income depends on the stage of the asset used in the calculation of ECL. For assets that are in stage 1 and stage 2 the interest recognition is based on the gross carrying amount while for assets in stage 3 on the carrying amount (including POCI). The gross carrying amount of a financial asset is defined as the amortised cost before adjusting for any loss allowance.

2.3.19.2 Net fee and commission income

The Bank presents the revenue of different transaction under this line item. Most of these fall under the scope of IFRS 15 Revenue from Contracts with Customers as they cover services and goods provided by the Bank to its customers while certain transactions reported under Commitment credit are accounted for under IFRS 9. The revenue recognised on these transactions reflect the amount of consideration to which it expects to be entitled in exchange for transferring goods or service to the customers. For the recognition of revenue the Bank needs to identify the contract and define what the promises are (performance obligations) in the transaction. Thereafter the transaction price is calculated and allocated to all performance obligations identified in the contract. Revenue is recognised only when the Bank has satisfied the performance obligation.

The revenue from fiduciary and trading services falls under the scope of IFRS 15. These transactions are straightforward because the Bank provides series of distinct services which is consumed by the customer simultaneously when the benefits are provided. The Bank is remunerated after executed transactions or on a timely basis, the fee is determined as a fixed amount or a percentage. The fee arrangements do not include variable compensation and revenue is estimated and recognised straightforward. Due to the nature of the promises the Bank recognises these revenues at that point in time or over time.

NOTE 2 – ACCOUNTING POLICIES (continued)

Commitment credit represents revenue on fees received from lending and financial leasing business that are not considered as part of the Effective Interest Rate and consequently, have to be recognised under the scope of IFRS 15, except for financial guarantees which are accounted for in accordance with IFRS 9. This includes typically credit-related fees like loan administration fees or fees charged as prepayment fees. The Bank also recognises fees received for the issuance of guarantees, letters of credit, standby credit agreement and similar transactions. It also includes fees charged to companies with specific financing needs requiring integrated or highly complex structure. The terms applied by the Bank on these revenue do not contain complex arrangements and relates to a certain percentage of the transaction and variability is limited. The terms of the provided services are straightforward and are recognised in general at the point when the actual service has been performed or transferred to the customer except for financial guarantees for which the received fees are treated as income and recognised in general over time until expiry of the guarantee.

Fee income also contains fees related to payment services whereby the Bank charges the customer for different transactions linked with its current accounts, domestic or foreign payments, payment services through ATM, etc. These services are mainly completed when the actual transaction is executed therefore the relating consideration can be recognised directly at that point in time.

2.3.20 Employee benefits

2.3.20.1 Short-term employee benefits
Short-term employee benefits, such as salaries, paid absences, performance-based cash awards and social security costs are recognised over the period in which the employees provide the related services. The relating expenses are presented under the income statement as Staff expenses.

2.3.20.2 Post-employment benefits

A number of employees of the Bank receive post-employment benefits in the form of defined benefit plans. The defined benefit plan belongs to post-employment benefits. The components of the benefit costs related to the program are recorded as follows in the financial statements:

- vested benefits and costs arising from the change of the program's conditions as personal expenses in the income statement
- interest expenses related to the defined benefit plan as interest and similar expense in the income statement
- the revaluation of the defined benefit plan (e.g. impact of change of the curves used to the estimation and discount calculation or change of the tax rate related to the benefit) in other comprehensive income.

2.3.21 Government grants

Government grants are assistance by government in the form of transfers of resources to the Bank in return for past or future compliance with certain conditions relating to the operating activities of the entity.
Government grants are recognised when there is a reasonable assurance that the grant will be received and the conditions attached to it will be met. The grants are recognised in the income statement in a systematic basis to match the way that the Bank recognises the expenses for which the grants are intended to compensate.
Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset. The Bank applies the deferred income (gross) presentation method.

2.3.22 Levies

Public authorities could impose different levies on the Bank. The amount of the levies can be dependent on the amount of revenue (mainly interest) generated by the Bank, on the amount of deposits accepted from customers, on the total balance sheet volume with corrections based on some specific ratio's. Levies are recognised, in accordance with IFRIC 21, when the obligating event that gives rise to the recognition of the liability, as stated in the relevant legislation, has occurred. Depending on the obligating event, levies can be recognised at one point or over time. The majority of the levies imposed on the Bank have to be recognised at one point, which occurs mainly at the beginning of the financial year. The Bank recognises the levies as part of Operating Expenses (See Note 2.5).

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.23 Income tax

Income tax consists of two elements: current year's taxes paid/payable and changes in deferred tax assets/liabilities. Income tax is accounted for either in the income statement or in the Other Comprehensive Income depending on where the items that triggered the tax are accounted for. Income taxes that are initially accounted for in the Other Comprehensive Income and that relate to gains/losses that are subsequently recognised in the income statement, are recycled in the income statement in the same period that the item is accounted for in the income statement. Current taxation is provided for in accordance with the fiscal regulations of Hungary.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized.

Deferred tax assets are recognised for the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilized.

Deferred and current tax assets and liabilities are offset only if the Bank has a legally enforceable right to set off, and the Bank intend to settle them on a net basis or to realize the assets and settle the liabilities simultaneously

2.3.24 Non-current assets held-for-sale, liabilities associated with disposal groups

Non-current assets or group of assets and liabilities held for sale are those for which the Bank will recover the carrying amount from a sale transaction that is expected to qualify as a sale within a year, instead of through continuing use.

In line with IFRS 5 standard the Bank presents an instrument as Non-current asset or disposal group classified as held-for-sale only if it is available for immediate sale in its present condition and the sale of the asset is highly probable.

The Bank measures a non-current asset or disposal group classified as held for sale at the lower of carrying amount or fair value less cost to sell.

Non-current assets held for sale and liabilities held for sale are reported separately from the other assets and liabilities in the statement of financial position at the end of the reporting date.

Non-current assets held for sale (disposals groups) are not depreciated but measured at the lower of their carrying amount and fair value less costs to sell.

A discontinued operation is a component of the Bank that either has been disposed of, or that is classified as held for sale, and:

- represents a separate major line of business or geographical area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business
- or geographical area of operations; or is a subsidiary acquired exclusively with a view to resale.

2.3.25 Fiduciary assets

Assets held in trust or in a fiduciary capacity are not assets of the Bank and accordingly are not included in these financial statements.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.26 Events after reporting period

Events after the reporting date are defined as favourable or unfavourable events that occur between the reporting date and the date that the financial statements are authorised for issue. There are two types of events after the reporting period:

- those which provide evidence of conditions that existed at the reporting date (adjusting events)
- those that are indicative of conditions that arose after the reporting date (non-adjusting events).

The impact of adjusting events has already been reflected in the financial position and performance of the current year.
The impact and consequences of the non-adjusting events are disclosed in the notes of the financial statements.

2.4 Changes in accounting policies

2.4.1 Adoption of new or revised standards and interpretations

The following amended standards became effective from 1 January 2020, but did not have any material impact on the Group:

- IAS 39, IFRS 9 and IFRS 7 Amendment of IBOR reform
- Definition of a business – Amendments to IFRS 3
- Definition of materiality – Amendments to IAS 1 and IAS 8
- Amendments to the Conceptual Framework for Financial Reporting
- COVID-19-Related Rent Concessions Amendment to IFRS 16

2.4.2 New accounting pronouncements

The Bank has not applied the following IASs, IFRSs and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that have been issued but are not yet effective. The Bank will apply these standards when they become mandatory.

IFRS 17 Insurance contracts

In May 2017, the IASB issued IFRS 17 (Insurance contracts), which will become effective on 1 January 2023. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds.

As the Bank does not provide insurance services, no major impact was identified.

NOTE 2 – ACCOUNTING POLICIES (continued)

Other changes

The IASB published several limited amendments to existing pronouncements. They will be applied when they become mandatory, but their impact is currently estimated to be negligible.

The list of amendments:

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28
  Effective from: to be determined by the IASB

- Classification of liabilities as current or non-current – Amendments to IAS 1
  Effective from: 1 January 2023

- Proceeds before intended use, Onerous contracts – cost of fulfilling a contract, Reference to the Conceptual Framework – narrow scope amendments to IAS 16, IAS 37 and IFRS 3, and Annual Improvements to IFRSs 2018-2020 – amendments to IFRS 1, IFRS 9, IFRS 16 and IAS 41
  Effective from: 1 January 2023

- Interest rate benchmark (IBOR) reform – phase 2 amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16
  Effective from: 1 January 2021

2.5 Taxes and levies payable by financial institutions

Credit institutions and financial institutions are exposed to pay the so called “bank tax” introduced in 2010 in Hungary (see Note 12). The actual bank tax and its reversal (if any) are recorded as expense in the financial period in which it is legally payable. As the bank tax is payable based on non-net income measures it does not meet the definition of income tax under IFRS and is therefore presented as an operating expense in the income statement.

The IFRIC 21 Levies interpretation identifies the obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation. Based on the interpretation of IFRIC 21 the “bank tax” amount is recognized at the beginning of the year in a lump sum in the Bank’s Financial Statements.

In addition to the regular “bank tax” extraordinary tax payment had to be made in 2020. As the additional “bank tax” is deductible in the next 5 years’ regular tax obligation, it has no effect on the profit or loss, but it is reported as an outstanding claim in the statement of financial position.

In 2013 a tax called financial transaction levy (FTL) has been introduced. The FTL is payable based on specified type of transactions (including cash movements and money transfers). Subject of the levy are financial service providers (with seat or branch in Hungary). The FTL is recorded as part of general administrative expenses when the underlying business transaction occurs.

In the case of bankcard transactions the FTL is recognized at the beginning of the year in a lump sum, because the base of this levy is the bankcard transactions of the previous year that triggers the payment obligation of the levy at the beginning of the year.

The Investor Protection Fund (IPF) is established to provide indemnity to investors against property damages arising from the potential insolvency of investment service providers. Members make annual contribution payments to the IPF. Based on the interpretation of IFRIC 21 the amount is recognized at the beginning of the year in a lump sum in the Bank’s Financial Statements.

The Resolution Fund was established in 2014 to shift the costs of crisis management in the financial sector to the members of the sector. The Fund is financed by credit institutions and investment firms from the annual fees paid by the members. According to IFRIC 21 the Bank records the total annual fee at the beginning of the period.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.6 Change in estimate

The Bank fine-tuned some of the valuation methods used for valuation of the assets and liabilities but the change has no significant effect on the financial statements in 2020.

2.7 Reclassifications

Some of the notes in the Financial Statements were changed in comparison with the previous year's presentation. The changed categories are marked in the concerned notes.

The reclassified notes are the following:

- Income statement
- Statement of financial position
- Statement of cash flows
- Note 4 – Net interest and similar income
- Note 5 – Net fee and commission income
- Note 25 - Non-current assets held for sale and disposal groups
- Note 30 - Property, plant and equipment
- Note 43.2 – Risk management – Liquidity and funding management

Loan related prepayment fees were reclassified from net fee and commission income to net interest and similar income due to their amortised characteristics. The related notes were changed accordingly.

The Bank reclassified non-current assets held for sale and disposal groups as at 31 December 2019, as the necessary classification criteria have not met in 2019. In these financial statements the assets were reclassified to property, plant and equipment and intangible assets in 2019 and presented as non-current assets held for sale and disposal groups in 2020 again. The related notes were changed accordingly.

NOTE 2 – ACCOUNTING POLICIES (continued)

The reclassifications caused the following changes in the Income Statement in 2019.

	Before reclassification 2019 MHUF	Reclassifi-cation MHUF	After reclassification 2019 MHUF
Income statement			
Net interest and similar income	78 917	911	79 828
Net fee and commission income	62 804	(911)	61 893

	Before reclassification 2019 MHUF	Reclassifi-cation MHUF	After reclassification 2019 MHUF
Statement of financial position			
Property, plant and equipment	48 836	1 720	50 556
Non-current assets held for sale and disposal groups	1 720	(1 720)	-

NOTE 3 – COVID-19 RELATED FINANCIAL MORATORIUM

The existence of novel coronavirus (Covid-19) was confirmed in early 2020 and has spread across the world, causing disruptions to businesses and economic activity.

With the aim of mitigating the economic impact of the coronavirus, on 18 March 2020 a financial moratorium was announced for the retail and corporate debtors for principal, interest and fee payments which would become due until 31 December 2020 (Government decree of 47/2020 and 62/2020). The payment moratorium was automatic for all eligible debtors and loans (but the debtor had the right to opt-out from the payment moratorium).

On 22 December 2020 the government announced the decree of 637/2020 about the introduction of the financial moratorium's special rules related to the Covid-19 crises. This decree prolongs the duration of the first moratorium according to which the financial moratorium is available for another half year until 30 June 2021.

The moratorium did not result in debt forgiveness: the unpaid interest and fee accumulated during the moratorium shall be redeemed after the moratorium in equal annual parts during the extended remaining tenor of the loan together with the due principal instalments. The tenor of the loan will be prolonged in a way that the debtor's new instalment covering the deferred interest and fee as well next to the due capital shall not exceed the instalment determined in the original payment schedule.

Although the debtors shall redeem all deferred payment obligations accumulated during the moratorium, as no interest can be charged on the unpaid interest the Bank recognized a negative P&L impact arising from the time value of the payment deferral. According to preliminary estimations, the loss will amount to approximately HUF 4 400 million which amount was calculated based on the number of eligible debtors taking into account the opt-out rate of the clients. The estimated negative impact is recognized as a modification to the gross carrying amount of the related loans in the Bank's statement of financial position and as modification losses on financial assets at amortized cost in the Bank's income statement in 2020.

The Financial Stability Board of the Magyar Nemzeti Bank (MNB) adopted on March 19 a comprehensive package of measures to mitigate the effects of the Covid-19 crises on the financial intermediation sector. Among them the MNB called on banks and their shareholders not to approve or pay dividends until the end of September 2020 and prolonged this period with another 1 year later on in 2020.

In April MNB launched the latest scheme of the Funding for Growth Programme in order to support access to finance for SMEs. The scheme makes financial funds available to micro-, small and medium-sized businesses from April 20 through credit institutions and financial businesses at a fixed interest rate of a maximum 2.5%, available on a wider scale than before, helping SMEs to overcome the economic effects of the coronavirus.

In addition, based on Government decree of 1170/2020. (IV.21.) for the mitigation of the negative effects of the Covid-19 crises to SMEs and corporates, Garantiqa Hitelgarancia Zrt. launched a loan guarantee program with specific conditions giving a maximum 90% guarantee which quickens the application of loans for the companies.

NOTE 3 – COVID-19 RELATED FINANCIAL MORATORIUM (continued)

The following table presents the Bank's loan portfolio under moratorium as at 31 December 2020.

	Gross carrying amount		Accumulated impairment		
	Performing	Non-performing	Performing	Non-performing	Total carrying amount
	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances* at 31 December 2020					
General government	2	-	-	-	2
Corporate	283 693	11 978	(12 179)	(4 093)	279 399
of which: Small and Medium enterprises	147 280	4 503	(5 167)	(2 099)	144 517
Households	257 376	5 913	(6 330)	(2 160)	254 799
Consumer credit	57 528	655	(1 193)	(446)	56 544
Credit card	4 431	11	(76)	(6)	4 360
Current account	5 550	146	(326)	(119)	5 251
Finance lease	811	-	(12)	-	799
Mortgage loan	179 748	5 067	(4 389)	(1 580)	178 846
Term loan	9 308	34	(334)	(9)	8 999
Trade receivables	-	-	-	-	-
Total	541 071	17 891	(18 509)	(6 253)	534 200

*The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost.

Moratorium related significant judgements – effect on expected credit loss

The continuing public health crisis around the world has distressed financial markets amid concerns that the global economy, and the EU's economies in particular, were significantly affected in 2020. The Coronavirus pandemic has triggered a chain of events in the markets that has led to a sharp increase in volatility. The significant deterioration in the economic outlook has brought about an unprecedented monetary policy response from central banks and governments around the world.

Expected Credit Loss (ECL) models were not able to adequately reflect all the specifics of the Covid-19 crisis or the various government measures implemented in the different countries to support households, SMEs and Corporates through this crisis. Therefore, an expert-based calculation at portfolio level is required via a management overlay. The overlay calculation includes all segments of the group including Corporate SME and retail as well, and is based on the latest macroeconomic forecasts.

NOTE 3 – COVID-19 RELATED FINANCIAL MORATORIUM (continued)

Until now, only minor PD shifts have been observed in our portfolio, which is reflected in stable staging percentages (for further information, see note 4.2.1). Note that in line with ECB/ESMA/EBA guidance, any EBA-compliant government measures granted before the end of September 2020, as well as newly granted measures between 1 October 2020 and the end of December 2020, have not led to automatic transfer to stage 2 or stage 3. For the 31 December performing portfolio, the following 3-step approach was applied to estimate the additional Covid-19 impactCovid-19 impact:

- The methodology used for this purpose starts from the updated macroeconomic forecast for end December 2020 (see Note 43). The base scenario was translated to expert-based stress migration matrices, per country and per segment. The portfolio was transformed using this migration matrix, whereby a certain portion moved to inferior PD rating classes or default, a certain portion remained unchanged and a minor portion improved. After this transformation, the ECL was calculated again based on the new portfolio structure, including staging. The estimate of Covid-19 base-case ECL impact was then determined as the difference between the ECL calculated on the portfolio before and after applying the stressed migration matrix.
- In a second step, a sectoral effect was incorporated in the calculation to refine the Covid-19 ECL. The purpose of this step is to reflect the fact that some sectors will be more heavily affected than others, something which is not yet captured by the migration matrices. All exposures in the SME and Corporate portfolio were classified as high, medium or low risk based on the expected impact of the Covid-19 crisis on the sector affected (for Mortgages and Consumer Finance, no sectoral stress was applied). Based on this classification, the following expert-based weights were applied to the ECL impact as determined in the first step described above: 150% for high risk sectors, 100% for medium risk sectors and 50% for low risk sectors. This resulted in a “sector-driven” Covid-19 base-case ECL following the base-case scenario.

NOTE 3 – COVID-19 RELATED FINANCIAL MORATORIUM (continued)

The following table presents the distribution of the Bank's loan portfolio where the risk is the exposure of the sectors to the negative effects of the pandemia.

	Low risk	Medium risk	High risk
	%	%	%
Agriculture, Farming & Fishing	-	100	-
Authorities	100	-	-
Automotive	-	6	94
Aviation	-	-	100
Beverages	4	96	-
Building & Construction	-	86	14
Chemicals	11	89	-
Commercial Real Estate	3	74	23
Consumer Products	27	71	2
Distribution	52	22	26
Electricity	-	100	-
Electrotechnics	-	35	65
Finance & Insurance	100	-	-
Food Producers	99	1	-
Horeca	-	-	100
IT	-	71	29
Machinery & Heavy Equipment	-	-	100
Media	-	89	11
Metals	2	14	83
Oil, Gas & Other Fuels	-	3	97
Paper & Pulp	100	-	-
Private Persons	100	-	-
Services	24	46	30
Shipping	-	-	100
Telecom	100	-	-
Textile & Apparel	5	-	95
Timber & Wooden Furniture	-	100	-
Traders	-	92	8
Water	100	-	-

- Finally, a probability-weighted management overlay was calculated based on KBC Group's base-case, optimistic and pessimistic scenarios and attributed weights. An expert-based scaling factor was applied on the estimated sector-driven Covid-19 base-case ECL from the previous step to determine the collective Covid-19 impact under an optimistic and pessimistic scenario. The final overlay was then determined by weighting the resulting Covid-19 ECL under the three scenarios with the following weights: 55% for the base-case, 10% for the optimistic and 35% for the pessimistic scenario.

For the non-performing portfolio, an additional impact assessment was performed on a portfolio basis for the stage 3 collective exposures based on expert judgement of the local credit risk management departments. Additional impairments due to Covid-19 on individually assessed stage 3 loans are already reflected in the specific allowance of the exposure (hence already included in P&L impairments) and thus not included in the management overlay.

The total Covid-19 management overlay in 2020 amounts to HUF 19 730 million. The management overlay is fully presented as stage 2.

NOTE 3 – COVID-19 RELATED FINANCIAL MORATORIUM (continued)

Economic scenarios

The Bank has formulated three different forecasts that differ on the virus evolution and its impact on the lockdown measures. In short the three scenarios can be summarized as follows:

Optimistic scenario:

- Virus spread and impact more quickly under control thanks to earlier than expected large-scale availability of vaccines, allowing social distancing measures and other precautionary measures to be lifted sooner
- Steep and steady recovery from the first half of 2021 onwards, with a fast return to pre-Covid-19 levels of activity
- Sharp, short V-pattern

Base scenario:

- Start of vaccination process and wider testing and tracing will allow only a very moderate easing of precautionary measures in H1 2021. From mid-2021 on, the normalisation of socio-economic interactions will be helped by the mass rollout of effective vaccines. However, as the vaccination process will take time, socio-economic interactions will not return to normal before 2022
- The recovery will be gradual. It will take until the second half of 2021 for the mass rollout of vaccines to reinforce the recovery to pre-Covid-19 levels of activity by the end of 2023
- U-pattern

Pessimistic scenario:

- The virus reappears and continues to weigh on society and the economy, because of setbacks in the vaccination process (e.g., logistical problems, disappointing immunity results, etc.)
- Another (series of) shock(s) takes place, leading to an interrupted and unsteady path to recovery
- More L-like pattern, with right leg only slowly increasing

For more information about the key indicators (GDP growth, unemployment rate and house price index) of the three scenarios see Note 43.4.

NOTE 4 – NET INTEREST AND SIMILAR INCOME

	2020 MHUF	Reclassified 2019 MHUF
Financial assets at amortised cost	94 709	81 944
Financial assets at fair value through other comprehensive income	2 950	2 393
Positive interest on financial liabilities	1 769	303
Interest income calculated using the effective interest method	99 428	84 640
Financial assets held for trading	99	262
Financial assets mandatorily fair value through profit or loss other than held for trading	3 624	1 320
Asset/liability management derivatives	1 329	2 180
Hedging derivatives	11 305	11 900
Other similar income	16 357	15 662
Total interest and similar income	115 785	100 302
Financial liabilities measured at amortised cost	(13 289)	(7 564)
Other	(892)	(841)
Negative interest on financial assets	(1 427)	(1 728)
Interest expense calculated using the effective interest method	(15 608)	(10 133)
Asset/liability management derivatives	(1 271)	(1 386)
Hedging derivatives	(9 092)	(7 322)
Other financial liabilities at fair value through profit or loss	(1 388)	(1 622)
Interest and similar expense of defined benefit plans	(7)	(11)
Other similar expense	(11 758)	(10 341)
Total interest and similar expense	(27 366)	(20 474)
Net interest and similar income	88 419	79 828

The Bank recorded HUF 98 million interest income (unwinding discount effect) on impaired assets in 2020 (HUF 187 million in 2019).

NOTE 5 – NET FEE AND COMMISSION INCOME

	2020	Reclassified 2019
	MHUF	MHUF
Credit and guarantee fee income	7 419	4 027
Structured finance	38	120
Total fee income related to financial instruments not at fair value through profit or loss	7 457	4 147
Brokerage services	2 554	1 755
Trust and fiduciary activities	5 260	7 540
Payment services	51 119	50 629
Card services	15 930	16 132
Other	4 307	3 442
Fee and commission income	86 627	83 645
Brokerage services	(895)	(753)
Credit and guarantee fee expense	(2 860)	(2 295)
Commissions to agents	(692)	(466)
Structured finance	(21)	(36)
Payment transactions	(5 465)	(5 291)
Card services	(8 385)	(8 927)
Insurance commissions	(3 708)	(3 601)
Other	(553)	(383)
Fee and commission expense	(22 579)	(21 752)
Net fee and commission income	64 048	61 893

Front-end fees related to financial assets at amortised cost (loans and receivables) are part of the effective interest rate method calculation and are recorded as interest income or expenses over the life of the underlying asset.

Although the Bank is in the scope of IFRS 15, the disclosures prescribed by the standard are not presented due to immateriality.

NOTE 6 – NET GAINS / (LOSSES) FROM FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020 MHUF	2019 MHUF
Trading securities	143	28
Interest rate derivatives (including interest and fair value changes in trading derivatives)	(1 101)	1 779
Other financial liabilities designated at fair value through profit or loss	793	301
Mandatorily at fair value through profit or loss other than held for trading	5 269	1 523
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	(18 843)	(110)
Fair value adjustments in hedge accounting*	270	375
Net gains / (losses) from financial instruments at fair value through profit or loss	(13 469)	3 896

The result of foreign exchange trading and the line item of foreign exchange differences in the income statement compensate each other, the net result of foreign exchange amounted to HUF 13 779 million gain in 2020 (HUF 15 633 million gain in 2019).

*Results of cash flow hedge derivatives transferred from other comprehensive income to the income statement amounted to HUF 385 million gain in 2020 (HUF 529 million gain in 2019) and HUF 115 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 154 million loss in 2019).

The total of HUF 5 269 million gain presented as mandatorily at fair value through profit or loss other than held for trading in 2020 in the table above includes a gain of HUF 1 349 million which results from changing the fair value calculation of loans described in Note 18.

The change in the fair value of financial instruments at fair value through profit or loss, where the fair value calculation is based on non-observable parameters was HUF 184 million gain in 2020 (HUF 171 million gain in 2019).

NOTE 7 – NET REALISED GAINS FROM SECURITIES AT FAIR VAUE THROUGH OTHER COMPREHENSIVE INCOME

	2020 MHUF	2019 MHUF
Fixed-income assets	215	219
Net realised gains from fixed income assets	215	219

The Bank converted a part of its Visa Inc. C series preferred shares into A series since Visa Inc. plan to revoke the C series. Due to the conversion a gain of HUF 1 209 million was transferred from revaluation reserve of equity instruments to accumulated profit in 2020 (see statement of comprehensive income and statement of changes in equity).

NOTE 8 – DIVIDEND INCOME

The Bank recognised HUF 2 478 million dividend income in 2020 (HUF 2 676 million in 2019).

	2020	2019
	MHUF	MHUF
K&H Befektetési Alapkezelő Zrt.	2 309	2 238
K&H Csoportszolgáltató Kft	33	49
K&H Ingatlanlízing Zrt.	121	119
K&H Faktor Zrt.	0	254
VISA inc	15	16
Total dividend income	2 478	2 676

NOTE 9 – GAINS ON THE DISPOSAL OF ASSETS AT AMORTISED COST

	2020	2019
	MHUF	MHUF
Gain on the disposal of loans and advances	2 685	1 694
Gain on the disposal of assets at amortised cost	2 685	1 694

The disposals were not in contradiction with the prescription of the concerned business model.

NOTE 10 – OTHER INCOME AND EXPENSE

	2020	2019
	MHUF	MHUF
Gain on property, plant and equipment	536	454
Gain on sale of goods	126	175
Gain on other services	790	296
Recoveries related to operational risk	11	58
Other income - other	515	308
Gain on the sale of associated companies	-	11
Other income	1 978	1 302

The income of HUF 790 million reported as revenue on other services in 2020 (HUF 296 million 2019) results from finance and accounting, business management, technical, logistics and bank security services granted by the Bank to other KBC Group entities operating in Hungary.

NOTE 10 – OTHER INCOME AND EXPENSE (continued)

	2020 MHUF	2019 MHUF
Losses on property, plant and equipment	(12)	-
Losses due to operational risks	(293)	(544)
Other expense - other	(652)	(367)
Other expense	(957)	(911)

NOTE 11 – GENERAL ADMINISTRATIVE EXPENSES

	2020 MHUF	2019 MHUF
IT expenses	(13 002)	(11 079)
Rental expenses	567	459
Repair and maintenance	(2 201)	(1 720)
Marketing expenses	(1 106)	(1 647)
Professional fees	(2 785)	(3 496)
Other facilities expenses	(4 224)	(4 964)
Communication expenses	(25)	(346)
Travel expenses	(19)	(112)
Training expenses	(164)	(532)
Personnel related expenses	(267)	(391)
Financial transaction levy	(26 206)	(26 954)
Other administrative expenses	(5 861)	(4 976)
Other provision	(471)	(179)
Total general administrative expenses	(55 764)	(55 937)

NOTE 12 – BANK TAX

The Bank paid a bank tax of HUF 5 708 million in 2020 (HUF 5 529 million in 2019). The basis of the tax amounted to HUF 2 886 471 million for 2020 (HUF 2 776 788 million for 2019). The effective tax rate was 0,198 percent in 2020 (0.199 percent in 2019).

The bank tax payable by the Bank for the year 2020 is calculated as follows.

For credit institutions the tax base includes the total asset value as at 31 December 2018, less:

- Hungarian interbank loan receivables, including bank deposits and repo transactions;
- bonds and shares issued by Hungarian credit institutions, financial enterprises and investment enterprises;
- loan receivables, subordinated and supplementary subordinated loan receivables with respect to capital provided to Hungarian financial enterprises and investment enterprises (including receivables under repos, collateralized repos, repos settled in kind);
- receivables deriving from EU inter-bank credits, bonds and shares issued by other credit institutions.

In 2019 the tax base of credit institutions was the total asset value as at 31 December 2017 adjusted by the above mentioned decreasing items.

NOTE 12 – BANK TAX (continued)

The bank tax for credit institutions is payable at 0.15 % on tax base below HUF 50 000 million and 0.20 % on tax base above HUF 50 000 million in 2020 (0.15% and 0.20% in 2019).

The bank tax for the Bank is expected to be HUF 6 330 million in 2020. In 2021 the tax base of credit institutions is the total asset value as at 31 December 2019 adjusted by the above mentioned decreasing items.

For the Bank the liability of HUF 6 330 million is established on January 1, 2021.

The sector of financial institutions was obligated to pay an extra tax related to the Covid-19 crises. The tax base is the same as in case of the bank tax and it is calculated on the tax base above HUF 50 000 million applying a tax rate of 0.19%. The Group paid an extra tax of HUF 5 351 million in 2020 which is not recorded as tax expense in the income statement since banks are allowed to deduct it from their bank tax in the upcoming 5 years.

NOTE 13 – AVERAGE NUMBER OF PERSONNEL AND STAFF EXPENSES

	2020	2019
White-collar staff	3 169	3 293
Management	38	35
Total average number of persons employed	3 207	3 328

	2020 MHUF	2019 MHUF
Wages and salaries	22 989	23 874
Social security charges	5 369	6 197
Defined benefit plan	(25)	(30)
Share based payments	56	71
Other staff expenses	2 697	2 710
Total staff expenses	31 086	32 822

NOTE 14 – INCOME TAXES

The components of income tax expense for the year ended 31 December 2020 and 2019 are:

	Notes	2020 MHUF	2019 MHUF
Statutory income tax expense		(3 287)	(3 971)
Statutory income tax from self-revision of prior years		(83)	456
Local business tax expense		(4 617)	(4 355)
Deferred taxes on income	27	366	(461)
Income tax (expense) / benefit		(7 621)	(8 331)

NOTE 14 – INCOME TAXES (continued)

Statutory income tax expense

In 2020 and 2019 corporate income tax was payable at 9% on yearly profits.

Considered their non-turnover characteristics, local business taxes are presented as an income tax expense for IFRS purposes. Local business taxes include local government tax and innovation tax.

There is no procedure for final agreement of tax assessments in Hungary. The tax authorities may examine the accounting records and revise assessments for up to six years after the period to which they relate. Consequently, the Bank may be subject to further assessments in the event of an audit by the tax authorities The corporate tax returns for the Bank have been reviewed and closed off by the taxation authorities for the years up to 2017, except for 2015 year. Management is not aware of any additional significant non-accrued potential tax liability which might arise relating to years not audited by the tax authorities.

The effective income tax rate varied from the statutory income tax rate due to the following items:

	2020	2019
	MHUF	MHUF
Profit / (loss) before tax	40 074	58 745
Income tax rate	9,00%	9.00%
Income tax calculated	(3 607)	(5 287)
Plus/minus tax effects attributable to:		
Tax base decreasing items	913	865
Adjustments related to prior years	(83)	456
Local taxes and investment services tax	(4 617)	(4 355)
Tax base increasing items	(346)	(147)
Other	119	137
Total tax effects	(4 014)	(3 044)
Income tax expense (income tax calculated + total tax effects)	(7 621)	(8 331)

The effective income tax rate for 2020 is 19.02% (2019: 14.18%).

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY PORTFOLIO AND PRODUCT

	Held for trading	Mandatorily fair value through profit or loss	At fair value through other comprehensive income	At amortised cost*	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets at 31 December 2020						
Securities	564	-	112 299	987 119	-	1 099 982
Loans and advances	-	139 570	-	2 860 953	-	3 000 523
Derivatives	66 638	-	-	-	25 465	92 103
Total	67 202	139 570	112 299	3 848 072	25 465	4 192 608

	Held for trading	Mandatorily fair value through profit or loss	At fair value through other comprehensive income	At amortised cost*	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets at 31 December 2019						
Securities	11 806	-	93 040	796 685	-	901 531
Loans and advances	-	67 016	-	2 300 662	-	2 367 678
Derivatives	65 220	-	-	-	29 507	94 727
Total	77 026	67 016	93 040	3 097 347	29 507	3 363 936

*Including cash balance with central banks and other demand deposits to credit institutions.

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2020					
Deposits from central banks	-	-	-	247 198	247 198
Deposits from credit institutions and investment firms*	-	-	-	299 475	299 475
Deposits from customers and debt certificates	-	33 051	-	3 264 147	3 297 198
Deposits from customers	-	29 513	-	3 217 565	3 247 078
Demand deposits	-	-	-	2 746 833	2 746 833
Time deposits	-	29 513	-	146 660	176 173
Savings deposits	-	-	-	324 072	324 072
Debt certificates	-	3 538	-	46 582	50 120
Certificates of deposits	-	-	-	232	232
Non-convertible bonds	-	3 538	-	0	3 538
Non-convertible subordinated liabilities	-	-	-	46 350	46 350
Derivatives	64 168	-	24 365	-	88 533
Other	-	-	-	17 450	17 450
Total carrying value	64 168	33 051	24 365	3 828 270	3 949 854

*Of which HUF 43 428 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 15 458 million.

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2019					
Deposits from central banks	-	-	-	95 408	95 408
Deposits from credit institutions and investment firms*	-	-	-	261 988	261 988
Deposits from customers and debt certificates	-	52 614	-	2 606 850	2 659 464
Deposits from customers	-	46 727		2 564 664	2 611 391
Demand deposits	-	-	-	2 113 617	2 113 617
Time deposits	-	46 727	-	161 757	208 484
Savings deposits	-	-	-	289 290	289 290
Debt certificates	-	5 887	-	42 186	48 073
Certificates of deposits	-	-	-	233	233
Non-convertible bonds	-	5 887	-	-	5 887
Non-convertible subordinated liabilities	-	-	-	41 953	41 953
Derivatives	61 193	-	25 021	-	86 214
Other	-	-	-	15 379	15 379
Total carrying value	61 193	52 614	25 021	2 979 625	3 118 453

*Of which HUF 29 945 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 23 086 million.

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Details of financial instruments

Securities

Debt securities at fair value through other comprehensive income and at amortised cost are performing, non-past due bonds classified as stage 1 under IFRS 9.

The breakdown of securities is presented in the tables below.

	2020 MHUF	2019 MHUF
Held for trading		
Hungarian Treasury bills	20	11 555
Hungarian government bonds issued in HUF	544	251
Total held for trading securities	564	11 806

	2020 MHUF		2019 MHUF	
	Gross carrying amount MHUF	Impair-ment MHUF	Gross carrying amount MHUF	Impair-ment MHUF
Fair value through other comprehensive income				
Hungarian government bonds issued in HUF	107 997	(59)	88 818	(48)
Listed equity instrument	3 231	-	2 423	-
Unlisted equity instruments	646	-	13 037	(190)
Mortgage bonds	-	-	210	-
Bond issued by non-financial corporations in HUF	485	(1)	993	(1)
Total fair value through other comprehensive income	112 359	(60)	105 481	(239)

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

FVOCI equity instruments contain as at 31 December 2020 unlisted equity instruments in a value of HUF 645 million (HUF 645 million at the end of 2019) for which a fair value cannot be measured reliably. These investments are not traded on active markets. Management believes that the carrying value of the investments held at cost approximates their fair value.

The fair value of the Bank's investment in Visa Inc. is presented as listed equity instrument in the table above.

These FVOCI investments contain long term investments in companies where the Bank does not have significant influence.

FVOCI investments disclosed on their net carrying amount are:

	2020 MHUF	2019 MHUF
Garantiqa Hitelgarancia Zrt.	640	640
SWIFT S.C.	5	5
	645	645

The Bank recorded HUF 419 million gain after tax in other comprehensive income as a result of the fair value revaluation of FVOCI debt securities in 2020(HUF 2 254 million losses after tax for in 2019).

The unrealised result of FVOCI debt securities is cumulatively HUF 4 700 million gain after tax as at 31 December 2020 (HUF 5 301 million gain as at 31 December 2019).

Debt securities at amortised cost consisted of the following types of securities.

	2020 MHUF		2019 MHUF	
	Gross carrying amount MHUF	Impair-ment MHUF	Gross carrying amount MHUF	Impair-ment MHUF
At amortised cost				
Government bonds issued in HUF	899 070	(568)	749 323	(433)
Government bonds issued in foreign currenc	67 749	0	31 874	(14)
Bonds issued by municipality issued in HUF	260	-	422	-
Bonds issued by financial corporations in HUF	8 950	(5)	9 832	-
Bonds issued by non-financial corporations ii HUF	11 695	(30)	5 686	(5)
Total at amortised cost	987 724	(603)	797 137	(452)

Bonds issued by financial corporations include bonds issued by the Investor Protection Fund and the National Deposit Insurance Fund of Hungary.

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

The Bank participated in the Bond Funding for Growth Scheme (BGS) launched by MNB (National Bank of Hungary) with the aim of developing local bond market, boosting securitization of existing loans and diversifying the funding structure of corporate sector. Within the framework of the scheme, MNB purchases bonds in both the primary and secondary markets.

Assets pledged as collateral for liabilities and contingent liabilities

	2020 MHUF	2019 MHUF
Assets pledged for:		
Repo liabilities	15 357	21 014
Funding for Growth Scheme launched by the National Bank of Hungary	231 303	98 154
Derivative transactions	31 625	21 389
Clearing transactions	-	708
Mortgage refinancing loans	180 225	159 450
Total assets pledged as collateral	458 510	300 715

Assets pledged as collateral for refinancing credits, derivatives and clearing transactions contain cash and cash equivalents and securities. These assets are not transferred to the counterparty. In case of derivatives the terms and conditions of collateral settlement are defined in separate CSAs (Credit Support Annexes) between the counterparties. In case of securities the collateral requirement is defined on portfolio basis and it is held in custody at a central clearing house (KELER).

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

The following table presents the breakdown of financial assets mandatorily at fair value through profit or loss and at amortised cost by portfolio and product as at 31 December 2020.

	Mandatorily at fair value through profit or loss			At amortised cost		
	Gross carrying amount	Accumulated negative changes in fair value due to credit risk	Total	Gross carrying amount	Accumulated impairment	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020*						
Central bank and credit institutions	4 032	-	4 032	1 158 548	(39)	1 158 509
General government	34	-	34	82 003	(405)	81 598
Corporate	1 746	-	1 746	972 921	(27 298)	945 623
of which: Small and Medium enterprises	36	-	36	580 753	(13 856)	566 897
Households	133 869	(111)	133 758	697 282	(22 059)	675 223
Consumer credit	99 312	(5)	99 307	88 473	(2 458)	86 015
Credit card	-	-	-	5 880	(117)	5 763
Current account	-	-	-	10 859	(1 111)	9 748
Finance lease	-	-	-	3 470	(36)	3 434
Mortgage loan	34 557	(106)	34 451	565 778	(17 900)	547 878
Term loan	-	-	-	22 822	(437)	22 385
Total	139 681	(111)	139 570	2 910 754	(49 801)	2 860 953

For details of the valuation method of loans and advances mandatorily at fair value through profit or loss see Note 18.

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

The following table presents the breakdown of financial assets mandatorily at fair value through profit or loss and at amortised cost by portfolio and product as at 31 December 2019.

	Mandatorily at fair value through profit or loss			At amortised cost		
	Gross carrying amount	Accumulated negative changes in fair value due to credit risk	Total	Gross carrying amount	Accumulated impairment	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2019*						
Central bank and credit institutions	1 553	-	1 553	811 656	(45)	811 611
General government	61	-	61	52 686	(354)	52 332
Corporate	3 356	-	3 356	834 566	(14 079)	820 487
of which: Small and Medium enterprises	100	-	100	535 201	(10 767)	524 434
Households	62 349	(303)	62 046	636 684	(20 452)	616 232
Consumer credit	40 422	(2)	40 420	70 014	(1 997)	68 017
Credit card	-	-	-	5 934	(139)	5 795
Current account	-	-	-	11 784	(973)	10 811
Finance lease	-	-	-	2 934	(21)	2 913
Mortgage loan	21 927	(301)	21 626	523 128	(17 219)	505 909
Term loan	-	-	-	22 890	(103)	22 787
Total	67 319	(303)	67 016	2 335 592	(34 930)	2 300 662

*From the total balance of loans and advances to Central bank and credit institutions HUF 601 192 million is either repayable on demand or is maturing in less than 90 days (HUF 361 159 million in 2019). Reverse repo transactions amounted to HUF 25 399 million in 2020 (in 2019: HUF 6 716 million).

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Refinancing credits

The Bank has entered into several refinancing credit facilities with financial institutions (such as Takarékbank, MFB – Development Bank, EXIM Bank) for the purpose of funding portions of the Bank's activities. There are several covenants governing the determination of qualified recipients, the on-going monitoring process of the ultimate recipients and the repayment process. In all cases the Bank assumes all credit risk related to the ultimate borrower and must check compliance with all covenants.

The National Bank of Hungary (NBH) launched a program called Funding for Growth Scheme in 2013. The aim of the program is the refinancing of small and medium enterprises (SME) through the Hungarian bank system. The NBH funds the credit institutions attending the program through below market rate refinancing loans during a temporary period and in a limited amount. These funds are used by the credit institutions for granting credits to SMEs with similar, favourable conditions for pre-determined purposes. The maximum maturity of the refinancing loans is 10 years at initiation and it corresponds to the maturity of the loans granted to the customers.

The latest phase of Funding for Growth Scheme launched in April 2020 aims to help SMEs and corporations to mitigate the negative financial effects of the Covid-19 crises. The scheme makes financial funds available to micro-, small and medium-sized businesses through credit institutions and financial businesses at a fixed interest rate of a maximum 2.5%. The maximum tenor of the loans is set at 20 years. In a further easing of terms compared to previous phases of the scheme, it will be possible to draw down loans within three years from the signing of the contract. The minimum loan amount is reduced to HUF 1 million and the maximum loan amount per one SME is HUF 20 000 million. Financial institutions must assess loan applications within two weeks from the availability of the necessary information.

At 31 December 2020, Management believes that the Bank is in compliance with all covenants. Refinancing credits are presented as financial liabilities at amortised cost in the statement of financial position.

	2020 MHUF	2019 MHUF
Refinancing credits in the frame of the Funding for Growth Scheme	247 198	95 408
Other refinancing credits	236 514	208 108
Total refinancing credits	483 712	303 516

Non-convertible subordinated liabilities

	2020 MHUF	2019 MHUF
Subordinated loan from KBC Group	46 350	41 953

In June 2006, the Bank borrowed EUR 60 million (HUF 21 908 million in 2020 and HUF 19 831 million in 2019) of subordinated debt from KBC Bank N.V. Dublin branch, a member of the KBC Group. In 2014 KBC Bank N.V. has taken over the facility from its branch. In March 2015 the loan's original maturity of 30 June 2016 was extended with 10 years. The loan bears a variable interest rate of 3 month-EURIBOR plus 2.70 percent per annum.

In September 2015 the Bank agreed on an additional subordinated debt of EUR 30 million (HUF 10 954 million in 2020 and HUF 9 916 million in 2019) with KBC Bank N.V. with conditions of 10 years maturity and a variable interest rate of 3 month-EURIBOR plus 3.05 percent per annum.

The third subordinated loan contract between the Bank and KBC Bank N.V. was made in December 2017. KBC Bank N.V. granted an additional EUR 37 million (HUF 13 510 million in 2020 and HUF 12 229 million in 2019) loan to the Bank with a maturity of 10 years and a variable interest rate of 3 months-EURIBOR plus 1.53 percent per annum.

NOTE 15 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Non-convertible subordinated liabilities are presented as financial liabilities at amortised cost in the statement of financial position.

NOTE 16 – TRANSFERRED FINANCIAL ASSETS

The following table includes transferred financial assets continued to be recognised in their entirety.

	2020		2019	
	Carrying amount of transferred asset	Carrying amount of associated liability	Carrying amount of transferred asset	Carrying amount of associated liability
	MHUF	MHUF	MHUF	MHUF
Held-for-trading debt instruments	1 802	1 833	-	-
Debt securities at amortised cost	10 004	10 101	20 279	15 691
Debt securities at fair value through other comprehensive income	3 551	3 524	735	735
Total transferred assets and associated liabilities	15 357	15 458	21 014	16 426

Repo and reverse repo agreements

Under reverse repo transactions, the Bank obtains legal ownership of the respective collateral received and, thus, is permitted to utilise the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity, which generates a liability recorded as financial liability held at amortised cost in the financial position. The Bank recorded a HUF 25 399 million reverse repo transaction as at 31 December 2020 (in 2019 HUF 6 555 million).

The terms of repos and reverse repo transactions are less than three months and the interest rate is based on HUF interbank rates (BUBOR).

The Bank has no associated liabilities which have recourse limited only to the transferred assets.

NOTE 17 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

The following tables present the financial assets and liabilities which are subject to enforceable master netting agreements as at 31 December 2020:

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial assets	Gross amount of financial liabilities set off	Net amounts of financial assets	Financial instruments	Cash collateral received	Securities collateral received	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	92 102	-	92 102	67 866	1 920	-	22 316
Reverse repurchase agreements	25 399	-	25 399	-	-	25 291	108
Total financial assets subject to offsetting or master netting agreements	117 501	-	117 501	67 866	1 920	25 291	22 424

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial liabilities	Gross amount of financial assets set off	Net amounts of financial liabilities	Financial instruments	Cash collateral pledged	Securities collateral pledged	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	88 533	-	88 533	67 866	19 568	16	1 083
Repurchase agreements	15 458	-	15 458	-	-	15 357	103
Total financial liabilities subject to offsetting or master netting agreements	103 991	-	103 991	67 866	19 568	15 373	1 186

NOTE 17 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES (continued)

The following tables present the financial assets and liabilities which are subject to enforceable master netting agreements as at 31 December 2019:

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial assets	Gross amount of financial liabilities set off	Net amounts of financial assets	Financial instruments	Cash collateral received	Securities collateral received	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	94 727	-	94 727	80 169	4 280	-	10 278
Reverse repurchase agreements	6 716	-	6 716	-	-	6 555	161
Total financial assets subject to offsetting or master netting agreements	101 443	-	101 443	80 169	4 280	6 555	10 439

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial liabilities	Gross amount of financial assets set off	Net amounts of financial liabilities	Financial instruments	Cash collateral pledged	Securities collateral pledged	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	86 214	-	86 214	80 169	3 032	14	2 999
Repurchase agreements	23 086	-	23 086	-	-	21 014	2 072
Total financial liabilities subject to offsetting or master netting agreements	109 300	-	109 300	80 169	3 032	21 028	5 071

NOTE 17 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES (continued)

Derivatives, repurchase and reverse repurchase agreements are subject to different netting agreements as ISDA (International Swaps and Derivatives Association) Master Agreements, CSAs (Credit Support Annex) and GMRAs (Global Master Repurchase Agreement) in case of institutional clients (credit institutions and investment firms) or treasury limits in case of corporate customers.

Financial assets and liabilities subject to master netting agreements are not netted in the statement of financial position, since the Bank has no intention to settle these instruments on a net basis in the normal course of business.

Given cash collaterals are recognised in the loans-and-receivables portfolio as loans and advances to credit institutions and investment firms repayable on demand. Cash collaterals received are included in financial liabilities held on amortised cost and are recognised as demand deposits from credit institutions and investment firms.

Securities collaterals received are not recorded in the consolidated statements of financial position. Securities collaterals pledged are recognised in the consolidated statement of financial position in the appropriate portfolio (and are presented as assets pledged as collateral for liabilities and contingent liabilities in Note 15).

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The table below presents information concerning the fair value of financial assets and liabilities for year 2020:

	Fair value							
	Quoted market price (level 1)	**Valuation techniques - observable inputs (level 2)**	**Valuation techniques - un-observable inputs (level 3)**	**Total fair value**	**Total carrying amount**	**Accumulated difference between FV and carrying amount not recognised in PL or equity**	**Recognised in other comprehensive income: un-observable input**	**Recognised in profit or loss un- observable inputs***
	MHUF	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**
Cash and cash balances with central banks and other demand deposits with credit institutions	71 154	319 891	-	391 045	391 045	-	-	-
Financial assets	1 141 743	972 946	1 826 474	3 941 163	3 872 717	68 446	373	6 014
Held for trading	13	61 495	5 694	67 202	67 202	-	-	4 512
Mandatorily at fair value through profit or loss other than held for trading	-	4 032	135 538	139 570	139 570	-	-	1 502
Fair value through other comprehensive income	109 315	889	2 095	112 299	112 299	-	373	-
Measured at amortised cost	1 032 415	881 065	1 683 147	3 596 627	3 528 181	68 446	-	-
Hedging derivatives	-	25 465	-	25 465	25 465	-	-	-
Total financial assets and cash and cash balances with central banks and other demand deposits with credit institutions	1 212 897	1 292 837	1 826 474	4 332 208	4 263 762	68 446	373	6 014
Financial liabilities								
Held for trading	16	58 490	5 662	64 168	64 168	-	-	(4 480)
Fair value option	-	33 051	-	33 051	33 051	-	-	-
Measured at amortised cost	-	142 008	3 688 435	3 830 443	3 828 270	(2 173)	-	-
Hedging derivatives	-	24 365	-	24 365	24 365	-	-	-
							-	
Total financial liabilities	16	257 914	3 694 097	3 952 027	3 949 854	(2 173)	-	(4 480)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss in the income statement.

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The table below presents information concerning the fair value of financial assets and liabilities for year 2019:

	Fair value							
	Quoted market price (level 1)	Valuation techniques - observable inputs (level 2)	Valuation techniques - un-observable inputs (level 3)	Total fair value	Total carrying amount	Accumulated difference between FV and carrying amount not recognised in PL or equity	Recognised in other comprehensive income: un-observable input	Recognised in profit or loss un- observable inputs*
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Cash and cash balances with central banks and other demand deposits with credit institutions	54 226	359 276	-	413 502	413 502	-	-	-
Financial assets	933 298	591 022	1 557 084	3 081 404	3 004 660	76 744	852	3 419
Held for trading	246	72 433	4 347	77 026	77 026	-	-	3 231
Mandatorily at fair value through profit or loss other than held for trading	-	1 553	65 463	67 016	67 016	-	-	188
Fair value through other comprehensive income	88 769	1 202	3 069	93 040	93 040	-	852	-
Measured at amortised cost	844 283	486 327	1 484 205	2 814 815	2 738 071	76 744	-	-
Hedging derivatives	-	29 507	-	29 507	29 507	-	-	-
Total financial assets and cash and cash balances with central banks and other demand deposits with credit institutions	987 524	950 298	1 557 084	3 494 906	3 418 162	76 744	852	3 419
Financial liabilities								
Held for trading	14	56 822	4 357	61 193	61 193	-	-	(3 248)
Fair value option	-	52 614	-	52 614	52 614	-	-	-
Measured at amortised cost	-	125 357	2 855 566	2 980 923	2 979 625	(1 298)	-	-
Hedging derivatives	-	25 021	-	25 021	25 021	-	-	-
Total financial liabilities	14	259 814	2 859 923	3 119 751	3 118 453	(1 298)	-	(3 248)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss in the income statement.

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Hungarian government bonds have quoted market price except for some treasury bills and bonds maturing within 3 months, which are valued based on BUBOR yield curve within 3 months maturity. In 2020 no debt instruments were transferred from Quoted market price to Valuation techniques-market observable inputs category due to this change in valuation (nor in 2019).

The following evaluation tables present the change in the fair value of financial instruments for which no market observable inputs are available.

Financial assets	**Held-for trading-derivatives**	**Mandatorily fair value through profit or loss**	**Fair value other comprehensive income**	**Total**
	MHUF	**MHUF**	**MHUF**	**MHUF**
Balance as at 31 December 2019	4 347	65 463	2 423	72 233
Net gains / (losses)				
In profit or loss	2 271	1 502	-	3 773
In other comprehensive income	-	-	373	373
Acquisitions	2 241	74 714	-	76 955
Settlement	(3 165)	(9 621)	(1 346)	(14 132)
Other	-	3 480	-	3 480
Balance as at 31 December 2020	5 694	135 538	1 450	142 682

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Financial assets	**Held-for trading-derivatives**	**Mandatorily fair value through profit or loss**	**Fair value other comprehensive income**	**Total**
	MHUF	**MHUF**	**MHUF**	**MHUF**
Balance as at 31 December 2018	4 296	20 066	1 571	25 933
Net gains / (losses)				
In profit or loss	(59)	188	-	129
In other comprehensive income	-	-	852	852
Acquisitions	3 290	49 285	-	52 575
Settlement	(3 180)	(4 690)	-	(7 870)
Other	-	614	-	614
Balance as at 31 December 2019	4 347	65 463	2 423	72 233

Financial liabilities	**Held-for-trading derivatives**
	MHUF
Balance as at 31 December 2019	4 357
Net (gains) / losses	
In profit or loss	2 272
Acquisitions	2 208
Settlement	(3 175)
Balance as at 31 December 2020	5 662

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Financial liabilities	Held-for-trading derivatives MHUF
Balance as at 31 December 2018	4 272
Net (gains) / losses	
In profit or loss	(51)
Acquisitions	3 299
Settlement	(3 163)
Balance as at 31 December 2019	4 357

Fair value of financial instruments

Financial instruments at fair value

Held-for-trading instruments, financial instruments designated at fair value through profit or loss, financial assets mandatorily at fair value through profit or loss, financial assets at fair value through other comprehensive income and hedging derivatives are carried at their fair value.

Financial instruments which have an active market with regularly published price quotations are marked to market. Usually treasury bills, Hungarian government bonds, other listed bonds and listed equity instruments belong to this category, excluding Hungarian government bonds denominated in HUF and maturing within 3 months, premium Hungarian government bonds denominated in EUR, bonus Hungarian government bonds denominated in HUF and some treasury bills. There are no price quotations for Hungarian government bonds denominated in HUF and maturing within 3 months therefore they are valued based on BUBOR yield curve within 3 months maturity. For premium Hungarian government bonds denominated in EUR no active secondary market exists therefore they are valued at the price quoted at issuance. Since the Government grants the repurchase of the bonds at the issuance price Management believes that the carrying amount of these bonds approximates their fair value.

If there is no active market or quoted prices for a financial instrument then valuation techniques based on observable market parameters are used, such as discounted cash flow analysis or option pricing models. Bonus Hungarian government bonds denominated in HUF, most of the financial liabilities designated at fair value through profit or loss and most of the derivatives are valued based on these techniques, such as currency forwards and swaps, foreign exchange and interest rate options, cross currency- and interest rate swaps and forward rate agreements.

When market parameters are not available, the Bank uses its best estimations and assumptions to determine the relevant circumstances which have to be taken into account during the model valuation. Valuation techniques based on unobservable market parameters are used in case of held-for-trading exotic derivatives.

Exotic derivatives are primarily revalued by built-in models of the front office system using market observable parameters. For which no system model exists, there are two alternatives; (1) position is either back-to-back hedged, and the Bank accepts the hedging partner prices (when hedging bank acts as valuation agent) or (2) valuation is based on internal model based best estimates (e.g. in case of municipality bonds embedded swaption valuation).

The Bank provides exotic derivatives on back to back basis, accordingly immaterial result is recorded on held-for-trading exotic derivatives in the income statement. From the same reason, applying alternative assumptions for the fair value calculation would cause no result in the income statement.

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The calculation of the fair value of Visa Inc. preferred shares is based on the amount of shares the Bank holds, the conversion rate to Visa Inc. listed shares, the Visa Inc. share price as listed on the New York Stock Exchange and the illiquidity discount. Management believes that changing the measure of illiquidity gap (as the only level 3 component of the fair value calculation) would not change the calculated fair value intrinsically.

For determination of the fair value of loan portfolios which failed the IFRS9 SPPI test the Bank applies a discounted cash-flow model for subsequent measurement. The estimates of expected cash-flows are based on stochastic model using historical demographical data. The Bank determines the fair value as the present value of the expected cash-flows to incorporate time value and addition factors - not yet captured by cash-flow estimation - into the valuation model, such as impact of market rates, liquidity risk, credit risk, cost of capital, operational costs.

The difference between the fair value and the transaction price of financial instruments not recognised in profit or loss was immaterial at the end of the year in 2020 and 2019.

The following describes the methodology and assumptions used to determine fair values for those financial instruments which are not recorded at fair value in the financial statements.

FVOCI equity instruments held at cost

FVOCI equity instruments contain as at 31 December 2020 equity instruments in a value of HUF 645 million (HUF 645 million as at 31 December 2019) which fair value cannot be measured reliably.

Management believes that the carrying value of the investments held at cost approximates their fair value (for more information see Note 15).

Underlying the definition of fair value is the presumption that the Bank is a going concern without any intention or requirement to curtail materially the scale of its operations or to undertake a transaction on adverse terms.

Financial assets and financial liabilities measured at amortised cost

Debt securities at amortised cost include Hungarian government bonds issued in HUF and EUR. The fair value of Hungarian government bonds denominated in HUF and maturing over 3 months disclosed in this Note is calculated based on regularly quoted market prices, since these instruments have an active market. Hungarian government bonds denominated in HUF and maturing within 3 months are valued based on BUBOR yield curve within 3 months maturity. Hungarian government bonds issued in EUR have an active market with regularly published price quotations and are marked to market.

For premium Hungarian government bonds denominated in EUR no active secondary market exists therefore premium Hungarian government bonds are held at the price quoted at issuance in the statement of financial position. Since the Government grants the repurchase of the bonds at an exit price of 98% the Bank considers this exit price for calculation of the fair value in this note.

Bonus Hungarian government bonds denominated in HUF are valued by a valuation technique where the future cash flow is discounted by a curve calculated from IRS curves modified by asset swap and illiquidity spreads. Although illiquidity spread is non-market observable input, due to its immaterial effect in the fair value of the asset the bond is classified as financial instrument valued by valuation techniques – market observable inputs in the fair value hierarchy.

Municipality bonds were issued in HUF. There is an embedded option which assures that the municipality can change the denomination of the bond at any point of time during its duration to EUR or CHF at the spot rate of the conversion date. Nevertheless, the interest spread remains unchanged over the reference rate.

This optionality corresponds to a sold, deferred premium, American type multicurrency differential swaption from the Bank's point of view. Cross-currency swaption of this kind is an instrument for which no market value is available but its intrinsic value can be calculated from available market parameters. The value of the swaption is not material.

NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The municipality bond as such can be split to two components which fair values give the total fair value of the bond. The two instruments are (1) bonds and, (2) swaptions. The market value of the bonds is calculated using discounted present value of the future cash flows. The future cash flow of the bond is predicted by the default money market yield curve. The value of swaptions is calculated regularly.

There is no active market for these municipality bonds to get market observable parameters for the revaluation especially for credit spread which is a risk on the top of the Hungarian government bonds. To challenge the fair valuation model, the Bank uses a reasonably possible alternative assumption to increase the applied credit spread.

Municipality bonds did not fail the IFRS 9 SPPI test since the reference interest follows the concerned currency before and after the conversion as well.

For loans and advances and financial liabilities that are liquid or have a short term remaining maturity (less than one year) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity, and variable rate financial instruments. Fair value adjustments of refinanced loans with fixed or variable interest are included in unrecognised gain / (loss) of financial assets at amortised cost, fair value adjustments of refinancing liabilities with fixed or variable interest are included in unrecognised gain / (loss) of financial liabilities measured at amortised cost.

The estimated fair value of fixed interest bearing deposits with more than one year remaining maturity and refinancing liabilities (carried at amortised cost) is based on discounted cash flows using current interbank market yield curve appropriate for the remaining term to maturity.

The estimated fair value of fixed interest bearing assets with more than one year remaining maturity and refinanced loans (carried at amortised cost) is based on discounted cash flows using current interbank market yield curve appropriate for the remaining term to maturity which is adjusted with the average margin of the retail and corporate loan portfolio of the Bank to arrive at the estimated market yield curve of the asset.

The Bank believes that the carrying amount of the impaired loans is the best estimation of their fair value and therefore does not present any unrecognised gain or loss on impaired loans and advances in this Note.

NOTE 19 – FINANCIAL ASSETS MANDATORILY AT FAIR VALUE AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020 MHUF	2019 MHUF
Financial assets mandatorily at fair value through profit or loss		
Loans to customers	139 570	67 016
	139 570	67 016

Loans to customers measured mandatorily at fair value through profit and loss include customer loans which failed the SPPI test at the IFRS9 transition due to their interest conditions. In 2020 the significant increase is primarily attributable to the state subsidized loan (prenatal baby support loan).

	2020 MHUF	2019 MHUF
Financial liabilities designated at fair value through profit or loss		
Term deposits:		
- retail	126	188
- corporate	2 187	2 190
- investment funds	27 200	44 349
Other issued bonds	3 538	5 887
	33 051	52 614

In 2007 the Bank established a bond issuance program. The Bank, as issuer sells dematerialised bonds via public placement. The bonds may be denominated in HUF, EUR or USD. The maturities are between 60 days and 20 years with the interest rates being fixed or floating, linked to an index (equity, currency or commodity), or credit linked.

Upon initial recognition the bonds were designated by the Bank at fair value through profit or loss as the bonds are economically hedged by derivatives which do not achieve the criteria for hedge accounting.

Included in financial liabilities designated at fair value through profit or loss are retail and corporate term deposits combined with currency options which are accounted for as embedded derivatives. The fair value of the deposits and the options are not separated.

Based on the Bank's treasury policy the long term fixed rate deposits from investment funds included in financial liabilities designated at fair value through profit or loss are economically hedged by interest rate derivatives, and do not qualify for hedge accounting.

The amount that the Bank would contractually be required to pay at maturity is HUF 628 million lower than the fair value of the deposits and issued bonds (HUF 1 million higher as at 31 December 2019).

NOTE 20 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND GEOGRAPHIC LOCATION

The Bank's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2020 can be analysed by the following geographical regions.

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Designated at fair value through profit or loss	Mandatory fair value through profit or loss	At fair value through other comprehensive income	Amortised cost	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Hungary	184 256	28 592	-	135 518	109 062	3 166 586	45	3 624 059
EMU countries	110 282	38 092	-	4 042	6	360 647	23 540	536 609
East-European countries	4 021	1	-	-	-	723	-	4 745
Russia	455	-	-	-	-	13	-	468
Other European countries	2 040	517	-	-	-	135	1 880	4 572
Non-European countries	18 837	-	-	10	3 231	77	-	22 155
Total	319 891	67 202	0	139 570	112 299	3 528 181	25 465	4 192 608
Financial liabilities								
Hungary	-	6 679	33 051	-	-	3 705 621	449	3 745 800
EMU countries	-	57 172	-	-	-	100 672	23 683	181 527
East-European countries	-	68	-	-	-	8 934	-	9 002
Russia	-	-	-	-	-	1 406	-	1 406
Other European countries	-	249	-	-	-	6 057	233	6 539
Non-European countries	-	-	-	-	-	5 580	-	5 580
Total	0	64 168	33 051	0	0	3 828 270	24 365	3 949 854

NOTE 20 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND GEOGRAPHIC LOCATION (continued)

The Bank's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2019 can be analysed by the following geographical regions.

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Designated at fair value through profit or loss	Mandatory fair value through profit or loss	At fair value through other comprehensive income	Amortised cost	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Hungary	280 334	26 853	-	65 463	90 612	2 313 708	51	2 777 021
EMU countries	70 973	49 356	-	1 553	5	418 202	26 471	566 560
East-European countries	4 030	12	-	-	-	685	-	4 727
Russia	471	-	-	-	-	1 126	-	1 597
Other European countries	684	805	-	-	-	4 299	2 985	8 773
Non-European countries	2 784	-	-	-	2 423	51	-	5 258
Total	359 276	77 026	-	67 016	93 040	2 738 071	29 507	3 363 936
Financial liabilities								
Hungary	-	6 494	52 614	-	-	2 855 256	746	2 915 110
EMU countries	-	54 421	-	-	-	103 503	23 817	181 741
East-European countries	-	17	-	-	-	7 927	-	7 944
Russia	-	-	-	-	-	1 729	-	1 729
Other European countries	-	261	-	-	-	5 428	458	6 147
Non-European countries	-	-	-	-	-	5 782	-	5 782
Total	-	61 193	52 614	-	-	2 979 625	25 021	3 118 453

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY

Credit quality per class of financial assets

The table below presents the credit quality by asset classes as at 31 December 2020:

	Loans and advances mandatorily at fair value through profit or loss			
	Gross carrying amount		Accumulated negative changes in fair value due to credit risk	
	Performing	Non-performing	Non-performing	Total
	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020				
Central bank and credit institutions	4 032	-	-	4 032
General government	34	-	-	34
Corporate	1 746	-	-	1 746
of which: Small and Medium enterprises	36	-	-	36
Households	133 626	243	(111)	133 758
Consumer credit	99 264	48	(5)	99 307
Credit card	-	-	-	-
Current account	-	-	-	-
Finance lease	-	-	-	-
Mortgage loan	34 362	195	(106)	34 451
Term loan	-	-	-	-
Trade receivables	-	-	-	-
Total	139 438	243	(111)	139 570

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

	Loans and advances at amortised cost*					
	Gross carrying amount			Accumulated impairment		
	Performing MHUF	Non-performing MHUF	Total MHUF	Performing MHUF	Non-performing MHUF	Total MHUF
Loans and advances at 31 December 2020						
Central bank and credit institutions	1 158 543	5	1 158 548	(39)	-	(39)
General government	81 624	379	82 003	(30)	(375)	(405)
Corporate	954 407	18 514	972 921	(18 416)	(8 882)	(27 298)
of which: Small and Medium enterprises	572 377	8 376	580 753	(9 530)	(4 326)	(13 856)
Households	674 739	22 543	697 282	(10 607)	(11 452)	(22 059)
Consumer credit	87 723	750	88 473	(1 923)	(535)	(2 458)
Credit card	5 847	33	5 880	(96)	(21)	(117)
Current account	9 909	950	10 859	(877)	(234)	(1 111)
Finance lease	3 470	-	3 470	(36)	-	(36)
Mortgage loan	545 018	20 760	565 778	(7 259)	(10 641)	(17 900)
Term loan	22 772	50	22 822	(416)	(21)	(437)
Trade receivables	-	-	-	-	-	-
Total	2 869 313	41 441	2 910 754	(29 092)	(20 709)	(49 801)

The table includes the net carrying amount of loans and advances at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

The table below presents the credit quality by asset classes as at 31 December 2019:

	Loans and advances mandatorily at fair value through profit or loss			
	Gross carrying amount		Accumulated negative changes in fair value due to credit risk	
	Performing MHUF	Non-performing MHUF	Non-performing MHUF	Total MHUF
Loans and advances at 31 December 2019				
Central bank and credit institutions	1 553	-	-	1 553
General government	61	-	-	61
Corporate	3 356	-	-	3 356
of which: Small and Medium enterprises	100	-	-	100
Households	61 936	413	(303)	62 046
Consumer credit	40 412	10	(2)	40 420
Credit card	-	-	-	-
Current account	-	-	-	-
Finance lease	-	-	-	-
Mortgage loan	21 524	403	(301)	21 626
Term loan	-	-	-	-
Trade receivables	-	-	-	-
Total	66 906	413	(303)	67 016

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

	Loans and advances at amortised cost*					
	Gross carrying amount			Accumulated impairment		
	Performing MHUF	Non-performing MHUF	Total MHUF	Performing MHUF	Non-performing MHUF	Total MHUF
Loans and advances at 31 December 2019						
Central bank and credit institutions	811 636	20	811 656	(45)	-	(45)
General government	52 343	343	52 686	(15)	(339)	(354)
Corporate	816 239	18 327	834 566	(2 922)	(11 157)	(14 079)
of which: Small and Medium enterprises	521 915	13 286	535 201	(1 913)	(8 854)	(10 767)
Households	605 204	31 480	636 684	(4 271)	(16 181)	(20 452)
Consumer credit	69 355	659	70 014	(1 507)	(490)	(1 997)
Credit card	5 879	55	5 934	(103)	(36)	(139)
Current account	10 437	1 347	11 784	(342)	(631)	(973)
Finance lease	2 934	-	2 934	(21)	-	(21)
Mortgage loan	493 775	29 353	523 128	(2 229)	(14 990)	(17 219)
Term loan	22 824	66	22 890	(69)	(34)	(103)
Trade receivables	-	-	-	-	-	-
Total	2 285 422	50 170	2 335 592	(7 253)	(27 677)	(34 930)

The table includes the net carrying amount of loans and advances at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

Aging analysis of loans per class of financial assets

	Loans and advances*							
	Performing				Non-performing			
	Not past due	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020								
Central bank and credit institutions	1 162 536	-	-	-	5	-	-	1 162 541
General government	80 114	1 514	-	-	-	-	4	81 632
Corporate	935 060	2 169	427	81	8 060	164	1 408	947 369
of which: Small and Medium enterprises	561 798	584	425	76	2 570	159	1 321	566 933
Households	779 934	15 477	1 967	380	2 878	522	7 823	808 981
Consumer credit	181 471	3 268	259	66	66	14	178	185 322
Credit card	5 724	21	6	-	7	-	5	5 763
Current account	8 326	509	38	159	639	3	74	9 748
Finance lease	3 434	-	-	-	-	-	-	3 434
Mortgage loan	558 785	11 518	1 663	155	2 153	505	7 550	582 329
Term loan	22 194	161	1	-	13	-	16	22 385
Trade receivables	-	-	-	-	-	-	-	-
Total	2 957 644	19 160	2 394	461	10 943	686	9 235	3 000 523

*The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

Past due assets include those that are past due even by one day.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

	Loans and advances*							
	Performing				Non-performing			
	Not past due	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2019								
Central bank and credit institutions	813 144	-	-	-	20	-	-	813 164
General government	50 845	1 544	-	-	-	-	4	52 393
Corporate	804 813	11 676	122	62	5 380	514	1 276	823 843
of which: Small and Medium enterprises	512 027	7 894	121	60	2 686	514	1 232	524 534
Households	642 869	17 946	2 032	22	2 724	626	12 059	678 278
Consumer credit	106 182	1 820	258	-	10	2	165	108 435
Credit card	5 595	170	11	-	4	1	14	5 795
Current account	7 943	2 068	67	17	593	9	114	10 811
Finance lease	2 913	-	-	-	-	-	-	2 913
Mortgage loan	497 612	13 775	1 679	4	2 115	614	11 736	527 535
Term loan	22 624	113	17	1	2	-	30	22 787
Trade receivables	-	-	-	-	-	-	-	-
Total	2 311 671	31 166	2 154	84	8 124	1 140	13 339	2 367 678

*The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

Maximum exposure to credit risk without taking into account of any collateral and credit enhancements

The table below presents the maximum exposure to credit risk for the components of the statement of financial position, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	2020	2019
	MHUF	MHUF
Debt instruments*	1 096 106	898 464
Loans and advances	3 071 677	2 421 904
Derivatives*	92 103	94 727
Other assets	22 746	19 416
Total assets	4 282 632	3 434 511
Commitments to extend credit	667 977	604 304
Guarantees	287 152	270 294
Letters of credit	12 016	9 768
Total commitments and contingent liabilities	967 145	884 366
Total credit exposure	5 249 777	4 318 877

The amounts shown above represent the current credit risk exposure, which may change over time as a result of changes in values (derivative financial instruments, financial investments, etc.) and changes in FX rates (due to FCY lending). The effect of collateral and other risk mitigation techniques is shown in Note 43.4.

Risk concentration of the maximum exposure to credit risk

Concentration of risk is managed by client/client group and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2020 was HUF 65 241 million (HUF 59 408 million as of 31 December 2019) before taking account of any collateral or other credit enhancements.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

Gross carrying amount transfers between impairment stages

	From Stage 1 to Stage 2	From Stage 2 to Stage 1	From Stage 2 to Stage 3	From Stage 3 to Stage 2	From Stage 1 to Stage 3	From Stage 3 to Stage 1	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020*							
Central bank and credit institutions	-						
General government	69 997	-	-	-	-	-	-
Corporate	30 597	6 059	4 982	23	2 857	5	83 923
of which: Small and Medium enterprises	13 438	5 883	195	22	170	5	36 872
Households	2 901	24 566	1 889	2 625	1 130	94	43 742
Consumer credit	104	1 337	278	27	62	13	4 618
Credit card	491	203	9	1	9	1	327
Current account	59	782	21	334	6	37	1 671
Finance lease	9 378	129	-	-	-	-	188
Mortgage loan	505	21 562	1 576	2 262	1 053	43	35 874
Term loan	-	553	5	1	-	-	1 064
Trade receivables		-	-	-	-	-	-
Total	83 435	30 625	6 871	2 648	3 987	99	127 665
Loan commitments	38 225	8 467	42	23	63	11	46 831
Financial guarantees	4 388	14 006	165	-	-	-	18 559
Other commitments	18	-	-	-	-	-	18
Total	42 631	22 473	207	23	63	11	65 408

*The table includes the gross carrying amount of loans and advances at amortised cost.

NOTE 21 – LOANS AND ADVANCES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

	Gross carrying amount transfers between impairment stages						
	From Stage 1 to Stage 2 MHUF	From Stage 2 to Stage 1 MHUF	From Stage 2 to Stage 3 MHUF	From Stage 3 to Stage 2 MHUF	From Stage 1 to Stage 3 MHUF	From Stage 3 to Stage 1 MHUF	Total MHUF
Loans and advances at 31 December 2019*							
Central bank and credit institutions	-	-	-	-	-	-	-
General government	1 122	-	-	-	-	-	1 122
Corporate	24 791	11 871	123	187	7 094	47	44 113
of which: Small and Medium enterprises	16 477	7 546	122	187	2 613	46	26 991
Households	16 868	34 772	1 699	2 102	409	37	55 887
Consumer credit	1 530	653	174	26	186	3	2 572
Credit card	148	141	15	3	19	1	327
Current account	711	685	58	16	30	4	1 504
Finance lease	91	198	-	-	-	-	289
Mortgage loan	14 106	32 678	1 446	2 057	174	29	50 490
Term loan	282	417	6	-	-	-	705
Trade receivables	-	-	-	-	-	-	-
Total	42 781	46 643	1 822	2 289	7 503	84	101 122
Loan commitments	7 455	79 739	39	4	615	4	87 856
Financial guarantees	17 037	10 404	27	-	150	-	27 618
Other commitments	429	-	-	-	-	-	429
Total	24 921	90 143	66	4	765	4	115 903

*The table includes the gross carrying amount of loans and advances at amortised cost.
demand deposits to credit institutions.

NOTE 22 – IMPAIRMENT ON FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

The Bank recorded an additional impairment of HUF 11 million on debt securities at fair value through other comprehensive income in 2020 (HUF 24 million in 2019).

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs/sales	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost classified as stage 1 at 31 December 2020												
Debt securities	452	194	(44)	-	-	-	-	-	-	2	-	604
Loans and advances*												
Central bank and credit institutions	45	14	(281)	(4)	-	-	-	-	-	265	-	39
General government	15	12	(8)	7	-	-	-	-	-	4	-	30
Corporate	2 050	1 111	(182)	704	(269)	181	4	-	(32)	(44)	114	3 637
of which: Small and Medium enterprises	1 338	687	-	202	(87)	177	4	-	(2)	(240)	66	2 145
Households	1 185	560	(70)	(322)	(55)	160	-	(48)	(2)	(90)	-	1 318
of which: POCI	-	-	-	-	-	-	-	-	-	-	-	-
Consumer credit	904	528	(68)	(417)	(42)	23	-	(1)	1	1	-	929
Credit card	45	3	(2)	(13)	(1)	1	-	-	1	(1)	-	33
Current account	42	1	(2)	1	(4)	70	-	-	(4)	(66)	-	38
Finance lease	7	3	-	(6)	-	(1)	-	-	-	3	-	6
Mortgage loan	134	25	2	113	(8)	67	-	(47)	-	(26)	-	260
Term loan	53	-	-	-	-	-	-	-	-	(1)	-	52
Total impairment on loans and advances	3 295	1 697	(541)	385	(324)	341	4	(48)	(34)	135	114	5 024

* Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs/sales	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost classified as stage 2 at 31 December 2020												
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances*												
Central bank and credit institutions	-	-	-	-	-	-	-	-	-	-	-	-
General government	-	-	11	-	-	-	-	-	-	(11)	-	-
Corporate	872	493	57	7 009	7 677	(329)	6	45	-	(1 899)	848	14 779
of which: Small and Medium enterprises	575	399	-	5 033	4 167	(169)	6	9	-	(2 924)	289	7 385
Households	3 086	356	(163)	4 585	1 701	(1 136)	425	(232)	(22)	680	9	9 289
of which: POCI	-	-	-	-	-	-	-	-	-	-	-	-
Consumer credit	603	156	(27)	123	428	(292)	7	-	-	(4)	-	994
Credit card	58	6	(3)	10	31	(36)	-	-	-	(3)	-	63
Current account	300	64	(47)	252	109	(97)	283	-	(23)	(6)	4	839
Finance lease	14	14	-	9	8	(12)	-	-	-	(3)	-	30
Mortgage loan	2 095	116	(86)	4 191	1 125	(699)	135	(232)	1	348	5	6 999
Term loan	16	-	-	-	-	-	-	-	-	348	-	364
Total impairment on loans and advances	3 958	849	(95)	11 594	9 378	(1 465)	431	(187)	(22)	(1 230)	857	24 068

*Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance MHUF	Incr. due to origin. MHUF	Decr. due to derecog. MHUF	Chg in cr. risk – no stage transfers MHUF	Chg in cr. risk – transf. from stage 1 MHUF	Chg in cr. risk – transf. from stage 2 MHUF	Chg in cr. risk – transf. from stage 3 MHUF	Chg due to modif. MHUF	Decr. due to write-offs/sales MHUF	Other MHUF	Transl. diff. MHUF	Closing balance MHUF
Impairment on financial assets at amortised cost classified as stage 3 at 31 December 2020												
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances*												
Central bank and credit institutions	-	-	-	-	-	-	-	-	-	-	-	-
General government	339	-	-	-	-	-	-	-	-	-	36	375
Corporate	11 157	185	(723)	(39)	764	1 343	(13)	-	(4 099)	(40)	347	8 882
of which: Small and Medium enterprises	8 854	171	-	(656)	28	50	(13)	-	(4)	(4 226)	122	4 326
Households	16 181	88	(465)	(609)	318	559	(554)	317	(5 294)	853	58	11 452
of which: POCI	7 783	10	-	166	-	55	(149)	41	-	(2 641)	-	5 265
Consumer credit	490	18	(10)	57	12	163	(23)	40	(208)	(4)	-	535
Credit card	36	-	(5)	(4)	5	6	(1)	-	(18)	2	-	21
Current account	631	15	(52)	(4)	4	12	(243)	-	(127)	(2)	-	234
Finance lease	-	-	-	-	-	-	-	-	-	-	-	-
Mortgage loan	14 990	55	(398)	(658)	297	378	(287)	277	(4 941)	870	58	10 641
Term loan	34	-	-	-	-	-	-	-	-	(13)	-	21
Total impairment on loans and advances	27 677	273	(1 188)	(648)	1 082	1 902	(567)	317	(9 393)	813	441	20 709

*Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

The significant increase of impairment on loans and advances in 2020 is mainly results from the Covid-19 related changes in estimations and accounting judgements (see Note 3).

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs/sales	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost classified as stage 1 at 31 December 2019												
Debt securities	572	156	(276)	-	-	-	-	-	-	-	-	452
Loans and advances*												
Central bank and credit institutions	15	10	(5)	32	-	-	-	-	-	(7)	-	45
General government	16	8	(6)	(4)	-	-	-	-	-	1	-	15
Corporate	1 403	771	(143)	68	(19)	13	2	-	(27)	(33)	15	2 050
of which: Small and Medium enterprises	1 100	329	(53)	1	(15)	4	2	-	(22)	(21)	13	1 338
Households	851	773	(94)	(360)	(44)	(11)	-	(7)	(9)	86	-	1 185
of which: POCI	-	-	-	-	-	-	-	-	-	-	-	-
Consumer credit	591	727	(87)	(317)	(28)	13	-	-	2	3	-	904
Credit card	50	7	(3)	(3)	(2)	1	-	-	-	(5)	-	45
Current account	45	1	(1)	12	(4)	-	-	-	(10)	(1)	-	42
Finance lease	9	4	-	(6)	(1)	-	-	-	-	1	-	7
Mortgage loan	124	34	(3)	(46)	(9)	(25)	-	(7)	(1)	67	-	134
Term loan	32	-	-	-	-	-	-	-	-	21	-	53
Total impairment on loans and advances	2 285	1 562	(248)	(264)	(63)	2	2	(7)	(36)	47	15	3 295

* Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs/sales	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost classified as stage 2 at 31 December 2019												
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances*												
Central bank and credit institutions	-	-	-	-	-	-	-	-	-	-	-	-
General government	-	-	-	-	-	-	-	-	-	-	-	-
Corporate	893	79	(322)	(194)	407	(149)	-	-	-	149	9	872
of which: Small and Medium enterprises	675	69	(224)	(196)	228	(128)	-	-	-	150	1	575
Households	4 052	471	(319)	(431)	597	(1 375)	235	(25)	(57)	(63)	1	3 086
of which: POCI	-	-	-	-	-	-	-	-	-	-	-	-
Consumer credit	365	355	(173)	(41)	151	(164)	4	-	(29)	135	-	603
Credit card	79	8	(7)	(1)	25	(34)	1	-	(3)	(10)	-	58
Current account	286	27	(41)	63	78	(60)	3	-	(25)	(31)	-	300
Finance lease	8	10	-	-	2	(6)	-	-	-	-	-	14
Mortgage loan	3 302	71	(98)	(452)	341	(1 111)	227	(25)	-	(161)	1	2 095
Term loan	12	-	-	-	-	-	-	-	-	4	-	16
Total impairment on loans and advances	4 945	550	(641)	(625)	1 004	(1 524)	235	(25)	(57)	86	10	3 958

*Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs/sales	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost classified as stage 3 at 31 December 2019												
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances*												
Central bank and credit institutions	-	-	-	-	-	-	-	-	-	-	-	-
General government	364	-	(7)	(26)	-	-	-	-	-	(1)	9	339
Corporate	11 020	627	(691)	534	783	65	(79)	2479	(2 764)	(915)	98	11 157
of which: Small and Medium enterprises	9 819	627	(686)	548	446	64	(79)	941	(2 087)	(788)	49	8 854
Households	22 274	301	(1 450)	(664)	231	784	(1 192)	35	(5 661)	1 476	47	16 181
of which: POCI	10 581	14	(718)	(695)	-	256	(592)	32	(2 716)	1 621	-	7 783
Consumer credit	603	102	(860)	(622)	127	117	(25)	-	(175)	1 221	2	490
Credit card	39	1	(6)	(5)	13	10	(4)	-	(13)	1	-	36
Current account	700	152	(161)	91	21	42	(18)	-	(200)	1	3	631
Finance lease	105	-	-	-	-	-	-	-	-	(105)	-	-
Mortgage loan	20 790	46	(423)	(128)	70	615	(1 145)	35	(5 273)	361	42	14 990
Term loan	37	-	-	-	-	-	-	-	-	(3)	-	34
Total impairment on loans and advances	33 658	928	(2 148)	(156)	1 014	849	(1 271)	2 514	(8 425)	560	154	27 677

*Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

The gross carrying amount of loans and advances which were sold by the Bank amounted to HUF 15 978 million in 2020 (HUF 13 384 million in 2019). The Bank recorded a HUF 8 104 million income on the disposals (HUF 6 477 million in 2019). The gross carrying amount of loans written-off instead of selling them amounted to HUF 963 million in 2020 (HUF 3 359 million in 2019).

Stage transfers show shifts between stages having impact on profit or loss. ‘Stage transfers from’ columns decrease the balance of impairments in the old stage category and increase the balance in the new stage category.

The breakdown of impairments on cash balances with central banks and other demand deposits to credit institutions and financial assets at amortised cost recorded in the income statement is presented below.

	Stage 1	Stage 2	Stage 3	Total
	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost at 31 December 2020				
Debt securities	(150)	-	-	(150)
Loans and advances*				
Central bank and credit institutions	271	-	-	271
General government	(11)	(11)	-	(22)
Corporate	(1 549)	(14 958)	(1 517)	(18 024)
of which: Small and Medium enterprises	(983)	(9 445)	420	(10 008)
Households	(225)	(5 536)	346	(5 415)
of which: POCI	-	-	(123)	(123)
Consumer credit	(23)	(395)	(257)	(675)
Credit card	12	(8)	(1)	3
Current account	(66)	(564)	268	(362)
Finance lease	4	(19)	-	(15)
Mortgage loan	(152)	(4 550)	336	(4 366)
Term loan	-	-	-	-
Total	(1 664)	(20 505)	(1 171)	(23 340)

*Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

	Stage 1	Stage 2	Stage 3	Total
	MHUF	MHUF	MHUF	MHUF
Impairment on financial assets at amortised cost at 31 December 2019				
Debt securities	120	-	-	120
Loans and advances*				
Central bank and credit institutions	(37)	-	-	(37)
General government	2	-	33	35
Corporate	(692)	179	(3 718)	(4 231)
of which: Small and Medium enterprises	(268)	251	(1 861)	(1 878)
Households	(257)	847	1 955	2 545
of which: POCI	-	-	1 703	1 703
Consumer credit	(308)	(132)	1 161	721
Credit card	-	8	(9)	(1)
Current account	(8)	(70)	(127)	(205)
Finance lease	3	(6)	-	(3)
Mortgage loan	56	1 047	930	2 033
Term loan	-	-	-	-
Total	(864)	1 026	(1 730)	(1 568)

*Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on loan commitments and guarantees classified as stage 1 at 31 December 2020												
Loan commitments	283	377	(71)	19	(6)	4	-	-	-	10	-	616
Financial guarantees	31	113	(19)	27	-	1	-	-	-	-	-	153
Other commitments	2	34	(2)	-	-	-	-	-	-	1	-	35
Total	316	524	(92)	46	(6)	5	-	-	-	11	-	804
Impairment on loan commitments and guarantees classified as stage 2 at 31 December 2020												
Loan commitments	200	28	(27)	(12)	68	(69)	-	-	-	9	-	197
Financial guarantees	50	7	(22)	5	3	(20)	-	-	-	(1)	-	22
Other commitments	5	-	(5)	1	-	-	-	-	-	-	-	1
Total	255	35	(54)	(6)	71	(89)	-	-	-	8	-	220

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on loan commitments and guarantees classified as stage 3 at 31 December 2020												
Loan commitments	53	86	-	(23)	-	-	-	-	-	1	-	117
Financial guarantees	708	13	(507)	(121)	-	21	-	-	-	8	-	122
Other commitments	-	-	-	-	-	-	-	-	-	-	-	-
Total	761	99	(507)	(144)	-	21	-	-	-	9	-	239

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on loan commitments and guarantees classified as stage 1 at 31 December 2019												
Loan commitments	251	74	(54)	11	(6)	6	-	-	-	1	-	283
Financial guarantees	9	23	(37)	37	-	-	-	-	-	(1)	-	31
Other commitments	1	1	(1)	1	-	-	-	-	-	-	-	2
Total	261	98	(92)	49	(6)	6	-	-	-	-	-	316
Impairment on loan commitments and guarantees classified as stage 2 at 31 December 2019												
Loan commitments	168	339	(44)	27	81	(44)	-	-	-	(327)	-	200
Financial guarantees	13	27	(4)	4	11	(1)	-	-	-	-	-	50
Other commitments	-	1	-	-	4	-	-	-	-	-	-	5
Total	181	367	(48)	31	96	(45)	-	-	-	(327)	-	255

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

		Changes recorded in the income statement as impairment on assets at amortised cost							Other changes			
	Opening balance	Incr. due to origin.	Decr. due to derecog.	Chg in cr. risk – no stage transfers	Chg in cr. risk – transf. from stage 1	Chg in cr. risk – transf. from stage 2	Chg in cr. risk – transf. from stage 3	Chg due to modif.	Decr. due to write-offs	Other	Transl. diff.	Closing balance
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Impairment on loan commitments and guarantees classified as stage 3 at 31 December 2019												
Loan commitments	110	206	(110)	-	-	-	-	-	-	(153)	-	53
Financial guarantees	1 035	11	(377)	(128)	-	-	-	-	-	167	-	708
Other commitments	68	-	(68)	-	-	-	-	-	-	-	-	-
Total	1 213	217	(555)	(128)	-	-	-	-	-	14	-	761

NOTE 23 – IMPAIRMENT ON FINANCIAL ASSETS AT AMORTISED COST AND PROVISION FOR CREDIT COMMITMENTS (continued)

The breakdown of provision on loan commitments and guarantees recorded in the income statement in 2020 is presented below.

	Stage 1	Stage 2	Stage 3	Total
	MHUF	MHUF	MHUF	MHUF
Loan commitments	323	(12)	63	374
Financial guarantees	122	(27)	(594)	(499)
Other commitments	32	(4)	-	28
Total	477	(43)	(531)	(97)

The breakdown of provision on loan commitments and guarantees recorded in the income statement in 2019 is presented below.

	Stage 1	Stage 2	Stage 3	Total
	MHUF	MHUF	MHUF	MHUF
Loan commitments	(31)	(359)	(96)	(486)
Financial guarantees	(23)	(37)	494	434
Other commitments	(1)	(5)	68	62
Total	(55)	(401)	466	10

	2020	2019
	MHUF	MHUF
Impairment on other		
Intangible assets	(2 469)	(305)
Investment property	(2)	(1)
Property, plant and equipment	(2 267)	(181)
Other	190	(4)
Total impairment on other	(4 548)	(491)

The Bank recorded impairment on software in a significant amount in 2020 since upgrades of more source system are in progress in recent years. The impairment recorded on property, plant and equipment relates mainly to right of use assets, where the Bank has changed its intention concerning the usage of the headquarter building, which led to the write-down of the right of use asset.

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS

	Year ended 31 December 2020				Year ended 31 December 2019			
	Notional amount Assets	Notional amount Liabilities	Positive fair value Assets	Negative fair value Liabilities	Notional amount Assets	Notional amount Liabilities	Positive fair value Assets	Negative fair value Liabilities
Derivatives held for trading	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**
Foreign exchange derivatives								
Currency forwards	115 994	115 213	1 773	(919)	100 690	100 725	638	(555)
Currency futures	44 327	44 508	13	(16)	40 337	40 488	14	(14)
Currency swaps	1 034 894	1 035 692	11 828	(12 707)	975 277	975 190	4 964	(5 067)
Currency options bought and sold	215 583	215 583	7 768	(7 761)	322 244	322 244	4 589	(4 596)
Total foreign exchange derivatives	1 410 798	1 410 996	21 382	(21 403)	1 438 548	1 438 647	10 205	(10 232)
Interest rate derivatives								
Interest rate swaps	2 281 308	2 281 308	45 001	(40 487)	2 253 695	2 253 695	54 027	(45 248)
Cross currency interest rate swaps	53 941	54 137	(488)	(1 718)	183 037	187 008	78	(5 311)
Interest rate options	14 438	14 438	244	(244)	12 802	12 802	80	(80)
Forward rate agreements	-	-	-	-	-	-	-	-
Total interest rate derivatives	2 349 687	2 349 883	44 757	(42 449)	2 449 534	2 453 505	54 185	(50 639)
Equity options	- -	-	-	-	-	-	-	-
Commodity swaps	1 587	1 587	39	(39)	1 005	1 005	23	(23)
Commodity options	4 302	4 302	459	(277)	6 175	6 175	807	(299)
Total derivatives held for trading	3 766 374	3 766 768	66 637	(64 168)	3 895 262	3 899 332	65 220	(61 193)
Derivatives designated as micro fair value hedges								
Interest rate swaps	20 815	20 815	-	(1 253)	20 632	20 632	-	(737)
Derivatives designated as portfolio fair value hedges								
Interest rate swaps	1 321 714	1 321 714	19 106	(21 138)	953 648	953 648	21 111	(22 979)
Derivatives designated as cash flow hedges								
Interest rate swap	363 818	363 818	6 258	(264)	314 968	314 968	8 396	(618)
Cross currency interest rate swaps	48 496	50 630	101	(1 710)	25 300	26 026	-	(687)
Total derivatives held for hedging	1 754 843	1 756 977	25 465	(24 365)	1 314 548	1 315 274	29 507	(25 021)
Total derivative financial instruments	5 521 217	5 523 745	92 102	(88 533)	5 209 810	5 214 606	94 727	(86 214)

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Options

Although options are not accounted for as hedges, the Bank has an operational policy where the risks of options sold and purchased are matched on a one to one basis with offsetting deals conducted with counterparties of sound credit standing.

The Bank applies hedge accounting for some of its derivatives concluded in frame of Asset and Liability Management.

Cash flow hedge of interest rate risk

The aim of the cash-flow hedges designated by the Bank is to hedge changes in cash flows group of assets and liabilities related to changes in interest and foreign exchange rates. The hedging instruments are EUR and HUF interest rate swaps.

Hedging relationships are subject to prospective and retrospective effectiveness measurement. Fair value changes in hedging instruments for the effective part of the hedging relationship are recognised in other comprehensive income and are accumulated to Cash flow hedge reserve. Since the exchange revaluation result of the hedged assets and liabilities is recorded as Net gains / (losses) from financial instruments at fair value through profit or loss, the foreign exchange revaluation effect of the hedging cross currency interest rate swaps recorded in Other comprehensive income was transferred to the income statement at the same time.

The Bank recorded a HUF 1 398 million loss (HUF 4 652 million gain in 2019) in other comprehensive income in 2020 resulting from the changes of the fair value of hedging derivatives. The result is recorded as Cash flow hedge - Net gain / (loss) from fair value changes in other comprehensive income. In 2020 the Bank transferred HUF 115 million loss to the net profit due to ineffectiveness (HUF 154 million loss in 2019) recorded as Cash flow hedge – Ineffective part in other comprehensive income. The result of the transfers were recorded as Net gains / (losses) from financial instruments at fair value through profit or loss in the income statement (see Note 7).

The Bank recognised HUF 4 925 million gain in other comprehensive income as the effective portion at 31 December 2020 (HUF 6 003 million gain in 2019). Other comprehensive income includes HUF 52 million gain reserve on discontinued cash flow hedges in 2020 (HUF 644 million gain in 2019).

The periods when the cash flows are expected to occur are the following:

	2020		2019	
	Expected cash flows		Expected cash flows	
	Inflow	Outflow	Inflow	Outflow
	MHUF	MHUF	MHUF	MHUF
< 3 months	1 044	(354)	307	(58)
3-6 months	459	(325)	666	(126)
6 months - 1 year	625	(518)	2 065	(222)
1-2 years	3 358	(1 196)	2 814	(842)
2-5 years	34 636	(31 255)	6 017	(4 032)
> 5 years	18 251	(19 743)	3 243	(3 854)
Total	58 373	(53 391)	15 112	(9 134)

Forecast transactions for which hedge accounting had previously been used but which is no longer expected to occur amounted to HUF 36 million as at 31 December 2020 (HUF 43 million as at 31 December 2019). The related transfer was presented as Cash flow hedges – Gross amount in other comprehensive income.

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Fair value hedge of interest rate risk

The risk to be hedged under fair value hedge of interest rate risk is interest rate risk, arising from changes in fair value of non-maturity deposits to changes in the risk-free (interest rate swap) yield curve. The hedging instruments are HUF interest rate swaps.

The accumulated fair value changes of hedged item under portfolio hedge of interest rate risk is presented separately in the statement of financial position and amounted to HUF 14 614 million loss and HUF 17 841 million gain in 2020 (HUF 15 827 million loss and HUF 19 042 million gain in 2019). The loss recorded on the hedged item was compensated by a gain recorded on the hedging instrument in the same amount. The fair value changes of the hedged item and the hedging instrument in the current year is recorded as Net gains / (losses) from financial instruments at fair value through profit or loss in the income statement.

Fair value hedge of fixed rate FVOCI bonds

The Bank defines the risk to be hedged as the interest rate risk arising from changes in fair value of FVOCI bonds to changes in the risk-free (interest rate swap) yield curve. The hedging instruments are fixed rate payer-floating rate receiver (BUBOR 3M-6M) interest rate swaps.

The changes in the fair value of the FVOCI government bonds and the interest rate swaps due to interest rate risk are offset in the income statement and the unhedged credit spread of the bonds remains in the other comprehensive income. The change in the fair value of the hedged instrument amounted to a loss of HUF 1 029 million in 2020 (a gain of HUF 971 million in 2019).

The following table presents information related to the hedged items under fair value hedge in 2020. Hedging instruments are interest rate swaps.

	Micro Fair value hedge		Portfolio fair value hedge	
	Carrying amount MHUF	Accumulated fair value adjustments MHUF	Carrying amount MHUF	Accumulated fair value adjustments MHUF
Hedged items				
Debt securities at fair value through other comprehensive income	-	-	26 077	777
Debt securities at amortised cost	-	-	344 915	15 162
Loans and advances at amortised cost	22 170	1 047	126 616	1 406
Total hedged assets	22 170	1 047	497 608	14 533
Deposits at amortised cost	-	-	857 915	15 191
Total hedged liabilities	-	-	857 915	15 191

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The following table presents information related to the hedged items under fair value hedge in 2019. Hedging instruments are interest rate swaps.

	Micro Fair value hedge		Portfolio fair value hedge	
	Carrying amount MHUF	Accumulated fair value adjustments MHUF	Carrying amount MHUF	Accumulated fair value adjustments MHUF
Hedged items				
Debt securities at fair value through other comprehensive income	-	-	72 717	1 806
Debt securities at amortised cost	-	-	254 164	14 376
Loans and advances at amortised cost	21 519	580	238 479	2 736
Total hedged assets	21 519	580	565 360	18 918
Deposits at amortised cost	-	-	470 475	15 827
Total hedged liabilities	-	-	470 475	15 827

There is no remaining fair value adjustment recognised on any hedged item in case of discontinued hedges in the financial position in 2020 (nor in 2019).

NOTE 25 – NON-CURRENT ASSETS HELD FOR SALE AND DISPOSAL GROUPS

Non-current assets held for sale and disposal Banks include IT equipments. In 2020 the Bank decided to sell the IT equipmets in a short term and reclassified it from property and equipment, intangible assets to non-current assets held for sale and disposal Banks.

The assets are measured at the carrying amount since it is lower than its fair value less costs to sell.

NOTE 26 – OTHER ASSETS

	2020	2019
	MHUF	MHUF
Prepayments	5 424	601
Trade receivables	1 583	1 382
Receivables from employees	-	2
Receivables from bankcard service	6 449	7 785
Items in transit due to payment services	416	401
Items in transit due to trading in securities	29	49
Income accruals and cost prepayments	5 313	5 136
Inventories	410	714
Other receivables	3 123	3 346
	22 747	19 416

Prepayments include HUF 5 351 million extra tax prepayment, further details in Note 14.

Trade receivables and receivables from bankcard and payment services are performing short term receivables without any delay. Other receivables include a HUF 214 million non-performing other claim due to retail clients (HUF 227 million as at 31 December 2019) for which a HUF 213 million impairment charge is recorded in the income statement (HUF 227 million as at 31 December 2019).

NOTE 27 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES

The deferred tax included in the statement of financial position and changes recorded in the income statement and equity are as follows:

For the period ended 31 December 2020:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	6	1	-
Losses carry forward	-	-	-	-
Tangibles and intangibles assets	-	(778)	277	-
Other provisions for risk and charges and credit commitments	-	(178)	91	-
Impairment for losses on loans and advances	-	-	-	-
Financial instruments at fair value	-	-	-	-
Fair value adjustments FVOCI	-	699	-	116
Cash flow hedge	-	448	-	150
Transition to IFRS	-	-	-	-
Other	-	(4)	(3)	-
Total	-	193	366	266

For the period ended 31 December 2019:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	7	-	(1)
Losses carry forward	-	-	-	-
Tangibles and intangibles assets	-	(501)	43	-
Other provisions for risk and charges and credit commitments	-	(87)	34	-
Impairment for losses on loans and advances	-	-	-	-
Financial instruments at fair value	-	-	-	-
Fair value adjustments FVOCI	-	815	-	(338)
Cash flow hedge	-	598	-	(385)
Transition to IFRS	-	-	(538)	-
Transition to IFRS 9	-	(7)	-	-
Other				
Total	-	825	(461)	(724)

In 2020 and 2019 income taxes were calculated on all temporary differences under the asset and liability method using a tax rate of 9 % or 10.82 % (9% corporate income tax and 10.82% local business tax).

NOTE 28 – INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED COMPANIES

	2020 MHUF	2019 MHUF
K&H Autópark Kft.	410	410
K&H Csoportszolgáltató Kft.	60	60
K&H Equities Zrt.	4 771	4 582
K&H Tanácsadó Zrt.	850	850
K&H Faktor Zrt.	450	450
K&H Ingatlanlízing Zrt.	50	50
K&H Jelzálogbank Zrt.	5 500	5 500
K&H Értékpapír Zrt.	319	300
Total	12 410	12 202

The table includes the net carrying amount of investments.

For more information on the subsidiaries and associated companies see Note 41.

NOTE 29 – INVESTMENT PROPERTIES

	Investment properties MHUF
At 31 December 2018	
Cost	1 804
Accumulated depreciation	(115)
Net book value	1 689
Movements in 2019	
Additions	804
Disposals - net	(594)
Impairment charge	(1)
Depreciation charge	(24)
At 31 December 2019	
Cost	2 009
Accumulated depreciation	(135)
Net book value	1 874
Movements in 2020	
Additions	376
Disposals - net	(712)
Impairment charge	(2)
Depreciation charge	-
At 31 December 2020	
Cost	1 645
Accumulated depreciation	(109)
Net book value	1 536

Investment properties include collaterals obtained by taking in possession. The Bank intends to sell investment properties within a reasonable time period.

NOTE 29 – INVESTMENT PROPERTIES (continued)

The following table presents the results related to investment properties.

	2020 MHUF	2019 MHUF
Impairment on investment property		
Additions	(2)	(3)
Reversals	-	2
Total impairment	(2)	(1)
Expenses from investment properties		
Acquisition cost	(95)	(107)
Maintenance expenses	(171)	(182)
Sale related cost	(51)	(39)
Total expenses	(317)	(328)

Expenses recorded in 2020 (and 2019) were not recognised as asset in the statement of financial position.

The difference between the fair value and the carrying amount of the assets is immaterial as at 31 December 2020 (and as at 31 December 2019).

The Bank believes that the carrying amount of investment properties approximates their fair value (classified as level 3 in the fair value hierarchy).

NOTE 30 – PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Reclassified IT equipment	Office equipment	Right of use assets	Other	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
At 31 December 2018						
Cost	48 814	13 943	8 737	-	2 442	73 936
Accumulated depreciation	(21 292)	(8 176)	(7 441)	-	(712)	(37 621)
Net book value	27 522	5 767	1 296	-	1 730	36 315
Movements in 2019						
First time application impact of IFRS16	-	-	-	16 809		16 809
Additions (acquired separately)	1 644	1 996	925	-	182	4 747
Disposals - net	(25)	-	-	4	(52)	(73)
Impairment charge	(114)	(8)	(16)	(37)	(6)	(181)
Depreciation charge	(1 868)	(1 936)	(381)	(2 520)	(356)	(7 061)
At 31 December 2019						
Cost	49 978	13 939	9 254	16 772	2 512	92 455
Accumulated depreciation	(22 819)	(8 120)	(7 430)	(2 516)	(1 014)	(41 899)
Net book value	27 159	5 819	1 824	14 256	1 498	50 556

NOTE 30 – PROPERTY, PLANT AND EQUIPMENT (continued)

	Land and buildings	IT equipment	Office equipment	Right of use assets	Other	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
At 31 December 2019						
Cost	49 978	13 939	9 254	16 772	2 512	92 455
Accumulated depreciation	(22 819)	(8 120)	(7 430)	(2 516)	(1 014)	(41 899)
Net book value	27 159	5 819	1 824	14 256	1 498	50 556
Movements in 2020						
Additions (acquired separately)	2 644	1 005	732	4 363	713	9 457
Disposals - net	(1 568)	(30)	-	322	(157)	(1 433)
Transfers	-	(1 474)	-	-	-	(1 474)
Impairment charge	(744)	(2)	(15)	(1 499)	(7)	(2 267)
Depreciation charge	(1 969)	(1 976)	(384)	(2 627)	(423)	(7 379)
At 31 December 2020						
Cost	51 613	12 661	9 723	19 636	2 849	96 482
Accumulated depreciation	(26 091)	(9 319)	(7 566)	(4 821)	(1 227)	(49 024)
Net book value	25 522	3 342	2 157	14 815	1 622	47 458

The reclassification of IT equipments as Non-current assets held for sale and disposal groups is presented as transfer in the table above (see Note 25).

Expenditure on items in the course of construction amounted to HUF 27 796 million as at 31 December 2020 (HUF 18 084 million as at 31 December 2019).

Fully amortised tangible assets which were still in use amounted to HUF 18 468 million as at 31 December 2020 (HUF 17 560 million as at 31 December 2019).

NOTE 31 – INTANGIBLE ASSETS

	Software	Other intangible assets	Total
	MHUF	MHUF	MHUF
At 31 December 2018			
Cost	54 908	42	54 950
Accumulated depreciation	(34 903)	(42)	(34 945)
Net book value	20 005	-	20 005
Movements in 2019			
Additions (acquired separately)	14 944	-	14 944
Impairment charge	(306)	-	(306)
Depreciation charge	(4 221)	-	(4 221)
At 31 December 2019			
Cost	69 814	42	69 856
Accumulated depreciation	(39 392)	(42)	(39 434)
Net book value	30 422	-	30 422
Movements in 2020			
Additions (acquired separately)	24 294	-	24 294
Impairment charge	(2 469)	-	(2 469)
Depreciation charge	(5 806)	-	(5 806)
At 31 December 2020	-	-	-
Cost	93 329	42	93 371
Accumulated depreciation	(46 888)	(42)	(46 930)
Net book value	46 441	-	46 441

Fully amortised intangible assets which were still in use amounted to HUF 32 060 million as at 31 December 2020 (HUF 29 617 million as at 31 December 2019).

NOTE 32 – PROVISIONS FOR RISK AND CHARGES

	Provision for restructuring MHUF	Provision for tax litigation and pending legal disputes MHUF	Other MHUF	Total MHUF
Balance as at 31 December 2018	-	70	67	137
Amounts allocated	149	117	180	446
Unused amounts reversed	-	(58)	(6)	(64)
Other (foreign exchange revaluation)				
Balance as at 31 December 2019	149	129	241	519
Amounts allocated	386	51	790	1 227
Amounts used	(149)	-	-	(149)
Unused amounts reversed	-	(11)	(4)	(15)
Balance as at 31 December 2020	386	169	1 027	1 582

The Bank is party to litigation and claims arising in the normal course of business, the provision of HUF 164 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2020 relates to these litigations (HUF 129 million at 31 December 2019). Management considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 1 262 million as at 31 December 2020 (HUF 1 332 million as at 31 December 2019) is presented in Note 23 and Note 36. The sum of HUF 1 582 million provision for risk and charges and HUF 1 262 million provisions for credit commitments amounts to HUF 2 844 million (HUF 1 851 million in 2019).

NOTE 33 – OTHER LIABILITIES

	2020 MHUF	2019 MHUF
Trade creditors	6 309	6 163
Lease liabilities	23 733	23 766
Items in transit due to payment services	9 163	6 527
Items in transit due to lending activity	773	820
Items in transit due to trading securities	1	1 343
Liabilities from bankcard service	3 880	4 023
Other	16 279	17 273
Total other liabilities	60 138	59 915

Other liabilities include mainly short term liabilities.

Other includes trading tax liabilities, social charges, liability from transactional levy not settled yet, liabilities due to employees (see Note 38) and other accrued charges and deferred income arising from the normal course of business recorded as general administrative expenses in the income statement.

NOTE 34 – SHARE CAPITAL

	2020 MHUF	2019 MHUF
Ordinary shares issued and outstanding	140 978	140 978

The nominal value of the ordinary shares issued and outstanding at 31 December 2020 is HUF 1 per share (31 December 2019: HUF 1).

Shareholders of the Bank:

	2020 Shareholding %	2019 Shareholding %
KBC Bank N. V.	100.00	100.00
	100.00	100.00

NOTE 35 – ADDITIONAL INFORMATION TO THE CASH FLOW STATEMENT

Net debt with regard to financing activities are presented in the table below.

	Notes	2020 MHUF	2019 MHUF
Cash and cash equivalents		817 949	289 788
Subordinated liabilities (see Note 15)	15	(46 350)	(41 953)
Borrowing – repayable within 1 year	15	(10 063)	(27 058)
Borrowing – repayable after 1 year	15	(473 649)	(276 458)
Net debt		287 887	(55 681)

NOTE 35 – ADDITIONAL INFORMATION TO THE CASH FLOW STATEMENT (continued)

The components of net debt changed as follows in 2020.

	Cash	Cash balances with central banks	Other demand deposits with credit institutions	Loans and advances to banks repayable on demand and term loans to banks < 3 months	Deposits from banks repayable on demand and redeemable at notice	Subordinated liabilities	Borrowing – repayable within 1 year	Borrowing – repayable after 1 year	Total net debt
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net debt as at 31 December 2019	54 226	272 000	87 276	1 639	(125 353)	(41 953)	(27 058)	(276 458)	(55 681)
Cash flows	16 928	(88 428)	43 671	712 999	(168 876)	3 117	16 995	(186 481)	349 925
Foreign exchange adjustments	-	-	4 937	9 289	(597)	(4 392)	-	(2 155)	7 082
Other non-cash movements	-	527	(92)	(2 622)	425	(3 122)	-	(8 555)	(13 439)
Net debt as at 31 December 2020	71 154	184 099	135 792	721 305	(294 401)	(46 350)	(10 063)	(324 583)	287 887

NOTE 35 – ADDITIONAL INFORMATION TO THE CASH FLOW STATEMENT (continued)

The components of net debt changed as follows in 2019.

	Cash	Cash balances with central banks	Other demand deposits with credit institutions	Loans and advances to banks repayable on demand and term loans to banks < 3 months	Deposits from banks repayable on demand and redeemable at notice	Subordinated liabilities	Borrowing – repayable within 1 year	Borrowing – repayable after 1 year	Total net debt
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net debt as at 31 December 2018	42 833	361 464	76 350	51 290	(119 697)	(40 802)	(10 687)	(262 470)	98 281
Cash flows	11 393	(98 157)	9 417	(44 585)	(6 383)	1 053	(16 427)	(9 246)	(152 935)
Foreign exchange adjustments	-	-	1 475	(844)	736	(1 147)	-	(1 737)	(1 517)
Other non-cash movements	-	8 693	34	(4 222)	(9)	(1 057)	56	(3 005)	490
Net debt as at 31 December 2019	54 226	272 000	87 276	1 639	(125 353)	(41 953)	(27 058)	(276 458)	(55 681)

NOTE 36 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES

In the normal course of business, the Bank is a party to credit related financial instruments with off-statement of financial position risk. These financial instruments include commitments to extend credit, financial guarantees and commercial letters of credit. These instruments involve elements of credit risk in excess of the amounts recognized in the statement of financial position.

Credit risk for off-statement of financial position financial instruments is defined as the possibility of sustaining a loss because any other party to a financial instrument fails to perform in accordance with the terms of the contract. The Bank uses the same credit policies in making commitments and conditional obligations as it does for financial instruments in the statement of financial position through established credit approvals, risk control limits and monitoring procedures.

Commitments are contractual agreements to extend credit which generally have fixed expiration dates or other termination requirements and may require payment of a fee. The potential credit loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific standards. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Financial guarantees are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing guarantees is essentially the same as that involved in extending credit facilities to other customers. The Bank applies similar principles as those applied in assessing the required allowance for losses under other credit facilities when assessing the likelihood of loss under the guarantee.

Letters of credit represent a financing transaction by a Bank to its customer where the customer is usually the buyer/importer of goods and the beneficiary is typically the seller/exporter. Credit risk is limited as the merchandise shipped serves as collateral for the transaction.

NOTE 36 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

The Bank has the following commitments, contingent assets and liabilities:

	2020 MHUF	2019 MHUF
Credit commitments – undrawn amount		
Received	19 894	12 011
Given		
Irrevocable	381 672	321 926
Revocable	287 236	293 559
Total given	668 908	615 485
Collaterals		
Given	287 448	271 082
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets	45 921	55 476
Financial assets	3 318	4 096
For assets that are not impaired or past due		
Non-financial assets	2 049 057	1 622 274
Financial assets	304 048	302 991
Total guarantees received/collateral	2 402 344	1 984 837
Other commitments given – irrevocable	12 052	9 775

The amount of the received guarantees and collaterals includes the indexed or reviewed collateral value.

NOTE 36 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

The following table presents the nominal value and the provision for loan commitments and guarantees at 31 December 2020.

	Nominal amount			Provision			
	Performing		Non-performing	Performing		Non-performing	
	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Total MHUF
Loan commitments	613 050	54 849	1 010	(617)	(197)	(117)	667 978
Financial guarantees	268 587	18 326	535	(153)	(22)	(121)	287 152
Other commitments	11 925	127	-	(35)	(1)	-	12 016
Total	893 562	73 302	1 545	(805)	(220)	(238)	967 146

For evaluation of provision on commitments and contingent liabilities in 2020 see Note 23.

NOTE 36 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

The following table presents the nominal value and the provision for loan commitments and guarantees at 31 December 2019.

	Nominal amount			Provision			
	Performing		Non-performing	Performing		Non-performing	
	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Total MHUF
Loan commitments	578 714	24 957	1 170	(284)	(200)	(53)	604 304
Financial guarantees	242 573	27 466	1 043	(31)	(50)	(707)	270 294
Other commitments	9 052	723	-	(2)	(5)	-	9 768
Total	830 339	53 146	2 213	(317)	(255)	(760)	884 366

For evaluation of provision on commitments and contingent liabilities in 2019 see Note 23.

NOTE 36 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Bank has an established protocol of dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year-end the Bank had several unresolved legal claims in the amount of HUF 1 386 million (UF 1 365 million as at 31 December 2019) where the Bank has been advised by its legal advisor that it is possible, but not probable, that the action will succeed. Accordingly no provision for these claims has been made in these financial statements.

NOTE 37 – FINANCE AND OPERATING LEASES

Lessor position

The Bank offers open end financial lease (OEFL), closed end financial lease (CEFL) and operating Lease (OL) products for existing or targeted Corporate, Business and Micro SME customers of the Bank. The products are handled in the Bank's normal credit approval and monitoring process, which gives a well-defined and established basis for managing credit risk.

Leasing residual value risk management framework is in place which contains RV policy, RV limit setting methodology and guaranty framework.

Certain lease contracts designated as operating lease under Hungarian Accounting Standards are designated as finance lease according to the IFRS terminology.

The assets leased out by the Bank are predominantly cars and trucks. In finance lease, the lessee selects an asset and the Bank purchases that asset and gives it to the lessee. In this way the Bank acts as a financier of the assets borrowed by the lessee. The lessee will have to use the asset during the lease period and will have to pay for the cost of repairs, maintenance and insurance of the asset. The Bank is the legal owner of the asset during the period of lease and recovers a major part of the cost of the asset plus interest earned from lease payment by the lessee. The lessee assumes some risks of the ownership and enjoys some of the benefits. The lessee or the third party has the option to acquire ownership of the asset by paying a nominal price which is the repurchase price.

NOTE 37 – FINANCE AND OPERATING LEASES (continued)

The following tables indicate the key amounts of the Bank's lease activity:

	2020 MHUF	2019 MHUF
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	27 719	27 068
one to five years	59 269	50 769
more than five years	3 474	3 991
	90 462	81 828
The present value of minimum lease payments receivables*:		
less than one year	25 433	25 393
one to five years	54 716	48 435
more than five years	3 237	3 832
	83 386	77 660
Unearned finance income	7 075	4 168
Non-guaranteed residual values	14 240	14 281

*Net of impairment.

The total impairment recorded on finance lease receivables amounted to HUF 3 065 million as at 31 December 2020 (HUF 460 million as at 31 December 2019).

NOTE 37 – FINANCE AND OPERATING LEASES (continued)

Lessee position

Operative lease

The Bank has entered into property lease agreements which are accounted for as operating leases in previous years. According to IFRS 16 these contracts are presented as lease liabilities and right-of-use assets in 2019.

The following tables give additional information about the client types and the remaining maturity of these liabilities recorded according to IFRS 16.

	2020	2019
	MHUF	MHUF
< 1 year	70	53
1-5 years	10 895	2 272
5 years	5 987	12 270
Total financial lease liabilities	16 952	14 595

	2020	2019
	MHUF	MHUF
General government	1 040	1 400
Corporate	14 689	13 195
of which small and medium enterprises	1 223	1 270
Total financial lease liabilities	16 952	14 595

Expenses relating to short-term leases and low-value lease are included in general administration expenses and amounted to HUF 180 million in 2020 (HUF 272 million in 2019).

Following table shows the total cash outflow for leases.

	2020	2019
	MHUF	MHUF
Interest expense	128	154
Principal repayment	2 827	2 513
Total cash outflow	2 955	2 667

NOTE 37 – FINANCE AND OPERATING LEASES (continued)

Finance lease

A part of the headquarter building of the Bank is owned by a third party is object of finance lease. The tables below present the minimum lease payments and the present value of the lease liability.

	2020 MHUF	2019 MHUF
Net carrying amount of leased assets in the Statement of financial position	14 534	14 990
The present value of finance lease liabilities may be analysed		
less than one year	36	33
one to five years	184	167
more than five years	23 513	23 566
The present value of finance lease liabilities may be analysed	23 733	23 766
less than one year	846	710
one to five year	3 405	2 867
more than five years	41 791	43 526
Finance lease liabilities-minimum lease payments	46 042	47 103

NOTE 38 – RELATED PARTY TRANSACTIONS

For the purposes of these financial statements, related parties include all enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with the Bank (this includes parents, subsidiaries and fellow subsidiaries), key management and associated companies.

Parent:

KBC Bank N.V. owns 100.00 % of the ordinary shares in K&H Bank (2019: 100.00%). The ultimate parent of the Bank is KBC Group N.V.

Subsidiaries:

See list of subsidiaries in Note 41.

Associates:

See list of associates in Note 41.

Members of KBC Bank and other related parties:

CBC Banque SA
Československa Obchodni Banka a.s.
Československa Obchodna Banka a.s.
KBC Bank Ireland Plc.
KBC Asset Management SA
KBC Asset Management N.V.
KBC Credit Investments N.V.
KBC Fund Management Limited
KBC Groep N.V.
KBC Securities N.V.
K&H Biztosító Zrt.
Patria Finance a.s.
Omnia N.V.
K&H Pénzforgalmi Szolgáltató Kft.

Other related parties through key management

If the Bank's key management has direct or indirect authority and responsibility for planning, directing and controlling the activity of a company outside of KBC Group, the companies are presented as other related parties through key management.

The banking transactions entered into with related parties in the normal course of business including loans and deposits were carried out on normal commercial terms and conditions and at market rates. All loans and advances to related parties are performing and are free of any provision for possible loan losses.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

The year-end balances and the income and expenses in respect of related parties included in the financial statements are as follows:

	Parent	Subsi-diaries	Other related parties (KBC Group)	Other related parties (through key management)	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2020					
Assets					
Other demand deposit	123 193	327	1 107	-	124 627
Loans and advances	79 680	38 758	281 151	2 420	402 009
Current accounts	-	14 185	1	264	14 450
Term loans	79 680	24 573	281 150	2 156	387 559
Finance leases	-	-	-	-	-
Derivatives	61 363	-	228	-	61 591
Held for trading	37 892	-	228	-	38 120
Hedging	23 471	-	-	-	23 471
Other receivables	(36)	151	2 753	-	2 868
Total assets	264 200	39 236	285 239	2 420	591 095
Liabilities					
Deposits	10 838	173 710	48 052	2 446	235 046
Current accounts	10 838	24 643	47 986	2 446	85 913
Term deposits (with agreed maturity)	-	149 067	66	-	149 133
Subordinated liabilities	46 350	-	-	-	46 350
Non-convertible bonds	-	-	-	-	-
Derivatives	80 505	-	412	-	80 917
Held for trading	57 061	-	412	-	57 473
Hedging	23 444	-	-	-	23 444
Other liabilities	115	23 304	605	-	24 024
Total liabilities	137 808	197 014	49 069	2 446	386 337
Income statement					
Net interest and similar income	31	(3 547)	(888)	52	(4 352)
Interest and similar income	1 608	636	20	54	2 318
Interest and similar expense	(1 577)	(4 183)	(908)	(2)	(6 670)
Net fee and commission income	(307)	(175)	6 760	38	6 316
Fee and commission income	580	47	7 378	39	8 044
Fee and commission expense	(887)	(222)	(618)	(1)	(1 728)
Other income	-	168	1 423	-	1 591
Other expense	(887)	(961)	(4 137)	-	(5 985)
Total income statement	(1 163)	(4 515)	3 158	90	(2 430)
Off-statement of financial position items					
Commitments and contingent liabilities	193 972	22 014	4 799	2 060	222 845
Guarantees received	637	50	7 238	-	7 925
Notional amount of derivatives	4 327 165	-	55 499	-	4 382 664

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

	Parent	Subsi-diaries	Other related parties (KBC Group)	Other related parties (through key management)	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2019					
Assets					
Other demand deposit	70 959	-	3 573	-	74 532
Loans and advances	143 402	37 402	271 055	2 755	454 614
Current accounts	-	12 134	-	34	12 168
Term loans	143 402	25 268	271 055	2 721	442 446
Finance leases	-	-	-	-	-
Derivatives	74 953	-	210	-	75 163
Held for trading	48 913	-	210	-	49 123
Hedging	26 040	-	-	-	26 040
Other receivables	-	279	763	-	1 042
Total assets	289 314	37 681	275 601	2 755	605 351
Liabilities					
Deposits	27 218	157 291	37 742	1 028	223 279
Current accounts	-	14 553	-	1 028	15 581
Term deposits (with agreed maturity)	27 218	142 738	37 742	-	207 698
Subordinated liabilities	41 953	-	-	-	41 953
Non-convertible bonds	-	-	-	-	-
Derivatives	77 810	-	335	-	78 145
Held for trading	54 331	-	335	-	54 666
Hedging	23 479	-	-	-	23 479
Other liabilities	66	23 822	1 149	-	25 037
Total liabilities	147 047	181 113	39 226	1 028	368 414
Income statement					
Net interest and similar income	273	(2 914)	(950)	57	(3 534)
Interest and similar income	1 858	548	55	57	2 518
Interest and similar expense	(1 585)	(3 462)	(1 005)	-	(6 052)
Net fee and commission income	110	(293)	3 163	43	3 023
Fee and commission income	514	47	3 543	45	4 149
Fee and commission expense	(404)	(340)	(380)	(2)	(1 126)
Other income	23	158	290	-	471
Other expense	(439)	(938)	(3 030)	-	(4 407)
Total income statement	(33)	(3 987)	(527)	100	(4 447)
Off-statement of financial position items					
Commitments and contingent liabilities	120 816	22 725	4 475	666	148 682
Guarantees received	2 454	-	7 359	-	9 813
Notional amount of derivatives	4 049 596	-	47 691	-	4 097 287

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

The interest rate of other demand deposits and loans and advances from related parties varied in a range of -0.47 and 2.51 percent in 2020 (-0.46 and 2.51 percent in 2019). Deposits due to related parties bear a minimum interest rates of 0 and a maximum interest rate of 2.7 percent in 2020 (0 and 2.7 in 2019). For interest rate conditions of subordinated liabilities see Note 15.

Transactions with key management

The Bank's key management includes the members of the executive committee, senior executive directors and executive directors.

Loans

In accordance with the Bank's internal policy, all employees of the Bank, including key management may apply for loans with favourable conditions. Favourable conditions include a waiver of handling fees and lower than market interest rates.

The major part of the total of HUF 623 million outstanding amount of loans of key management at 31 December 2020 was housing loan (HUF 376 million at 31 December 2019), with the long-term maturity obligations ranging from 15-20 years.

Deposits

In accordance with the Bank's internal policy, all the employees of the Bank, including key management staff are entitled to have a bank account and a securities/bond account with condition of K&H 4000+ account package offered for companies with number of employees over 4 000. According to this package the interest paid on deposit is the basic interest rate of the Hungarian National Bank less 3.25% but if it is negative, then the interest rate for the K&H Demand Deposit Account.

At 31 December 2020 the outstanding amount of deposits was HUF 718 million (HUF 459 million at 31 December 2019). In 2020 the Bank didn't pay interest on these deposits (nor in 2019).

Staff expenses

The following amounts have been recorded related to key management personnel:

Type of benefit	2020	2019
	MHUF	MHUF
Short-term employee benefits	2 332	2 003
Other long-term benefits	19	17
Termination benefits	-	32
Share based payment (cash settled)	58	52
Total benefits	2 409	2 104

The liability of HUF 142 million (HUF 155 million in 2019) resulting from the carrying amount of share based payment is recorded as other liability in the statement of financial position.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

Share based payment

The Bank applies specific rules for Key Identified Staff (KIS). The performance-based remuneration of Key Identified Staff is awarded in a manner which promotes sound risk management and does not induce excessive risk-taking. This is ensured by specific rules, which are applicable to the variable remuneration of Key Identified Staff:

- At least 40% of variable remuneration awarded to Key Identified Staff may not be paid straightaway and its payment is spread over a period of three to five years;
- Half of the total amount of variable remuneration for Key Identified Staff is awarded in the form of non-cash instruments (phantom shares) with a one-year retention period;
- No advance payments may be made in relation to the variable component and claw-back/holdback is put in place (evidence of misconduct or serious error; significant deterioration in the financial performance of the Bank; major shortcomings in risk management; significant changes in the economic or regulatory capital base of the Bank).

Key Identified Staff who are allocated variable compensation of less than the amount stated in the Remuneration Policy are considered exempt Key Identified Staff. (In this case, variable remuneration is not subject to three years' deferral and payment in non-cash instruments, but 100% of the variable remuneration is settled upfront in cash.) The employees whose variable remuneration is subject to deferral and payment in non-cash instruments are called material Key Identified Staff.

Structure for 2020 variable compensation of material Key Identified Staff

<table>
<tr><td></td><td colspan="4">Individual variable remuneration awarded for 2020 performance year</td></tr>
<tr><td></td><td colspan="2">Upfront part</td><td colspan="2">Deferred part</td></tr>
<tr><td>In case of KBC Senior General Managers</td><td colspan="2">(40% of award)</td><td colspan="2">(60% of award)</td></tr>
<tr><td>In case of all KIS whose variable compensation is below the limit prescribed in the Remuneration Policy</td><td colspan="2">(60% of award)</td><td colspan="2">(40% of award)</td></tr>
<tr><td>In case of all KIS whose variable compensation is equal to or exceeds the limit prescribed in the Remuneration Policy</td><td colspan="2">(40% of award)</td><td colspan="2">(60% of award)</td></tr>
<tr><td></td><td>Cash (50% of Upfront)</td><td>Non-cash instrument (50% of Upfront)</td><td>Cash (50% of Deferred)</td><td>Non-cash instrument (50% of Deferred)</td></tr>
<tr><td>Vesting schedule</td><td>fully vested at grant</td><td>fully vested at grant</td><td>3/5-year equal vesting tranches</td><td>3/5-year equal vesting tranches</td></tr>
<tr><td>Retention period</td><td></td><td>retention period ends April 2022</td><td></td><td>retention period ends one year after vesting</td></tr>
</table>

The cash is payable following vesting. The non-cash instrument is payable following the retention period.

The number of phantom shares to which each Key Identified Staff is entitled is calculated based on the average price of the KBC share during the first three months of the year following the year to which the variable remuneration relates. Phantom shares are converted into cash on the basis of the average price of the KBC share during the first three months of the pay-out year.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

	2020		2019	
	number of shares	weighted average share price* HUF/share	number of shares	weighted average share price* HUF/share
Outstanding as at the beginning of the period	6 077	21 584	5 663	21 107
Granted	3 127	20 902	3 102	23 103
Exercised	(2 789)	19 155	(2 688)	17 117
Transferred**	4	19 155	-	17 117
Outstanding as at the end of the period	6 419	22 839	6 077	21 584

*Share prices as at the grant date weighted by the number of shares granted at that date.

**Shares granted to employees moving between KBC entities during the year may increase/decrease the number of shares to be exercised or paid off by the Bank. These changes are presented as transferred shares. Transferred shares also include no longer payable deferred amounts due to employment termination.

The value of the phantom shares outstanding as at 31 December 2020 based on the year-end closing price of KBC shares was 18 898 HUF/share (21 454 HUF/share as at 31 December 2019).

There were no shares exercisable as at 31 December 2020 (and as at 31 December 2019).

The weighted average share price of shares converted to cash as at the date of the exercise was 20 902 HUF/share in 2020 (19 301 HUF/share in 2019).

The weighted average remaining contractual life of phantom shares outstanding as at 31 December 2020 is 18 months (19 months as at 31 December 2019).

The Bank applied the share based payment plan for the 2020 performance as well.

As at 31 December 2020 the information related to the number of phantom shares for the 2020 performance is not available, since the first grant date is in April 2021.

From the grant date phantom shares are valued based on the quoted market prices of KBC shares. No intrinsic value is recorded.

A part of the Bank's employees are entitled to participate in defined benefit plan founded by the Bank. The amount of benefits to be provided depends on the employee's length of service in a certain past period and the level of reference interest rate. The future payments regarding to the plan have no significant effect on the Bank's cash flow.

NOTE 39 – DEFINED BENEFIT PLAN

The table below presents the reconciliation of defined benefit obligations recorded as other liabilities.

	2020 MHUF	2019 MHUF
Defined benefit obligations at the beginning of the period	318	365
Interest cost	7	11
Actuarial gains and losses arising from changes in financial assumptions	3	(8)
Benefits paid	(16)	(21)
Past service cost, including gains and losses arising from settlements	(26)	(29)
Defined benefit obligation at end of the period	286	318

Interest cost on defined retirement benefit plans are recorded as interest and similar expense in the income statement (see Note 4). Current service cost, benefits paid and past service includes the effect of the renegotiation of defined benefit plans. Current service costs are recorded as staff expenses in the income statement (see Note 13). Actuarial gains and losses arising from changes in financial assumptions are accounted directly in other comprehensive income.

NOTE 40 – AUDITOR'S REMUNERATION

	2020 MHUF	2019 MHUF
Fees for the statutory audit services	232	156
Fees related to permitted non-audit services provided by the statutory auditor	5	30
Total fees paid to audit firms	237	186

The amounts in the table above include VAT.

The Bank is provided with statutory audit services by PricewaterhouseCoopers Könyvvizsgáló Korlátolt Felelősségű Társaság.

Non-audit services provided by the statutory auditor includes professional education and audit reports on special lending activity.

NOTE 41 – SUBSIDIARIES

	Address of headquarter	Principal activities	Capital 2020	Effective Shareholding 2020	Effective Shareholding 2019
Fully consolidated subsidiaries			**MHUF**	**%**	**%**
K&H Jelzálogbank Zrt.	1095 Budapest, Lechner Ödön fasor 9.	Other credit granting services	3 200	100	100
K&H Autópark Kft.	1095 Budapest, Lechner Ödön fasor 9.	Operating lease	11	100	100
K&H Ingatlanlízing Zrt.	1095 Budapest, Lechner Ödön fasor 9.	Finance lease	50	100	100
K&H Tanácsadó Zrt.	1095 Budapest, Lechner Ödön fasor 9.	Business and management consultancy	850	100	100
K&H Csoportszolgáltató Kft.	1095 Budapest, Lechner Ödön fasor 9.	Group service center	60	100	100
K&H Equities Zrt.	1095 Budapest, Lechner Ödön fasor 9.	Business and management consultancy	38	100	100
K&H Faktor Zrt.	1095 Budapest, Lechner Ödön fasor 9.	Other financial services	51	100	100
K&H Értékpapír Zrt.	1095 Budapest, Lechner Ödön fasor 9.	Security and commodity contracts brokerage	301	100	100

The principal place of business of the companies mentioned in the table is Hungary.

NOTE 42 – SUBSEQUENT EVENTS

There were no subsequent events to be reported till the approval of the financial statements.

NOTE 43 – RISK MANAGEMENT

43.1 General

The Bank is not only a universal commercial bank and a major player in the Hungarian market but also part of the KBC Group. As such the activities of the Bank cover a wide range including the retail, corporate and the professional money market segments. In its role as a financial intermediary, the Bank faces different uncertainties presenting both risk and opportunity at the same time. The challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value.

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

- Value, risk and capital management are inextricably linked to one another.
- Risk management is 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.
- Primary responsibility for value and risk management lies with line management, while within Capital and Risk Oversight (CRO) Services Division separate Value and Risk Management departments – operating independently of line management – perform advisory, supporting and supervisory role.
- Every material subsidiary is required to adhere to the same risk governance model as the parent company.

The Bank risk management activity is primarily based on the on-going Internal Capital Adequacy Assessment Process (ICAAP) that is aligned with international standards and KBC Group principles. The ICAAP is subject of annual Supervisory Review and Evaluation Process (SREP) conducted by the local supervisor in the frame of Joint Capital Decision of home and host supervisors.

The Bank has Recovery Plan prepared according to the guidelines set out by KBC Group and the local supervisor. The Recovery Plan of the Bank is integrated into the Recovery Plan of KBC Group.

Risk management governance model

The risk management governance model seeks to define the responsibilities and tasks of various bodies and persons within the organisations with a view to ensuring the sound management of value creation and all the associated risks to which the banking business is exposed. The Bank's risk governance model is organised in three tiers:

- Overarching company and risk committees are the Board of Directors (BoD), the Audit Board (AB), Risk and Compliance Committee (RCC), the Executive Committee (ExCo), the Country Team (CT) and the Capital and Risk Oversight Committee (CROC). These committees concentrate on overarching risk management and on monitoring value creation.
- Specialised risk councils (Credit Risk Council (CRC), Operational Risk Councils (ORC) concentrate on implementing a group-wide framework for one particular type of risk and monitoring the associated risk management process. The risk councils are composed of representatives from line management and relevant Value and Risk Management departments.
- Line management and activity-specific committees have primary responsibility for value and risk management on the operational level. Whereas Value and Risk Management departments measure risks, economic capital and value creation for all relevant business entities and reports their findings directly to line management and the relevant activity-specific committees.
- Within CRO Services Division the Risk Integration and Support Directorate is dedicated to overarch the three existing risk centres of competence (Credit Risk, Market and Liquidity Risk and Non-financial Risks), enhance coordination and report to Management regarding value creation, risk and capital.

The Board of Directors and the Risk and Compliance Committee have an important role to play in value creation and risk governance. Regular reporting to the Risk and Compliance Committee – quarterly risk reports, yearly overview of the remuneration policy and the risk based pricing policy - ensures that there is an ample flow of information to the relevant members of the Board over the course of the year. Moreover, through the involvement of the entire Board in the annual round of approvals of risk-tolerance limits, the Board is able to take informed decisions on the degree of risk it finds acceptable for the Bank and on the adequacy of the risk management structure.

NOTE 43 – RISK MANAGEMENT (continued)

Risk measurement and – monitoring

Risk measurement and monitoring in general includes the following sub-processes:

- Identification of risks is a process of discovering and defining material risks, namely those risks that could have a positive or negative impact on the financial position of the Bank. Identification of risks is further ensured with setting up New and Active Products Process (NAPPs) in all business domains.

- Measurement of risks; qualitative and quantitative assessment of exposure to risk. The Bank uses amongst others the following risk measures for the following most significant risk types:
  - Credit default and migration risks: nominal positions (outstanding/exposure), PD (probability of default), LGD/EL (loss given default/expected loss), credit concentration ratios, loan delinquency ratios, renegotiated loan ratios, credit loss ratios, RWA, stress test results;
  - Trading risk: historic VaR (value at risk), and stress test results;
  - ALM (asset-liability management) risk: BPV (basis point value), results of stress test on interest income, parametric VaR;
  - Operational risk: KRI (key risk indicator), results of risk self-assessment, level of compliance with Group Standards, availability of crisis management plans;
  - Liquidity risk: liquidity gaps, loan-to-deposit ratio, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), liquidity concentration ratios, stress test results.

- Risk appetite and setting limits; is a way of authorizing specific forms of risk taking. A limit indicates how much risk the Bank considers being ‘an acceptable maximum’ for a portfolio or a segment of a portfolio. They 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 appetite and limits are agreed upon by the Board of Directors.

- Reporting; delivery of risk measurement results and compliance with the limits (comparison of risk exposure with the risk limit) to the decision makers (relevant risk committees) in a structured format. The main types of reports used in the Bank:
  - exposures to key risk types,
  - key risk indicators,
  - limit breaches,
  - losses,
  - advice from risk management department regarding the risk response.

  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 group risk committees and on to the KBC Group Executive Committee.

- Monitoring and response to shortcomings; the purpose of responding to risks is to constrain threats and take advantage of the opportunities. Management (or respective decision makers) need to come up with a response to risk and define, implement and execute controls instruments that help to achieve a residual risk level aligned with the Bank’s risk limits.

The following paragraphs deal with each of the material risk types in more detail.

43.2 Liquidity risk and funding management

Liquidity is the ability of the Bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses. The fundamental role of the Bank in the maturity transformation of short-term deposits into long-term loans makes the Bank inherently vulnerable to liquidity risk both of an institution-specific nature and that which affects markets as a whole. Liquidity risk management is of paramount importance because a liquidity shortfall at a single institution can have system-wide repercussions. Financial market developments in the past decade have increased the complexity of liquidity risk and its management.

NOTE 43 – RISK MANAGEMENT (continued)

The objective of the liquidity risk management framework is to limit liquidity risks by taking into account an adequate level of funding, the potential growth of the Bank, and in considering liquidity shocks to guarantee the availability of sufficient cash flow to meet all of the Bank's financial commitments:

- in a normal business environment;
- under extreme circumstances (shocks);
- and on different time horizons (short, medium and long term).

The Bank assesses the following liquidity risk aspects:

- Short-term liquidity risk represents the risk that the Bank will not be able to meet its payment obligations in full or in time. Short-term liquidity risk is measured up to 30-90 working days.
- Long-term liquidity risk represents the risk that additional refinancing funds will be available only at higher market interest rates. Long-term liquidity risk is measured from 1 year onwards.
- Concentration liquidity risk occurs when the Bank has an excessive level of exposure to individual depositor, type of deposit instrument, market segment or currency of denomination, mainly on the liabilities' side. However, concentration liquidity risk can be also due to concentration in a particular on- or off-statement of financial position instrument, which could significantly alter expected cash flows.
- Marketable asset risk represents the risk that the Bank will not be able to liquidate assets on the market only at a discount.

The core collateral pool (liquidity buffer or liquidity reserve) is considered as the liquidity resource of the Bank. The Bank maintains adequate liquidity resources at all times, both as to amount, maturity and quality, to ensure that the Bank can continue to meet its liabilities as they fall due, both in normal and stressed times.

The structure of the core collateral pool reflects the Bank's market position, and advantages resulting from the composition of shareholders and various internal and external prudential expectations such as:

- Attracting significant client funds (both corporate and retail);
- Having (indirect) access to international capital markets, funds provided by KBC Group (parent company);
- Keeping the cost of funding to a minimum, while maintaining competitiveness (prices should be in line with the rates of other key players in the market);
- Avoiding as much as possible reliance on volatile deposits;
- Offering full service to clients with the widest possible array of financial products.

The Bank maintains adequate balances on its accounts with the National Bank of Hungary and foreign correspondents to continuously meet its obligations.

NOTE 43 – RISK MANAGEMENT (continued)

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2020:

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial assets					
Cash balances with central banks and other demand deposits with credit institutions	391 045	-	-	-	391 045
Held for trading	33 237	17 104	16 861	-	67 202
Mandatorily at fair value through profit or loss	11 702	27 037	100 831	-	139 570
Fair value through other comprehensive income	58 907	49 515	-	3 877	112 299
Amortised cost	1 944 375	1 012 962	570 844	-	3 528 181
Fair value changes of hedged item under portfolio hedge of interest rate risk	17 841	-	-	-	17 841
Hedging derivatives	1 253	11 977	12 235	-	25 465
Total financial assets and cash balances with central banks and other demand deposits with credit institutions	2 458 360	1 118 595	700 771	3 877	4 281 603

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial liabilities					
Held for trading	31 043	21 076	12 049	-	64 168
Designated at fair value through profit or loss	16 348	16 703	-	-	33 051
Hedging derivatives	1 738	3 145	19 482	-	24 365
Measured at amortised cost	3 354 347	395 962	77 961	-	3 828 270
Fair value changes of hedged item under portfolio hedge of interest rate risk	14 614	-	-	-	14 614
Total financial liabilities	3 418 090	436 886	109 492	-	3 964 468
Commitments and contingent liabilities	968 409	-	-	-	968 409
Total financial liabilities, commitments and contingent liabilities	4 386 499	436 886	109 492	-	4 932 877

Financial assets and liabilities repayable on demand are included in the <=1 year category.

NOTE 43 – RISK MANAGEMENT (continued)

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2019:

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial assets					
Cash balances with central banks and other demand deposits with credit institutions	413 502	-	-	-	413 502
Held for trading	26 578	32 280	18 168	-	77 026
Mandatorily at fair value through profit or loss	5 553	15 984	45 479	-	67 016
Fair value through other comprehensive income	36 829	53 142	-	3 069	93 040
Amortised cost	1 414 273	842 837	480 961	-	2 738 071
Fair value changes of hedged item under portfolio hedge of interest rate risk	19 042	-	-	-	19 042
Hedging derivatives	1 195	11 557	16 755	-	29 507
Total financial assets and cash balances with central banks and other demand deposits with credit institutions	1 916 972	955 800	561 363	3 069	3 437 204

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial liabilities					
Held for trading	16 813	30 828	13 552	-	61 193
Designated at fair value through profit or loss	21 774	30 840	-	-	52 614
Hedging derivatives	470	5 749	18 802	-	25 021
Measured at amortised cost	2 631 883	278 923	68 819	-	2 979 625
Fair value changes of hedged item under portfolio hedge of interest rate risk	15 827	-	-	-	15 827
Total financial liabilities	2 686 767	346 340	101 173	-	3 134 280
Commitments and contingent liabilities	885 697	-	-	-	885 697
Total financial liabilities, commitments and contingent liabilities	3 572 464	346 340	101 173	-	4 019 977

Financial assets and liabilities repayable on demand are included in the <=1 year category.

NOTE 43 – RISK MANAGEMENT (continued)

The remaining maturity of non-financial assets and liabilities held as at 31 December 2020 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	3 058	-	3 058
Investment property	-	1 536	1 536
Property, plant and equipment	-	47 458	47 458
Intangible assets	-	46 441	46 441
Non-current assets held for sale and disposal groups	1 474	-	1 474
Other assets	22 747	-	22 747
Total assets	27 279	95 435	122 714
Tax liabilities	991	193	1 184
Provisions for risks and charges	2 828	16	2 844
Other liabilities	60 138	-	60 138
Total liabilities	63 957	209	64 166

The remaining maturity of non-financial assets and liabilities held as at 31 December 2019 is presented in the table below.

	Reclassified < 1 year MHUF	Reclassified > 1 year MHUF	Reclassified Total MHUF
Tax assets	2 505	-	2 505
Investment property	-	1 874	1 874
Property, plant and equipment	-	50 556	50 556
Intangible assets	-	30 422	30 422
Other assets	21 136	-	21 136
Total assets	21 926	82 852	104 773
Provisions for risks and charges	401	825	1 226
Other liabilities	1 835	16	1 851
Total liabilities	62 151	841	62 992

The expected remaining maturity breakdown above represents the current and non-current classification of non-financial assets and liabilities.

NOTE 43 – RISK MANAGEMENT (continued)

The following tables present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2020. For held-for-trading derivatives nominal values are disclosed in the table.

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading derivatives	Mandatory fair value through profit or loss	Fair value through other comprehensive income	Amortised cost	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
On demand and less than three months	319 893	572 722	3 668	6 386	906 496	422 464	2 231 629
More than three months but not more than one year	-	1 143 829	3 579	17 093	254 921	295 161	1 714 583
More than one but not more than five years	-	1 438 405	27 600	54 847	1 061 920	822 031	3 404 803
More than five years	-	425 104	101 635	41 604	1 300 775	317 245	2 186 363
Total	319 893	3 580 060	136 482	119 930	3 524 112	1 856 901	9 537 378

	Held for trading derivatives	Designated fair value through profit or loss	Amortised cost	Hedging deriv4atives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities					
On demand and less than three months	572 626	7 632	3 221 549	424 173	4 225 980
More than three months but not more than one year	1 143 466	21 066	104 502	295 537	1 564 571
More than one but not more than five years	1 438 194	2 232	435 836	822 399	2 698 661
More than five years	425 104	0	74 642	317 416	817 162
Total	3 579 390	30 930	3 836 529	1 859 525	9 306 374

NOTE 43 – RISK MANAGEMENT (continued)

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand and less than three months	668 909	287 448	12 052	968 409
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	668 909	287 448	12 052	968 409

The following tables present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2019. For held-for-trading derivatives nominal values are disclosed in the table.

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading derivatives	Mandatory fair value through profit or loss	Fair value through other comprehensive income	Amortised cost	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
On demand and less than three months	359 256	483 477	2 900	6 024	504 534	308 942	1 665 133
More than three months but not more than one year	-	850 298	2 890	-	334 189	614 666	1 802 043
More than one but not more than five years	-	2 129 834	15 984	51 539	865 169	358 374	3 420 900
More than five years	-	459 534	45 479	33 742	1 028 735	186 290	1 753 780
Total	359 256	3 923 143	67 253	91 305	2 732 627	1 468 272	8 641 856

NOTE 43 – RISK MANAGEMENT (continued)

	Held for trading derivatives	Designated fair value through profit or loss	Amortised cost	Hedging deriv4atives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities					
On demand and less than three months	475 214	4 166	2 504 648	309 839	3 293 867
More than three months but not more than one year	855 171	15 801	75 126	619 902	1 566 000
More than one but not more than five years	2 121 605	28 577	329 062	357 091	2 836 335
More than five years	459 534	-	73 080	186 290	718 904
Total	3 911 524	48 544	2 981 916	1 473 122	8 415 106

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand and less than three months	604 841	271 082	9 775	885 698
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	604 841	271 082	9 775	885 698

The Bank’s exposure to the risk arising from the outflows of cash or other financial asset which can occur significantly earlier or can be for significantly different amounts from the data presented in the tables above is immaterial.

The Bank uses different ratios to measure and limit liquidity risk that arises from financial intermediation. The operational liquidity is monitored via limits on the unsecured liquidity gap, stress tests and “Basel III” and local regulatory liquidity indicators. From a structural liquidity point of view a group wide net stable funding ratio is used. The Bank is also analysing liquidity stress test results.

NOTE 43 – RISK MANAGEMENT (continued)

Operational liquidity is measured by the unsecured liquidity gap limit. The operational liquidity gap is the difference between the cash in and outflows in different time horizons (5 days, 30 days) and an internal limit was set for the gap to be covered by National Bank of Hungary eligible collaterals. The Bank had sufficient liquidity gap surplus in 2020 and 2019, having increasing reliance on sight deposits.

Liquidity stress tests

Contingency liquidity risk is assessed in the Bank on the basis of several liquidity stress scenarios. The aim of the stress tests is to measure how the liquidity buffer of the Bank 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. Excess liquidity is the amount of cash that is available which is not required to cover immediately maturing liabilities. The simulated liquidity buffer is the sum of two components: the expected cash evolution under stressed scenarios and the expected liquidity increasing actions under stressed scenarios. In essence, there are four different types of stress tests: K&H specific empirical scenario, 2013's Cyprus banking crisis inspired empirical scenario, Combined general market turmoil and Central Europe specific scenarios, and a reverse stress scenario. Under all scenarios the Bank would achieve the internally set survival period of one month and also the time to wall period is indicated which is sufficiently remote in each stress test.

Basel III and regulatory ratios

LCR and NSFR ratios prescribed in regulation from Basel III origin on liquidity measurement are calculated and reported regularly as key liquidity risk measure. Effective LCR threshold is 100% since 1 October 2015, the Bank's LCR ratio stood at 222% at the end of 2020 and at 160% at the end of 2019 meeting all time the regulatory minimum requirement. NSFR's 100% regulatory compliance is postponed from beginning of 2019, but that does not restraint the Bank from monitoring it. The Bank stood at 171% at the end of 2020 and at 159% at the end of 2019.

43.3 Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchange rates. The Bank classifies exposures to market risk into either trading or non-trading portfolios.

Market risk – trading

The Bank is exposed to market risk via the trading books of the Bank's dealing room and via the FX exposure of the subsidiaries. The Bank has set limits on the level of market risk that may be accepted. The Bank applies VaR methodology to assess the market risk positions held and to estimate the potential economic loss based on a number of parameters and assumptions for various changes in market conditions. VaR is defined as an estimate of the amount of money that can be lost on a given portfolio due to market risk, over a defined holding period, to a given confidence level. The measure only considers the market risk of the current portfolio and does not attempt to capture possible losses due to further trading or hedging, counterparty default or operational losses.

In practice the actual trading results will differ from the VaR calculation and in particular, the calculation does not provide a meaningful indication of profits and losses in stressed market conditions. To determine the reliability of the VaR models, actual outcomes are monitored regularly to test the validity of the assumptions. Market risk positions are also subject to regular stress tests to assess if the Bank would withstand market shocks.

There are a number of different approaches used in the industry to generate VaR, with each having a varying level of suitability for different sizes and types of portfolios. The Bank has chosen to use the historical VaR methodology to measure and manage market risks in the trading book.

NOTE 43 – RISK MANAGEMENT (continued)

The hVaR approach uses the actual historic market performance to simulate possible future market evolutions. The hVaR methodology does not rely on assumptions regarding the distribution of price fluctuations or correlations, but is based on patterns of experience over the previous two years (500 scenario dates). The hVaR that the Bank applies is an estimate - using a confidence level of 99% and one-day holding period. The use of the 99% confidence level means that, within a one day horizon, losses exceeding the VaR figure should occur, on average, once every hundred days. However, the VaR method will not tell us how much we will lose on that day, only that it is expected to exceed a certain amount. HVaR has rapidly become the standard VaR approach in large, internationally active banks. Moreover, hVaR provides a much better fit with the increased emphasis on scenario-based risk management, which includes stress testing.

Beside the hVaR calculations and stress-test risk concentrations are also monitored via secondary limit: FX concentration limits to limit FX risk stemming from a particular foreign currency position..

VaR results can be presented as follows:

	Foreign exchange MHUF	Interest rate MHUF	Total VAR MHUF
2020 – 31 December	8	0	8
2020 – Average daily	10	7	12
2020 – Highest	51	25	51
2020 – Lowest	1	1	1
2019 – 31 December	11	2	12
2019 – Average daily	11	3	12
2019 – Highest	23	7	23
2019 – Lowest	3	2	4

From 2020, the Group switched to the calculation methodology based on 1-day holding period from the previously used 10-days holding period to measure VaR.

The Bank's average limit utilization was well below the hVaR limit.

Trading risk taking was stable at around 11% of the available VaR limit. There was no limit overrun in the examined period. In March 2018 trading positions were migrated to KBC (phase 1: interest rate positions).

From 2020 Q2, the Bank reports its trading risk capital requirement applying CRR. Art.94 – Derogation of Small Trading Book (STB), as a result of compliance with regulatory requirements. National Bank of Hungary (MNB) accepted that the Bank was going to use STB. Position risk' capital requirement is henceforth calculated under the credit risk framework, thus the trading risk capital requirement decreased significantly. There is continuous daily monitoring and strong control environment in place which was accepted by MNB to provide STB compliance and regulatory requirements. From this point of time, total VaR equals with the foreign exchange VaR figures and interest rate VaR is no longer considered within trading risk.

The Bank does not have exposure to direct equity risk. Trading portfolio buy back notes in closed and open-end capital protected funds from K&H Asset Management Funds so as to assure secondary market for these notes. Typically all funds are made of deposit and different option structures. The trading risk is managed with a EUR 5 million net nominal limit on these notes and above one year maturity all components are fully hedged. The structure of notes which are kept in trading book is dismantled and the option part is hedged back-to-back within the limits.

No exposure to equity risk in order to meet STB rules.

NOTE 43 – RISK MANAGEMENT (continued)

Market risk – Non-trading

The Capital and Risk Oversight Committee (CROC) is responsible for controlling the value creation, the maturity transformation and the market risks of the banking book. Risk tolerance levels are allocated by KBC Group and approved by the K&H Board of Directors.

Majority of the Bank's ALM risks are interest rate related risks; consequently the tolerance level is limited in BPV terms (10-basispoint upward parallel yield curve shift impact on net present value). The interest rate risk is also measured with scenario analyses (including stressed environment). ALM-Capital Model determines the amount of capital that is required in view of the ALM risk profile in the banking book. ALM-CM measures the impact of very severe events on the Available Capital under Pillar I. Banking book's inherent risks are interest rate risk, inflation, real estate and equity risk that are measured and monitored according to the Bank approach. Foreign currency risk is not inherent in the banking book.

The BPV tables below present the results of reasonable possible changes of the fair value of the financial instruments held at fair value on 31 December 2020 and 2019. Possible alternatives were calculated based on the scenarios of 10, 100, and 200 basis point parallel shifts in yield curves. The banking book is limited in BPV by an internally set limit. The results contain the impact of derivative exposures too.

NOTE 43 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2020	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up				
	EUR	(214)	23	(191)
	HUF	(376)	213	(163)
	USD	-	(1)	(1)
10 bp parallel up total		(591)	235	(356)
100 bp parallel up				
	EUR	(2 092)	355	(1 737)
	HUF	(9 814)	1 628	(8 186)
	USD	-	(18)	(18)
100 bp parallel up total		(11 906)	1 965	(9 941)
200 bp parallel up				
	EUR	(4 073)	430	(3 644)
	HUF	(19 960)	4 173	(15 788)
	USD	-	(23)	(23)
200 bp parallel up total		(24 034)	4 579	(19 455)

DOWN Scenarios, 31 December 2020	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down				
	EUR	216	(23)	192
	HUF	1 843	(214)	1 629
	USD	-	1	1
10 bp parallel down Total		2 058	(236)	1 823
100 bp parallel down				
	EUR	2 211	(86)	2 125
	HUF	12 437	(2 794)	9 643
	USD	-	4	4
100 bp parallel down total		14 649	(2 876)	11 773
200 bp parallel down				
	EUR	4 553	(510)	4 043
	HUF	24 612	(4 360)	20 252
	USD	-	23	23
200 bp parallel down total		29 165	(4 846)	24 319

NOTE 43 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2019	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up				
	EUR	(112)	103	(9)
	HUF	(1 052)	257	(795)
	USD	-	(3)	(3)
10 bp parallel up total		(1 164)	357	(807)
100 bp parallel up				
	EUR	(1 095)	1 125	30
	HUF	(9 548)	2 157	(7 391)
	USD	-	(44)	(44)
100 bp parallel up total		(10 643)	3 238	(7 405)
200 bp parallel up				
	EUR	(2 128)	1 989	(139)
	HUF	(18 595)	4 927	(13 668)
	USD	-	(65)	(65)
200 bp parallel up total		(20 723)	6 851	(13 872)

DOWN Scenarios, 31 December 2019	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down				
	EUR	113	(103)	10
	HUF	936	(258)	678
	USD	-	3	3
10 bp parallel down Total		1 049	(358)	691
100 bp parallel down				
	EUR	1 161	(910)	251
	HUF	10 366	(3 104)	7 262
	USD	-	21	21
100 bp parallel down total		11 527	(3 993)	7 534
200 bp parallel down				
	EUR	2 396	(2 133)	263
	HUF	21 320	(5 391)	15 929
	USD	-	68	68
200 bp parallel down total		23 716	(7 456)	16 260

NOTE 43 – RISK MANAGEMENT (continued)

Currency risk

Currency or foreign exchange (FX) risk basically arises from mismatches in the currency structure of the Bank's assets and liabilities. Positions are monitored on a daily basis and the hedging strategy of the Bank is to close all material FX positions in the bank's banking book, thus currency risk is managed exclusively within the trading book. Trading FX exposure is managed within the trading limit, and the global hVaR limit of the Bank. For details see the market risk-trading section above.

Fair valuation

One of the building blocks of a sound market risk management is also the prudent valuation of positions valued at Fair Value. This applies to *HFT instruments*: Held For Trading (adjustments impact P&L), *FIFV instruments*: financial instruments designated at fair value through profit or loss (adjustments impact P&L) and *FVOCI instruments*: Fair value through other comprehensive income (adjustments impact equity).

The Bank's overall Valuation Framework stipulates that, when available, published independent price quotations from well-established active markets are used to determine Fair Value. In case of non-active markets, other valuation techniques (i.e. mark-to-model) are used in order to arrive at realistic estimates of Fair Value.

Consequently a daily independent valuation of front-office positions is performed by the Treasury Middle Office. Market-observed prices used in the valuation are regularly validated by the Market and Liquidity Risk Department via a formal parameter review process. Apart from market parameters, valuation techniques/models are also subject of independent review by the Market and Liquidity Risk Department.

43.4 Credit risk

Credit risk is the potential shortfall relative to the value expected consequent on non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to an inter-professional transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay, or to events or measures taken by the political or monetary authorities of a particular country. The latter risk is also referred to as 'country risk'.

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of financial position. The Bank makes available to its customers guarantees which may require that the Bank makes payment on their behalf. Such payments are collected from customers based on the terms of the credit contracts. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

Credit risk is managed at both transactional and 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 accepting individual credit exposures. Managing the risk at portfolio level encompasses periodic reporting on (parts of) the loan portfolio, monitoring limit discipline and the specific portfolio management function.

Expected credit loss (ECL)

Expected credit losses are modelled over instrument's *lifetime period.* The *lifetime period* is equal to the remaining contractual period to maturity of debt instruments, adjusted for expected prepayments, if any. For loan commitments and financial guarantee contracts, it is the contractual period over which an entity has a present contractual obligation to extend credit. The exception from determining the lifetime exposure based on contractual maturity, for credit cards and overdrafts, the lifetime exposure is measured over a period that is based on expected life of the credit card contracts, based on internal statistics it is set to 30 years.

NOTE 43 – RISK MANAGEMENT (continued)

Management models *Lifetime ECL,* that is, losses that result from all possible default events over the remaining lifetime period of the financial instrument is based on various models developed both locally and centrally depending on the sub-portfolio. The *12-month ECL,* represents a portion of lifetime ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting period, or remaining *lifetime period* of the financial instrument if it is less than a year.

It is important to note that the ECLs estimated for the purposes of these financial statements are point-in-time estimates, rather than through-the-cycle estimates that are commonly used for regulatory purposes. The estimates consider *forward looking information,* that is, ECLs reflect probability weighted development of key macroeconomic variables (e.g. unemployment, GDP evolution) that have an impact on credit risk.

The ECL modelling does not differ for Purchased or Originated Credit Impaired (“POCI”) financial assets, except that (a) gross carrying value and discount rate are based on cash flows that were recoverable at initial recognition of the asset, rather than based on contractual cash flows, and (b) the ECL is always a lifetime ECL. POCI assets are financial assets that are credit-impaired upon initial recognition, such as loans affected by settlement of CHF mortgage loans which were NPL at the time of settlement. (On 16 June 2014, the Hungarian Supreme Court rendered its decision regarding the legal assessment of foreign currency based loans (“FX loans”) for consumers under Hungarian civil law. In accordance with the Conversion Act the Bank was required to convert foreign currency and foreign currency-based consumer mortgage loan contracts into Hungarian Forints with the effect date of 1 February 2015.)

For purposes of measuring PD, the Bank defines default as described in the Accounting policy – Definition of default chapter.

An instrument is considered to be no longer in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of three months. This period of three months has been determined based on an analysis that considers the likelihood of a financial instrument returning to default status after curing by using the definition of cures.

Although the default/non-default flag is conceptually conceived on client level, a different treatment is allowed in case of retail exposures. For these exposures, the definition of default can be applied at the level of a particular facility, rather than at the level of the obligor. As a consequence, a default of a client on one retail exposure does not require to treat all other retail exposure of this client as defaulted as well.

The assessment whether or not there has been a significant increase in credit risk (“SICR”) since initial recognition is performed on an individual basis and on a portfolio basis. On loans issued to corporate entities, interbank loans and debt securities at AC or at FVOCI, SICR is assessed on an individual basis by monitoring the triggers stated below. For loans issued to individuals and other financial assets, SICR is assessed either on a portfolio basis or an individual basis, depending on the existence of scoring models. The criteria used to identify an SICR are monitored and reviewed periodically for appropriateness by the Bank’s Risk Management Department. The presumption, being that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has not been rebutted.

The Bank considers a financial instrument to have experienced an SICR when one or more of the following quantitative, qualitative or backstop criteria have been met.

For interbank operations and bonds issued by banks or government:

- 30 days past due;
- award of risk grade “Special monitoring”;
- SICR based on relative threshold based either on external ratings or internal ratings, which corresponds to an approximate increase of PD by 4.0 times.

NOTE 43 – RISK MANAGEMENT (continued)

For loans issued to legal entities and bonds issued by corporate customers:

- 30 days past due;
- award of risk grade "Special monitoring";
- SICR based on relative threshold based either on external ratings or internal ratings. The following thresholds are used for external ratings: decrease of rating by 2 notches, for internal ratings by 5 notches, which corresponds to approximate increase of PD by 2.5 times;
- inclusion of loan into a watch list according to the internal credit risk monitoring process.

For loans to Individuals:

- 30 days past due;
- Relative threshold defined on the basis of a portfolio for products without existing scoring models: the Bank regularly monitors segments with increased credit risk (regions of higher credit risk, failed products, products on which issuing was stopped) and considers such portfolios to have a SICR; / Relative threshold defined on individual basis for products with existing scoring models: increase of the remaining lifetime PD compared to remaining lifetime PD estimated as of the date of initial recognition by 2.5 times.
- Due to the nature of the blanket moratorium instated by the Hungarian Government days past due information can no longer be used to identify a Significant Increase in Credit Risk. Thus transactional information is also being looked at, specifically the decrease of savings and wage information is also being used to identify SICR. It is being used as an Unlikely to Pay trigger and Forbearance trigger.

The level of ECL that is recognised in these financial statements depends on whether the credit risk of the borrower has increased significantly since initial recognition. This is a three-stage model for ECL measurement. A financial instrument that is not credit-impaired on initial recognition and its credit risk has not increased significantly since initial recognition has a credit loss allowance based on 12-month ECLs (Stage 1). If a SICR since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired and the loss allowance is based on lifetime ECLs. If a financial instrument is credit-impaired, the financial instrument is moved to Stage 3 and loss allowance is based on lifetime ECLs. The consequence of an asset being in Stage 3 is that the entity ceases to recognise interest income based on gross carrying value and applies the asset's effective interest rate to the carrying amount, net of ECL, when calculating interest income.

If there is evidence that the SICR criteria are no longer met, the instrument is transferred back to Stage 1. If an exposure has been transferred to Stage 2 based on a qualitative indicator, the Bank monitors whether that indicator continues to exist or has changed. The monitoring is done in an automated way in the engine which calculates ECL.

ECL for POCI financial assets is always measured on a lifetime basis. The Bank therefore only recognises the cumulative changes in lifetime expected credit losses.

The Bank has two approaches for ECL measurement: (i) assessment on an individual basis; (ii) assessment on a portfolio basis: internal ratings are estimated on an individual basis but the same credit risk parameters (e.g. PD, LGD) will be applied during the process of ECL calculations for the same credit risk ratings and homogeneous segments of the loan portfolio. The Bank performs an assessment on an individual basis for non-retail clients above HUF 300mln exposure. The Bank performs an assessment on a portfolio basis for the following types of loans: retail loans and non-retail loans where exposure is below HUF 300mln when no borrower-specific information is available.

ECL assessment on an individual basis is performed by weighting the estimates of credit losses for different possible outcomes against the probabilities of each outcome. The Bank defines at least two possible outcomes for each assessed loan, one of which leads to a credit loss even if the probability of such a scenario may be very low. Individual assessment is primarily based on the expert judgement of experienced officers from the Credit Management Department. Expert judgements are regularly tested in order to decrease the difference between estimates and actual losses.

NOTE 43 – RISK MANAGEMENT (continued)

When assessment is performed on a portfolio basis, the Bank determines the staging of the exposures and measures the loss allowance on a collective basis. The Bank analyses its exposures by segments determined on the basis of shared credit risk characteristics, such that exposures within a group have homogeneous or similar risks. The different segments also reflect differences in credit risk parameters such as PD and LGD. The appropriateness of groupings/models is monitored and reviewed on yearly periodic basis by the Modelling Department and validated by Credit Risk Department locally or centrally depending on the specific model.

In general, ECL is the sum of the multiplications of the following credit risk parameters: EAD, PD and LGD, that are defined as explained below, and discounted to present value using the instrument's effective interest rate. The ECL is determined by predicting credit risk parameters (EAD, PD and LGD) for each future year during the lifetime period for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has been repaid). This effectively calculates an ECL for each future period, that is then discounted back to the reporting date and summed up. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

EADs are determined based on the expected payment profile, that varies by product type. EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis for amortising products and bullet repayment loans. This will also be adjusted for any expected overpayments made by a borrower. Early repayment or refinancing assumptions are also incorporated into the calculation. For revolving products, the EAD is predicted by taking the current drawn balance and adding a "credit conversion factor" that accounts for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type, current limit utilisation and other borrower-specific behavioural characteristics.

PDs are used for calculating ECLs: The Bank uses different statistical approaches depending on the segment and product type to calculated lifetime ECLs, such as the extrapolation of 12-month ECLs based on migration matrixes, developing lifetime ECL curves based on the historical default data, hazard rate.

LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by the type of counterparty, type and seniority of the claim, and the availability of collateral or other credit support. LGDs are determined based on the factors that impact the expected recoveries after a default event. The approach to LGD measurement can be divided into three possible approaches:

- measurement of LGD based on the specific characteristics of the collateral;
- calculation of LGD on a portfolio basis based on recovery statistics; or
- individually defined LGD depending on different factors and scenarios.

The Bank calculates LGD based on specific characteristics of the collateral, such as projected collateral values, historical discounts on sales and other factors for loans secured by real estate, cash and liquid securities. LGD is calculated on a collective basis based on the latest available recovery statistics for the remainder of the corporate loan portfolio and for retail secured and unsecured products.

ECL measurement for financial guarantees and loan commitments. The ECL measurement for these instruments includes the same steps as described above for on-balance sheet exposures and differs with respect to EAD calculation. The EAD is a product of credit conversion factor ("CCF") and amount of the commitment ("$ExOff$"). CCF for undrawn credit lines of corporate customers, credit cards and overdrafts issued to both individuals and non-retail entities, and for financial guarantees is defined based on statistical analysis of past exposures at default.

NOTE 43 – RISK MANAGEMENT (continued)

Forward-looking information incorporated in the ECL models. The assessment of SICR and the calculation of ECLs both incorporate supportable forward-looking information. The Bank identified certain key economic variables that correlate with developments in credit risk and ECLs. Forecasts of economic variables (the "base economic scenario") are provided by the Bank's Chief Economist and provide the best estimate of the expected macro-economic development over the next five years. After five years, a mean reversion approach is used, which means that economic variables tend to revert to either a long run average rate (e.g. for unemployment) or a long run average growth rate (e.g. GDP). The impact of the relevant economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact that the changes in these variables historically had on the default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Bank's Credit Risk Department also provides other possible scenarios (e.g. stress tests) along with scenario weightings. The number of other scenarios used is set based on the analysis of each major product type to ensure that non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking into account the range of possible outcomes of which each chosen scenario is representative. The assessment of SICR is performed using the12 month PD as a proxy for Lifetime PD under each of the bases and the other scenarios, multiplied by the associated scenario weighting, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether a 12-month or lifetime ECL should be recorded. Following this assessment, the Bank measures ECL as either a probability-weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecast, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Bank's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

The Bank regularly reviews its methodology (back testing) and assumptions to reduce any difference between the estimates and the actual loss of credit. Such back testing is performed semi-annually.

The results of backtesting the ECL measurement methodology are communicated to Bank Management and further steps for tuning models and assumptions are defined after discussions between authorised persons.

Accounting judgements and estimates related to ECL

A sensitivity analysis of the impact of these multiple economic scenarios on the collectively calculated ECL (i.e. without the ECL on individually assessed files of HUF 9 354 million at year-end 2020 (HUF 11 578 million in 2019), shows that the base scenario results in an ECL of HUF 38 667 million (HUF 22 341 million in 2019), which is HUF 3 027 million lower than the "down"-scenario and HUF 926 million higher than the "up"-scenario (HUF 941 million lower and HUF 946 million higher in 2019). The collectively calculated weighted ECL results (which was booked) amounts to HUF 39 633 million (HUF 22 575 million in 2019). Note that these amounts take into account the Covid-19 related management overlay (per scenario) at the end of 2020 (see Note 3).

NOTE 43 – RISK MANAGEMENT (continued)

The Bank used supportable forward looking information for measurement of ECL, primarily an outcome of its own macro-economic forecasting model. The most significant forward looking assumptions for Hungary that correlate with ECL level and their assigned weights were as follows at 31 December 2020:

31 December 2020

			Assumption for:				
Variable	**Scenario**	**Assigned weight**	**2021**	**2022**	**2023**	**2024**	**2025**
Unemployment rate	Base	55%	5.6%	4.8%	4.0%	4.0%	4.0%
	Upside	10%	4.2%	4.0%	3.8%	3.8%	3.9%
	Downside	35%	7.5%	6.5%	5.8%	5.5%	5.2%
Real GDP Growth rate	Base	55%	5.0%	3.5%	3.0%	2.8%	2.6%
	Upside	10%	4.0%	3.5%	3.0%	2.8%	2.6%
	Downside	35%	4.0%	3.5%	3.0%	2.8%	2.6%

31 December 2019

			Assumption for:				
Variable	**Scenario**	**Assigned weight**	**2019**	**2020**	**2021**	**2022**	**2023**
Unemployment rate	Base	60%	3.55%	3.70%	3.68%	3.60%	3.67%
	Upside	20%	2.50%	2.20%	1.27%	0.65%	1.21%
	Downside	20%	4.80%	5.00%	4.90%	4.90%	4.75%
Real GDP Growth rate	Base	60%	3.30%	2.78%	3.00%	3.00%	2.78%
	Upside	20%	4.46%	4.43%	4.89%	4.88%	4.35%
	Downside	20%	2.12%	1.06%	1.11%	1.07%	1.18%

Two variables are used during ECL calculation: the unemployment rate and the real GDP growth rate. Macroeconomic assumptions are updated on a quarterly basis. There were no changes regarding the assigned weights during 2020.

NOTE 43 – RISK MANAGEMENT (continued)

The industry breakdown of loans and advances is presented in the table below:

	2020	2019
	MHUF	MHUF
Industry sector		
Agriculture, forestry and fishing	100 870	83 868
Mining and quarrying	898	951
Manufacturing	221 308	206 323
Electricity, gas, steam and air conditioning supply	66 329	39 404
Water supply	14 308	13 312
Construction	26 122	23 377
Wholesale and retail trade	133 277	115 952
Transport and storage	73 508	77 148
Accommodation and food service activities	18 807	12 464
Information and communication	8 099	5 129
Financial and insurance activities	97 836	85 134
Real estate activities	161 124	122 987
Professional, scientific and technical activities	30 923	34 584
Administrative and support service activities	13 344	11 758
Public administration and defence, compulsory social security	50	66
Education	1 381	1 382
Human health services and social work activities	1 938	2 025
Arts, entertainment and recreation	559	624
Central bank	624 118	272 001
Individuals	831 151	699 031
Central governments	60 275	32 438
Municipalities	21 762	20 309
Credit institutions	538 463	541 209
Other services	3 985	1 435
Gross loans and advances	3 050 435	2 402 911
Total impairment on loans and advances (see Note 23)	(49 912)	(35 233)
Total loans and advances	3 000 523	2 367 678

The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

Collateral and other credit enhancements

In compliance with its business policy the Bank does not grant collateral-based financing (i.e. financing that is not based on the loan repayment capacity of the client), however, there is one exception to this rule in case of a special credit type when the loan is collateralized with cash deposit. The borrower's cash flow represents the primary – direct – source of loan repayment to the Bank.

The inclusion of any type of collateral is subject to the assessment of the credit solvency of the client/guarantor, in the course of which the assets in question must be evaluated in compliance with the concerning internal regulations.

The main types of collateral applied are as follows:

- for retail lending, mortgages over residential real estate,
- for commercial lending, mortgage on real estate properties (both commercial and residential), state and institutional guarantees, and pledge on inventory and trade receivables,
- for securities lending cash deposits or security pledges.

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

In case of corporate clients relationship-managers monitor the market value of collaterals, regularly request for a review of the concerning collateral or requests additional collateral behind the deal if necessary. For defaulted counterparties, collaterals are assessed thoroughly to estimate expected recovery in order to set necessary level of impairments. For retail clients the regularly updated indexed market values are used.

The carrying amount of investment properties and other assets, which were obtained by the Bank by taking possession during 2020 amounted to HUF 375 million (HUF 803 million in 2019).

The Bank sells its assets obtained as collateral instead of using them for its operation.

The following tables present un-, under- and full or over collateralised loans and advances, The tables include the fair value of collaterals maximized to the net carrying amount of loans and advances, loan commitments, guarantees and other commitments given.

NOTE 43 – RISK MANAGEMENT (continued)

	Under collateralised loans		Full and over collateralised loans				
	Carrying amount of loans	Fair value of collateral	Carrying amount of loans	Fair value of collateral	Uncollateralised loans	Total carrying amount of loans	Total fair value of collateral
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020							
-Central bank and credit institutions	41 129	39 963	-	-	1 121 412	1 162 541	39 963
General government	46 213	38 889	3 291	-	32 128	81 632	42 180
Corporate	662 762	318 601	92 570	92 570	192 037	947 369	411 171
of which: Small and Medium enterprises	415 884	203 443	71 994	71 994	79 055	566 933	275 437
Households	101 873	86 703	607 751	607 751	99 357	808 981	694 454
Consumer credit	61 442	60 612	39 913	39 913	83 967	185 322	100 525
Credit card	-	- -	-	-	5 763	5 763	-
Current account	2 580	1 272	116	116	7 052	9 748	1 388
Finance lease	1 152	1 118	2 172	2 172	110	3 434	3 290
Mortgage loan	24 736	18 124	556 107	556 107	1 486	582 329	574 231
Term loan	11 963	5 577	9 443	9 443	979	22 385	15 020
--Trade receivables	-	-	-	-	-	-	-
Total	851 977	484 156	703 612	703 612	1 444 934	3 000 523	1 187 768
Loan commitments and guarantees at 31 December 2020							
Loan commitments	181 947	73 078	6 019	6 019	480 944	668 910	79 097
Financial guarantees	160 456	85 163	173	173	126 819	287 448	85 336
Other commitments	3 081	992	9	9	8 962	12 052	1 001
Total	345 484	159 233	6 201	6 201	616 725	968 410	165 434

The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions. The fair value of collaterals is maximised to the net carrying amount of the loans and loan commitments.

NOTE 43 – RISK MANAGEMENT (continued)

	Under collateralised loans		Full and over collateralised loans				
	Carrying amount of loans	Fair value of collateral	Carrying amount of loans	Fair value of collateral	Uncollateralised loans	Total carrying amount of loans	Total fair value of collateral
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2019							
Central bank and credit institutions	29 544	28 767	4 961	4 961	778 659	813 164	33 728
General government	44 436	40 320	73	73	7 884	52 393	40 393
Corporate	578 216	288 548	88 010	88 010	157 617	823 843	376 558
of which: Small and Medium enterprises	389 428	198 817	66 978	66 978	68 128	524 534	265 795
Households	54 542	41 498	494 242	494 242	129 494	678 278	535 740
Consumer credit	18 396	18 352	23 138	23 138	66 903	108 437	41 490
Credit card	-	-	-	-	5 795	5 795	-
Current account	2 967	1 648	536	536	7 308	10 811	2 184
Finance lease	545	541	2 255	2 255	113	2 913	2 796
Mortgage loan	21 120	15 594	458 031	458 031	48 384	527 535	473 625
Term loan	11 514	5 363	10 282	10 282	991	22 787	15 645
Trade receivables	-	-	-	-	-	-	-
Total	706 738	399 133	587 286	587 286	1 073 654	2 367 678	986 419
Loan commitments and guarantees at 31 December 2019							
Loan commitments	182 161	77 704	3 181	3 181	419 498	604 840	80 885
Financial guarantees	146 610	79 340	157	157	124 315	271 082	79 497
Other commitments	4 276	1 071	9	9	5 491	9 776	1 080
Total	333 047	158 115	3 347	3 347	549 304	885 698	161 462

The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions. The fair value of collaterals is maximised to the net carrying amount of the loans and loan commitments.

NOTE 43 – RISK MANAGEMENT (continued)

The breakdown of loans and advances* by the type of collateral is presented below.

	Collateralised by									
	residential immovable property		commercial immovable property		debt securities		other			
	Carrying amount of loans MHUF	Fair value of collateral MHUF	Carrying amount of loans MHUF	Fair value of collateral MHUF	Carrying amount of loans MHUF	Fair value of collateral MHUF	Carrying amount of loans MHUF	Fair value of collateral MHUF	Total carrying amount of loans MHUF	Total fair value of collateral MHUF
Loans and advances* at 31 December 2020										
Central bank and credit institutions	-	-	-	-	-	-	41 129	39 963	41 129	39 963
General government	-	-	8 283	1 426	-	-	41 221	40 754	49 504	42 180
Corporate	-	-	502 754	258 378	6 504	5 413	246 074	147 380	755 332	411 171
of which: Small and Medium enterprises	-	-	320 490	170 641	6 054	4 977	161 334	99 819	487 878	275 437
Households	682 197	674 755	11 337	5 505	269	257	15 821	13 937	709 624	694 454
Consumer credit	101 354	100 524	-	-	1	1	-	-	101 355	100 525
Credit card	-	-	-	-	-	-	-	-	-	-
Current account	-	-	1 625	782	-	-	1 071	606	2 696	1 388
Finance lease	-	-	-	-	-	-	3 324	3 290	3 324	3 290
Mortgage loan	580 843	574 231	-	-	-	-	-	-	580 843	574 231
Term loan	-	-	9 712	4 723	268	256	11 426	10 041	21 406	15 020
Trade receivables	-	-	-	-	-	-	-	-	-	-
Total	682 197	674 755	522 374	265 309	6 773	5 670	344 245	242 034	1 555 589	1 187 768
Unsecured exposures	85 436	-	626	-	4	-	1 358 868	-	1 444 934	-
Total carrying value loans and advances to customers at amortised cost (amount representing exposure to credit risk for each class of loans at amortised cost)	767 633	674 755	523 000	265 309	6 777	5 670	1 703 113	242 034	3 000 523	1 187 768

*The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions

NOTE 43 – RISK MANAGEMENT (continued)

	Collateralised by									
	residential immovable property		commercial immovable property		debt securities		other			
	Carrying amount of loans MHUF	Fair value of collateral MHUF	Carrying amount of loans MHUF	Fair value of collateral MHUF	Carrying amount of loans MHUF	Fair value of collateral MHUF	Carrying amount of loans MHUF	Fair value of collateral MHUF	Total carrying amount of loans MHUF	Total fair value of collateral MHUF
Loans and advances* at 31 December 2019										
Central bank and credit institutions	-	-	-	-	-	-	34 505	33 728	34 505	33 728
General government	-	-	5 222	1 698	-	-	39 287	38 695	44 509	40 393
Corporate	-	-	431 431	228 506	7 309	6 168	227 486	141 884	666 226	376 558
of which: Small and Medium enterprises	-	-	311 485	171 757	7 011	5 925	137 910	88 113	456 406	265 795
Households	520 333	514 763	10 421	5 814	748	717	17 282	14 446	548 784	535 740
Consumer credit	41 209	41 165	-	-	325	325	-	-	41 534	41 490
Credit card	-	-	-	-	-	-	-	-	-	-
Current account	-	-	2 173	1 444	3	3	1 327	737	3 503	2 184
Finance lease	-	-	-	-	-	-	2 800	2 796	2 800	2 796
Mortgage loan	479 124	473 598	-	-	27	27	-	-	479 151	473 625
Term loan	-	-	8 248	4 370	393	362	13 155	10 913	21 796	15 645
Trade receivables	-	-	-	-	-	-	-	-	-	-
Total	520 333	514 763	447 074	236 018	8 057	6 885	318 560	228 753	1 294 024	986 419
Unsecured exposures	115 406	-	958	-	-	-	957 295	-	1 073 659	-
Total carrying value loans and advances to customers at amortised cost (amount representing exposure to credit risk for each class of loans at amortised cost)	635 739	514 763	448 032	236 018	8 057	6 885	1 275 855	228 753	2 367 683	986 419

*The table includes the net carrying amount of loans and advances in the loans and receivables portfolio, cash and cash balances with central banks and other demand deposits to credit institutions.

Collaterals behind non performing or past due financial assets amounted to HUF 34 348 million as at 31 December 2020 (HUF 60 433 million as at 31 December 2019). The amount of the collaterals includes the indexed or reviewed collateral value limited to the carrying amount of the related asset.

NOTE 43 – RISK MANAGEMENT (continued)

The following table presents the quality of loans and advances by stage categories.

	Loans and advances at amortised cost						
	Gross carrying amount			Accumulated impairment			Total net carrying amount
	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	MHUF
Loans and advances* at 31 December 2020							
Central bank and credit institutions	1 158 543	-	5	(39)	-	-	1 158 509
General government	81 624	-	379	(30)	-	(375)	81 598
Corporate	842 795	111 612	18 514	(3 637)	(14 779)	(8 882)	945 623
of which: Small and Medium enterprises	514 837	57 540	8 376	(2 145)	(7 385)	(4 326)	566 897
Households	599 605	75 134	22 543	(1 318)	(9 289)	(11 452)	675 223
of which: purchased or originated credit impaired	-	4 787	11 341	-	-	(5 265)	10 863
Consumer credit	82 323	5 400	750	(929)	(994)	(535)	86 015
Credit card	5 628	219	33	(33)	(63)	(21)	5 763
Current account	7 402	2 507	950	(38)	(839)	(234)	9 748
Finance lease	3 202	268	-	(6)	(30)	-	3 434
Mortgage loan	481 480	63 538	20 760	(260)	(6 999)	(10 641)	547 878
Term loan	19 570	3 202	50	(52)	(364)	(21)	22 385
Trade receivables	-	-	-	-	-	-	-
Total	2 682 567	186 746	41 441	(5 024)	(24 068)	(20 709)	2 860 953

*Including cash balance with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

The following table presents the quality of loans and advances by stage categories.

	Loans and advances at amortised cost						
	Gross carrying amount			Accumulated impairment			Total net carrying amount
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances* at 31 December 2019							
Central bank and credit institutions	811 636	-	20	(45)	-	-	811 611
General government	51 221	1 122	343	(15)	-	(339)	52 332
Corporate	763 046	53 193	18 327	(2 050)	(872)	(11 157)	820 487
of which: Small and Medium enterprises	484 622	37 293	13 286	(1 338)	(575)	(8 854)	524 434
Households	507 354	97 850	31 480	(1 185)	(3 086)	(16 181)	616 232
of which: purchased or originated credit impaired	-	3 623	18 072	-	-	(7 783)	13 912
Consumer credit	65 602	3 753	659	(904)	(603)	(490)	68 017
Credit card	5 542	337	55	(45)	(58)	(36)	5 795
Current account	7 401	3 036	1 347	(42)	(300)	(631)	10 811
Finance lease	2 733	201	-	(7)	(14)	-	2 913
Mortgage loan	406 901	86 874	29 353	(134)	(2 095)	(14 990)	505 909
Term loan	19 175	3 649	66	(53)	(16)	(34)	22 787
Trade receivables	-	-	-	-	-	-	-
Total	2 133 257	152 165	50 170	(3 295)	(3 958)	(27 677)	2 300 662

*Including cash balance with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

Credit risk exposure for each internal risk rating

The table below includes outstanding exposure of loans and loan commitments to customers and banks (without any money market position). Past due assets are distributed to the internal risk rating classes.

	Historical default rates* 2020	Average unsecured share of exposure 2020	Total 2020 MHUF	Average unsecured share of exposure 2019	Total 2019 MHUF
PD 1-2	0.0000	0.7501	331 308	0.7859	350 615
PD 3-4	0.0007	0.5795	989 290	0.6196	863 993
PD 5-9	0.0462	0.5631	1 151 116	0.5574	971 362
PD 10-12	1.0000	0.3563	37 964	0.4024	57 804
Total			2 509 678		2 243 774

* Impaired (PD10-12) portfolio per credit grades compared to last year's total non-impaired portfolio.

NOTE 43 – RISK MANAGEMENT (continued)

The following tables present the distribution of the loan portfolio according to the internal ratings.

	PD1	PD2	PD3	PD4	PD5	PD6	PD7	PD8	PD9	PD10	PD11	PD12	Total
	%	%	%	%	%	%	%	%	%	%	%	%	%
Loans and advances* at 31 December 2020													
Central bank and credit institutions	6.8	22.5	-	9.4	-	-	-	-	-	-	-	-	38.7
General government	-	0.9	1.6	0.2	0.1	-	-	-	-	-	-	-	2.8
Corporate	0.3	1.7	2.3	5.3	9.9	7.3	2.2	1.2	0.4	0.4	0.1	0.2	31.3
of which: Small and Medium enterprises	0.3	0.5	1.8	3.0	5.9	3.8	1.8	0.6	0.2	0.1	0.1	0.1	18.2
Households	-	0.6	9.6	6.0	5.2	1.6	2.6	0.3	0.5	0.1	0.1	0.6	27.2
Consumer credit	-	-	-	3.1	0.4	0.5	2.0	-	0.1	-	-	-	6.1
Credit card	-	-	-	0.1	0.1	-	-	-	-	-	-	-	0.2
Current account	-	-	-	0.1	0.1	-	-	-	-	-	-	-	0.2
Finance lease	-	-	-	0.1	-	-	-	-	-	-	-	-	0.1
Mortgage loan	-	0.6	9.5	2.4	4.4	0.9	0.5	0.3	0.4	0.1	0.1	0.6	19.8
Term loan	-	-	0.1	0.2	0.2	0.2	0.1	-	-	-	-	-	0.8
Trade receivables	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	7.1	25.7	13.5	20.9	15.2	8.9	4.8	1.5	0.9	0.5	0.2	0.8	100.00

NOTE 43 – RISK MANAGEMENT (continued)

The following tables present the distribution of the loan portfolio according to the internal ratings.

	PD1	PD2	PD3	PD4	PD5	PD6	PD7	PD8	PD9	PD10	PD11	PD12	Total
	%	%	%	%	%	%	%	%	%	%	%	%	%
Loans and advances* at 31 December 2019													
Central bank and credit institutions	16.7	25.0	0.6	21.3	-	-	-	-	-	-	-	-	63.6
General government	-	0.5	2.9	-	-	-	-	0.1	-	-	-	-	3.5
Corporate	-	4.8	2.3	4.1	4.9	2.4	0.8	0.5	0.1	0.4	-	0.4	20.7
of which: Small and Medium enterprises	-	2.9	0.6	0.8	2.3	1.3	0.7	0.1	0.1	-	-	0.4	9.2
Households	-	-	0.2	2.5	0.7	1.0	5.3	0.2	0.3	0.2	0.2	1.6	12.2
Consumer credit	-	-	-	2.3	0.4	0.3	5.1	0.1	0.1	-	-	-	8.3
Credit card	-	-	-	-	0.2	0.1	-	-	-	-	-	-	0.3
Current account	-	-	-	0.1	-	0.1	-	-	0.1	-	-	-	0.3
Finance lease	-	-	-	-	-	-	-	-	-	-	-	-	-
Mortgage loan	-	-	-	-	-	-	0.1	0.1	0.1	0.2	0.2	1.6	2.3
Term loan	-	-	0.2	0.1	0.1	0.5	0.1	-	-	-	-	-	1.0
Trade receivables	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	16.7	30.3	6.0	27.9	5.6	3.4	6.1	0.8	0.4	0.6	0.2	2.0	100.0

NOTE 43 – RISK MANAGEMENT (continued)

43.5 Credit risk – forborne loans

The policy on forbearance is based on the directive of the European Banking Authorities (EBA) harmonizing the definitions of forbearance and non-performing loans within the EU from 30/09/2014 on and on Regulation 39/2016 issued by the National Bank of Hungary.

Forbearance is similar to distressed renegotiations, whereby the bank agrees to renegotiate the existing contracts and obligations for a borrower with financial difficulties in order to avoid default (e.g. in order to avoid overdue interest, rent, capital and/or fees). Please note that the moratorium instated by the Hungarian government is not an automatic trigger for forbearance.

Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments.

A concession refers to either of the following actions:

a) a modification of the terms and conditions of an existing contract because the debtor is considered unable to comply with the terms and conditions of the contract due to its financial difficulties and whereby the modification in principle would not have been granted in case the debtor would not have been in financial difficulties;
b) a total or partial refinancing of a troubled debt contract because the debtor is considered unable to comply with the terms and conditions of the troubled debt due to its financial difficulties and whereby the partial refinancing in principle would not have been granted in case the debtor would not have been in financial difficulties.

The above means that an exposure should be perceived as forborne in case that two conditions are met:

a) The bank granted concessions towards the borrower
b) due to the fact that the borrower has financial difficulties.

The forbearance classification is discontinued when all the following conditions are met:

- a minimum 2 year probation period has passed from the date the forborne exposure was considered as performing;
- the contract is considered as performing, including if it has been reclassified from the non-performing category after an analysis of the financial condition of the debtor showed it no longer met the conditions to be considered as non-performing;
- regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period;
- none of the exposures to the debtor is more than 30 days past-due at the end of the probation period.

A non-performing exposure for which forbearance measurement has been applied cannot be considered as performing for at least one year after the forbearance measurement.

The rating category of the debtor does not improve due to the forbearance measurement. The Bank classifies borrowers with forborne exposures to at least PD9. In the following cases forborne borrowers are classified to a default status (i.e. at least PD 10):

- a second forbearance during the probation period;
- in case of 30 days past due for an amount exceeding the default materiality threshold of 2% of the exposure or HUF 250 000 during the probation period;
- partial and/or full debt forgiveness.

Forbearance measurement is applied on facility level (not on entire exposure).

NOTE 43 – RISK MANAGEMENT (continued)

The following table presents forborne loans, loan commitments and guarantees.

	Mandatorily at fair value through profit or loss			At amortised cost		
	Gross carrying amount	Accumulated negative changes in fair value due to credit risk	Total	Gross carrying amount	Accumulated impairment	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020						
Central bank and credit institutions	-	-	-	-	-	-
General government	-	-	-	379	(375)	4
Corporate	-	-	-	4 472	(2 972)	1 500
of which: Small and Medium enterprises	-	-	-	2 365	(871)	1 494
Households	5	(1)	4	7 776	(2 940)	4 840
Consumer credit	-	-	-	63	(45)	18
Credit card	-	-	-	-	-	-
Current account	-	-	-	-	-	-
Finance lease	-	-	-	-	-	-
Mortgage loan	5	(1)	4	7 713	(2 895)	4 822
Term loan	-	-	-	-	-	-
Trade receivables	-	-	-	-	-	-
Total	5	(1)	4	12 627	(6 287)	6 344

Forborne loans mandatorily measured at fair value through profit or loss are non-performing loans.

NOTE 43 – RISK MANAGEMENT (continued)

The following table presents forborne loans, loan commitments and guarantees.

	Mandatorily at fair value through profit or loss			At amortised cost		
	Gross carrying amount	Accumulated negative changes in fair value due to credit risk	Total	Gross carrying amount	Accumulated impairment	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2019						
Central bank and credit institutions	-	-	-	-	-	-
General government	-	-	-	343	(339)	4
Corporate	-	-	-	9 806	(6 003)	3 803
of which: Small and Medium enterprises	-	-	-	6 141	(4 526)	1 615
Households	-	-	-	14 232	(3 757)	10 475
Consumer credit	-	-	-	33	(13)	20
Credit card	-	-	-	-	-	-
Current account	-	-	-	-	-	-
Finance lease	-	-	-	-	-	-
Mortgage loan	-	-	-	14 199	(3 744)	10 455
Term loan	-	-	-	-	-	-
Trade receivables	-	-	-	-	-	-
Total	-	-	-	24 381	(10 099)	14 282

Forborne loans mandatorily measured at fair value through profit or loss are non-performing loans.

NOTE 43 – RISK MANAGEMENT (continued)

There were no forborne commitments and guarantees in 2020 and 2019.

The following table explains the change of forborne loans.

	2020 MHUF	2019 MHUF
Balance as at the beginning of the period	14 282	20 098
Loans which have become forborne	1 590	3 039
Loans which are no longer considered to be forborne	(6 873)	(2 165)
Repayments	(12 714)	(7 085)
Change in the impairment of forborne loans	1 106	(2 328)
Other	8 953	2 723
Balance as at the end of the period	6 344	14 282

The Bank recorded HUF 526 million interest income on forborne loans in the income statement in 2020 (HUF 819 million in 2019).

NOTE 43 – RISK MANAGEMENT (continued)

Aging analysis quality of forborne loans and advances as at 31 December 2020 is as follows:

	Loans and advances*							
	Performing				Non-performing			
	Not past due	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2020								
Central bank and credit institutions	-	-	-	-	-	-	-	-
General government	-	-	-	-	-	-	4	4
Corporate	436	2	-	-	1 045	-	17	1 500
of which: Small and Medium enterprises	436	2	-	-	1 045	-	11	1 494
Households	833	378	71	-	1 017	263	2 278	4 840
Consumer credit	14	1	-	-	2	-	1	18
Credit card	-	-	-	-	-	-	-	-
Current account	-	-	-	-	-	-	-	-
Finance lease	-	-	-	-	-	-	-	-
Mortgage loan	819	377	71	-	1 015	263	2 277	4 822
Term loan	-	-	-	-	-	-	-	-
Trade receivables	-	-	-	-	-	-	-	-
Total	1 269	380	71	-	2 062	263	2 299	6 344

*The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

Aging analysis quality of forborne loans and advances as at 31 December 2019 is as follows:

	Loans and advances*							
	Performing				Non-performing			
	Not past due	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Past due <= 30 days	Past due > 30 days <= 90 days	Past due > 90 days	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances at 31 December 2019								
Central bank and credit institutions	-	-	-	-	-	-	-	-
General government	-	-	-	-	-	-	4	4
Corporate	296	37	-	-	3 220	-	250	3 803
of which: Small and Medium enterprises	296	37	-	-	1 032	-	250	1 615
Households	3 022	785	-	-	2 066	594	4 008	10 475
Consumer credit	11	1	-	-	6	1	1	20
Credit card	-	-	-	-	-	-	-	-
Current account	-	-	-	-	-	-	-	-
Finance lease	-	-	-	-	-	-	-	-
Mortgage loan	3 011	784	-	-	2 060	593	4 007	10 455
Term loan	-	-	-	-	-	-	-	-
Trade receivables	-	-	-	-	-	-	-	-
Total	3 318	822	-	-	5 286	594	4 262	14 282

*The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

Staging of forborne loans and advances are presented as follows.

	Loans and advances at amortised cost*						
	Gross carrying amount			Accumulated impairment			
	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Stage 1 MHUF	Stage 2 MHUF	Stage 3 MHUF	Total MHUF
Loans and advances* at 31 December 2020							
Central bank and credit institutions	-	-	-	-	-	-	-
General government	-	-	379	-	-	(375)	4
Corporate	-	523	3 949	-	(85)	(2 887)	1 500
of which: Small and Medium enterprises	-	523	1 842	-	(85)	(786)	1 494
Households	-	1 354	6 422	-	(72)	(2 868)	4 836
of which: purchased or originated credit impaired	-	923	3 438	-	-	(1 203)	3 158
Consumer credit	-	16	47	-	(1)	(44)	18
Credit card	-	-	-	-	-	-	-
Current account	-	-	-	-	-	-	-
Finance lease	-	-	-	-	-	-	-
Mortgage loan	-	1 338	6 375	-	(71)	(2 824)	4 818
Term loan	-	-	-	-	-	-	-
Trade receivables	-	-	-	-	-	-	-
Total	-	1 877	10 750	-	(157)	(6 130)	6 340

Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

Staging of forborne loans and advances are presented as follows.

	Loans and advances at amortised cost*						
	Gross carrying amount			Accumulated impairment			
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Loans and advances* at 31 December 2019							
Central bank and credit institutions	-	-	-	-	-	-	-
General government	-	-	343	-	-	(339)	4
Corporate	232	104	9 470	(1)	(2)	(6 000)	3 803
of which: Small and Medium enterprises	232	104	5 805	(1)	(2)	(4 523)	1 615
Households	-	3 888	10 344	-	(81)	(3 676)	10 475
of which: purchased or originated credit impaired	-	2 762	6 880	-	-	(1 729)	7 913
Consumer credit	-	12	21	-	-	(13)	20
Credit card	-	-	-	-	-	-	-
Current account	-	-	-	-	-	-	-
Finance lease	-	-	-	-	-	-	-
Mortgage loan	-	3 876	10 323	-	(81)	(3 663)	10 455
Term loan	-	-	-	-	-	-	-
Trade receivables	-	-	-	-	-	-	-
Total	232	3 992	20 157	(1)	(83)	(10 015)	14 282

Also including Cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

The industrial breakdown of forborne loans is included in the table below.

	2020	2019
	MHUF	MHUF
Industry sector		
Agriculture, forestry and fishing		
Manufacturing	2 377	7 766
Electricity, gas, steam and air conditioning supply	-	107
Wholesale and retail trade	-	76
Transport and storage	298	-
Accommodation and food service activities	171	-
Real estate activities	1 575	1 792
Professional, scientific and technical activities	51	65
Individuals	7 781	14 232
Non-credit institutions	379	343
	-	
Forborne loans and advances - gross	12 632	24 381
Accumulated impairment	(6 287)	(10 099)
Accumulated negative changes in fair value due to credit risk	(1)	-
Total forborne loans and advances	6 344	14 282

All forborne loans are granted to domestic clients in 2020 and 2019.

The table includes the net carrying amount of loans and advances mandatorily at fair value through profit or loss and at amortised cost, cash and cash balances with central banks and other demand deposits to credit institutions.

NOTE 43 – RISK MANAGEMENT (continued)

43.6 Operational risk

In line with KBC Group, the Bank applies the official Basel definition of Operational Risk and Operational Risk Management. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems and from external events. It includes legal and tax risks, but excludes strategic and systemic risks. The Bank takes reputation risk into account to a certain level. When controls fail to adequately perform, operational risks can result in financial loss, damage to reputation, have legal or regulatory consequences. The operational risks cannot be completely eliminated; but using sound control framework these risks can be mitigated to an acceptable level.

Processes and risk event types together are used as common and universal/uniform framework of reference for reporting purposes. The Bank implemented the use of a uniform set of processes, risk event types, risk mitigating/measuring processes and a toolkit for operational risk management.

The first element of the toolkit is the use of *Group-wide Control requirements (Group Key Controls)* which are the key controls, defined by a centre of competence intended to control or mitigate major inherent risks. All KBC Group entities must implement these Key Controls. The compliance with the Group Key Controls is monitored via a benchmarking (assessment) exercise, assessments which are used to determine the gap between the group-wide requirements and the local practice. The derived action plans are continuously monitored and reported to the Capital and Risk Oversight Committee and Operational Risk Councils. The Local line management is responsible for translating the Group Key Controls into local procedures as well as for the timely and proper implementation of action plans.

Risk Self-Assessments aim to identify and assess the operational risk inherent in all material products, activities, processes and systems by the line management with the involvement of other concerned parties.

A ‘*Case Study Assessment’* is the process of testing the level of the protection of the current control environment against severe operational risk events that have actually happened in the banking and insurance industry by detecting gaps in subsequent control layers.

In line with the guidelines of KBC, the Bank collects the *operational loss events* in a unified and integrated database which is also used for analysis and reporting purposes.

The method and framework of *Key Risk Indicators* were implemented in 2009. These are measurable metrics or indicators which help the organization with monitoring the inherent and / or residual exposure to certain key risks, and combine the measurement of risk with the actual management of risk. Changes in the risk exposure versus the risk tolerance of the Bank are measured by warning and alert thresholds that are set for each Key risk indicator.

Risk scans for operational, and business and reputation risks were performed there by the main business lines, Information security and ICT (Information and Communication Technology), to assess the most important non-financial risks using a top-down approach.

In order to assure the continuity of its critical business services, the Bank has an extensive business continuity framework in place, that includes business continuity plans for material activities, the testing of such plans in order to be prepared for potential crisis situations.

NOTE 44 – SOLVENCY AND CAPITAL

Based on the Hungarian Law (Act C of 2000, no. 114 / B. §)

	2020 MHUF	2019 MHUF
Share capital in accordance with IFRS	140 978	140 978
Capital reserve	48 775	48 775
Tied-up reserve	31 621	28 376
Revaluation reserve	10 357	12 833
Accumulated profit	123 909	75 531
Profit for the year	32 453	50 414
Total equity	388 093	356 907
from this		
Registered capital by the Registry Court	140 978	140 978
Distributable reserves available for dividend payment	156 362	125 945

In accordance with Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (banking law) and the EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), the Bank must have a minimum capital in place. The Bank reports its level of capital adequacy situation to the Hungarian National Bank (MNB) on a quarterly basis and also forecasts are prepared to the Capital and Risk Oversight Committee (CROC) of the Bank on a regular basis. When needed, the Bank's Executive Committee decides and proposes to KBC Group any necessary steps that the Committee believes need to be taken (such as capital increase, subordinated debt increase, dividend payment etc.).

	2020 MHUF	2019 MHUF
Tier 1 capital elements	355 613	318 866
Adjustments due to prudential filters	(4 845)	(6 262)
Tier 1 total	350 768	312 604
Tier 2 capital elements	54 300	41 976
Tier 2 total	54 300	41 976
Own funds	405 069	354 580

The Bank fulfilled the capital requirements set by MNB continuously during years 2020 (and 2019) and at 31 December 2020 (and at 31 December 2019). The Bank is required to set aside 10% of its profit calculated as a statutory reserve for use against future losses. The balance of this reserve as at 31 December 2020 was HUF 31 621 million (HUF 28 376 million as at 31 December 2019). The Bank had distributable reserves of HUF 156 362 million as at 31 December 2020 (HUF 125 945 million as at 31 December 2019).

No dividend is proposed for 2020 (nor in 2019).

Approved by the Board of Directors on 20 April 2021.

David Moucheron
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer
Member of the Board

K&H Bank Zrt.

Management Report

31 December 2020

Below we summarise the business operations, the operating conditions and the financial results of K&H Bank Zrt. (hereunder “Bank”) in 2020.

1. Economic environment

The fast spreading of Covid-19 virus in the world has caused a serious shock for the Hungarian economy as well. The growth dynamics experienced during the previous years continued at the beginning of 2020, but the lockdown measures pushed the economy into deep recession. Following the 13.6% yoy drop of GDP in the second quarter, the economy has started to present some signs of life in the second half of the year supported by the government’s and the central bank’s programs. Nevertheless, huge differences can be observed in the speed of the recovery among the sectors: while industrial production showed a fast rebound, some areas of the service sector has faced serious difficulties and also the investment willingness has moderated considerably due to the uncertain economic outlook.
Although the volume of both export and import activities decreased, the surplus of the trade balance improved in 2020, which stopped the trend of deteriorating current account balance for several years. The financing capability of the country has remained in positive territory, also thanks to the EU funds inflow. The government maintained a relative – under the given circumstances – tight fiscal policy in the first half of the year, but introduced significant fiscal stimulus in the second half of 2020. It pushed the general state budget deficit to around 9 percent of GDP and the gross public debt to over 80 percent of GDP, so decreasing trend since 2011 has stopped in 2020. Nevertheless, the country’s risk assessment was generally favorable and the rating agencies did not change Hungary’s debt rating.

	2019 actual	2020 preliminary
GDP growth	+4.6%	-5.1%
CPI (average)	3.4%	3.3%
Households’ consumption	+4.2%	-2.6%
Investments	+11.9%	-3.8%
Unemployment rate	3.2%	4.1%
Budget deficit (ESA) (in % of GDP)	-2.1%	-9.0%
Debt/GDP rate	65.4%	80.6%
Balance of payments (in % of GDP)	-0.5%	0.1%

Source: MNB, KSH, K&H

Similarly to the world's leading central banks, the National Bank of Hungary (MNB) has introduced a number of measures to support the stability of the banking system and the economic recovery. Regarding financial stability, next to the financial moratorium for debt repayment introduced by the government (see more details and its expected impact on K&H Bank on page 3) more flexible forebearance and NPL rules were announced by MNB, while the capital buffer requirements were also eased for the banks. MNB reduced the base rate from 0.9 percent to 0.6 percent in two steps. A new monetary policy tool was launched (1 week deposit) with the aim of supporting the short-end of the yield curve (and as a consequence the forint exchange rate), and several new tools (for instance more accommodative repo collateral rules) were introduced to boost the banking sector’s liquidity position. In order to support the government bond market, the MNB provided secured loans to the banks, and it became a more active market participant directly also via auction system and secondary market purchases, thus helping to finance the general government deficit and to stabilize the bond market. Also a new Funding for Growth program was announced (NHP Hajrá) for corporates and the conditions of the existing Bond Funding for Growth Scheme were adjusted, additionally the size of both programs has been increased during the year. Despite the fact that both the consumer price index and the core inflation filtered from indirect taxes remained in the upper half of the central bank's target band for most of the year, the Hungarian economy was surrounded by an accommodative monetary environment.

2. Key balance sheet and performance data

2.1. Balance sheet

HUF Bln	31 Dec 2019	31 Dec 2020	Variance
Total assets	3,554	4,417	+24.3%
Central Banks and credit institutions	813	1,163	+43.0%
Loans and advances to customers	1,555	1,838	+18.2%
Deposits from customers	2,611	3,247	+24.3%
Equity	357	388	+8.7%

Total assets of K&H Bank amounted to 4,417 bln on 31 Dec 2020 (+24.3% growth in 2020).

- *Loans and advances to customers* increased by 18% in 2020 (whereof appr. 2% is attributable to the 9 pct weakening of HUF): fulfilling its role to finance the economy K&H granted a total of 620 bln new loans in 2020, corresponding to a 23% yoy growth far exceeding the 3% growth of the market. The growth rate of both corporate and retail loan portfolio exceeded that of the market and K&H has strengthened its market share in both segments. In terms of retail lending, K&H's market share increased in mortgages, the state subsidized prenatal baby support loan products and also in cash loans. K&H contracted a total amount of 173 bln for the Funding for Growth Hajrá! scheme by 31 December.

- *Deposits from customers* increased by 24% during the year: the Bank's market share improved further in corporate deposits and remained unchanged in retail savings (deposits + funds) in 2020.

- *Shareholders' equity* increased by 31 bln (+9%) compared to 31 Dec 2019. Main elements of the change: profit of 2020 (+32.5 bln) and lower cash flow reserve (-1.5 bln).
  The capital adequacy ratio was 18.4% at 31 December 2020 which fulfilled the capital requirements set by MNB.

2.2. Profit

HUF bln	2019	2020
Profit after taxation	50.4	32.5

The Bank's profit for 2020 was negatively impacted by the one-off impacts of Covid19 pandemic:

- Modification loss from the moratorium: -4.4 bln[1]
- 19.7 bln Covid-19 related IFRS9 based collective impairments for expected future credit losses, consisting of two components:

[1] With the aim of mitigating the economic impact of the coronavirus, on 18 March 2020 a financial moratorium was announced by the government for the retail and corporate debtors for principal, interest and fee payments which would become due until 31 December 2020 (Government decree of 47/2020 and 62/2020). The moratorium does not result in debt forgiveness: the unpaid interest and fee accumulated during the moratorium shall be redeemed after the moratorium in equal annual parts during the remaining tenor of the loan together with the due principal instalments. The tenor of the loan will be prolonged in a way that the debtor's new instalment covering the unpaid interest and fee as well next to the due capital shall not exceed the instalment determined in the original payment schedule. The payment moratorium is automatic for all eligible debtors and loans (but the debtor has the right to opt-out from the payment moratorium).
Although the debtors shall redeem all deferred payment obligations accumulated during the moratorium, as no interest can be charged on the deferred interest the Bank shall recognize a negative P&L impact arising from the time value of the payment deferral.
On 22 December 2020 the government released the decree of 637/2020 prolonging the duration of the existing moratorium until 30 June 2021. According to estimations, the combined loss of the moratorium and its extension will amount to approximately HUF 4 400 million at 31 December 2020. The estimated negative impact is recognized as a modification to the gross carrying amount of the related loans in the Bank's standalone statement of financial position. At the end of 2020, in consequence of the voluntary opt-out choice, only 38% of the eligible retail and 36% of eligible corporate portfolio participated in the moratorium. Detailed description on the Covid19 related financial moratorium is included in the standalone financial statements (Note 3).

- o 1.9 bln impact was calculated by the ECL models through the updated macroeconomic variables
- o 17.8 bln management overlay (calculated from an expert-based stress migration matrix).

The evolution of the main P&L items:

- In comparison with the previous year, *net interest income* increased by 11% (2020: 88.4 bln, 2019: 79.8 bln) as the growing loan and deposit volumes overcompensated the negative impact of the lower interest environment and the reducing commercial margins (among others temporary regulatory cap was introduced for the new cash loan production in 2020).
- The moderate 3% growth in *net fee and commission income* (2020: 64.0 bln, 2019: 61.9 bln) was negatively impacted by a perceptible decrease in transactional income from March as a result of Covid-19.
- *Net gains from financial instruments at fair value & foreign exchange differences* went down (2020: 19.2 bln, 2019: 19.6 bln) primarily due to the technical loss in the credit, market and funding value adjustments related to the derivatives and lower customer derivative sales volume.
- *Operating expenses* amounted to 105.7 bln in 2020 (2019: 105.6 bln), disregarding banktax and financial transaction levy there is a 0.1% growth compared to the previous year (driven by higher ICT expenditure due to investment in digitalization and higher regulatory fees).
- There was a 23.2 bln negative P&L impact of *impairment* on financial assets at amortised cost of which 19.7 bln was connected to the estimated Covid-19 impact (see above). Otherwise portfolio quality remained stable in all segments.

3. Risk Management

Banks are exposed to several types of risks due to their operations. K&H Bank has a system in place for the measurement and appropriate management and limitation of these risks. The system has been aligned with the risk management system of the shareholder KBC Group both in terms of methodology and organisational set-up.

3.1 Risk management governance model

The risk management governance model seeks to define the responsibilities and tasks of various bodies and persons within the organisations ensuring the sound management of value creation and all the associated risks to which the banking and insurance businesses are exposed. The Group's risk governance model is organised in three tiers:

- Overarching company and risk committees are the Board of Directors (BoD), the Risk and Compliance Committee (RCC), the Audit Board (AB), the Supervisory Board (SB), the Executive Committee (ExCo), the Country Team (CT) and the Capital and Risk Oversight Committee (CROC). These committees concentrate on overarching risk management and on monitoring value creation.
- Specialised risk councils (Credit Risk Council (CRC), Operational Risk Councils (ORC)) concentrate on implementing a group-wide framework for one particular type of risk and monitoring the associated risk management process. The risk councils are composed of representatives from line management and Value and Risk Management Division.
- Line management and activity-specific committees have primary responsibility for value and risk management on the operational level. Value and Risk Management Division measures risks, economic capital and value creation for all relevant business entities and reports its findings directly to line management and the relevant activity-specific committees.
- Within Risk Management Division the Integrated Value and Risk Department is dedicated to overarch the three existing risk centers of competence (Credit Risk, Market and Liquidity Risk and Non-financial Risks), enhance coordination and report to senior management.

The Board of Directors and the Risk and Compliance Committee have an important role to play in value creation and risk governance. Regular reporting to the Risk and Compliance Committee – amongst others the quarterly risk reports, annual review of remuneration and risk based pricing policies – ensures that there is an ample flow of information to the members of the Board over the course of the year. Moreover, through the involvement of the Board in the annual round of approvals of risk appetite and risk-tolerance limits, the Board is able to take informed decisions on the degree of risk it finds acceptable for the Group and on the adequacy of the risk management structure.

3.2 Risk types

- **Credit risk** means the potential loss sustained by the bank if a customer becomes insolvent or cannot perform their payment obligations in due time. Credit risks are managed by risk mitigating techniques approved by the management of the Bank. Regulations cover the entirety of the lending process. The bank constantly monitors the credit portfolio and prepares reports on the findings to the senior management of the Bank.

  In the framework of the Basel II program, late 2010 the Bank was granted the permission of the regulator to use the internal rating model (IRB Foundation) which has been applied for regulatory capital calculation for credit risk since 1 January 2011. During the program, the Bank reviewed all debtor rating models and upgraded them in line with the new uniform group-level methodology.

  In the subsequent years, the bank paid special attention to the enhancement of the applied risk management methodology, with special regard to the analyses of the various stress scenarios affecting the credit portfolio (macro-economic indicators, foreign exchange rate changes and the changes in real estate values). An additional instrumental component of the further development of the risk management methodology was the revision of the management reports to better highlight the various quantitative risk indicators in order to allow the continuous monitoring of the credit portfolio. Based on MNB permission, the Bank shifted to IRB Advanced methodology for regulatory capital calculation from 30 September 2015.

  As a response to the evolving covid crisis situation, management reports were redesigned to focus on the impact analysis, identification and monitoring of the vulnerable portfolios (necessitiated also by the fact that usual risk metrics were not useable in the same way as in the past, for example days past due data lost it's information value during the moratorium).
  Looking at 2020 figures no perceptible evolution in the portfolio quality (such as PD migrations or other risk metrics) was observed that can be linked to the crisis. The effects of the crisis will most likely be shifted to a later period partially due to the moratorium and also because some time needs to pass before any changes in the portfolio can be observed.
  The Bank instated numerous restriction in acceptance and underwriting criteria in order to minimize risk. These restrictions are being reviewed regularly as portfolio evolutions require it. The Bank prepared simulations and stress tests which try to quantify the possible effects of the crisis on ECL and capital (these figures are reflected in the Bank's net result of 2020 and updated on a quarterly basis based on the newest macroeconomic forecasts).

  The main conclusions for 2020 are:
  - The performance of the corporate portfolio remained stable during 2020. Although some deterioration can be observed in some more vulnerable sectors, no trendlike worsening can be seen at this time. Quality of SME portfolio shows stable risk indicators, both NPL ratio and delinquencies. The bank continuously evaluates the evolution of the portfolio and if necessary makes the necessary risk decisions/advises to mitigate credit risk be they new limits, or other restrictions.
  - Retail portfolio remained stable. NPL volume continues to decrease mainly due to debt sale activity. Quality of new production remains good, with very low entries into default. As with the corporate portfolio, the monitoring is continuous, and evolves according to the crisis situation.

  It is expected that the current crisis situation will have an impact on the portfolio, but it is too early to make any substantial long term predictions.
  The Bank's large risk portfolio is stable, no significant change can be observed in the past years. The largest client with large risk is at 32.4% of the large risk limit, and the total volume of clients with large risk is at 10.7% of the total legal lending limit.

- **Market risk** means the potential loss suffered by the Bank upon a change in the value of foreign currency and interest positions. Both the asset-liability management and market risk management are based on the methodology applied by the shareholder KBC Group. Accordingly, the Capital and Risk Oversight Committee continuously monitors banking and trading book risks and controls them by setting limits (in compliance with the limit policy of KBC). Interest risks are measured and controlled by the joint application of various methods and limits (gap analysis, interest sensitivity, duration, BPV, NII, stress tests). There is also sovereign exposure monitoring in place.

The banking book is characterized by stable interest rate risk taking, at full sovereign limit utilization. KBC group level Internal Capital Calculation Method was underpinned by the regulatory 200bp stress test result throughout the year to prove its conservative stance.

Trading risk taking was stable at around 25% of the available VaR limit. There was no limit overrun in the examined period. In March 2018 trading positions were migrated to KBC (phase 1: interest rate positions), in the future FX positions will be migrated also (phase 2).
From 2020 Q2, K&H Bank reports its trading risk capital requirement applying CRR. Art.94 – Derogation of Small Trading Book (STB), as a result of compliance with regulatory requirements. National Bank of Hungary (MNB) accepted that K&H Bank was going to use STB. Position risk' capital requirement is henceforth calculated under the credit risk framework, thus the trading risk capital requirement decreased significantly. There is continues daily monitoring and strong control environment in place which was accepted by MNB to provide STB compliance and regulatory requirements.

- **Liquidity risk** means the risk of the inability of an institution to comply with net financing requirements. Liquidity risk may be caused by disturbances on the market, credit downgrading, which may result in the constant cessation of certain financing sources. On process level the bank is managing interest rate risk as part of the ILAAP framework through the cooperation of the affected departments. Management seeks to diversify the financing sources and manages assets with due regard to liquidity requirements, maintaining a healthy balance between cash, liquid funds and promptly marketable securities. Short term liquidity risk is measured by the operational liquidity limit which establishes whether there is sufficient coverage for the 30-day cumulative liquidity gap. Structural liquidity is monitored through Basel III liquidity ratios (LCR, NSFR) as well as FFAR (DMM) indicator and by liquidity stress tests and liquidity early warning signals. The department prepares regular reports to the K&H Bank Capital and Risk Oversight Committee on the various liquidity indicators and limits.

	31 Dec 2019	31 Dec 2020	Regulatory requirement
NSFR (%)	159	171	n.a*
LCR (%)	160	222	100
FFAR** (DMM) (%)	141	179	100

* Regulatory limit is expected to be introduced in 2021.
** Foreign exchange funding adequacy ratio

- K&H Bank group manages **operational risks** (the potential loss that may arise as a result of inappropriately operating systems, processes or human errors or external events) based on uniform principles and methodology. The methodology includes various techniques of risk identification, risk analysis such as self-assessments (top-down and bottom-up), analysis of losses incurred and the assessment and implementation of key control principles defined by KBC group. The risk mitigation measures (or risk acceptance) are decided according to the uniform accountability rules (decision-making authority).

  The identified exposures and handling of the risk is monitored and followed up by the Capital and Risk Oversight Committee and analyzed by the Operational Risk Councils that are established throughout the organization. K&H Bank group applies the standardized method to calculate the Pillar I. capital requirement for operational risk. Additionally, K&H also calculates the Pillar I. capital requirements according to the new SMA method, which will be introduced in the future.

4. Operating Conditions of the Bank

Capital investments in the branch network:

- During the year of 2020 the set-up, full or partial reconstruction of 22 branches was started or completed.
- Premium-banking offices were installed in 5 branches.
- By the end of 2020, altogether 483 ATMs (2019: 479 ATMs) were serving our customers (incl. 216 cash-in ATMs).

The number of branches at year end 2020 was 204.

The most important IT development projects were the followings:

- Several project size developments were initiated or completed to align with legal regulations such as: Domestic HUF Instant Payment, New AML, Regulatory Reporting, PSD2, HitReg, online/real time transaction Fraud management, Pandemic loan moratorium and bankcard management modification, management of Financial Data provision, NAV online data provision, Payment account Directive (PAD), FX pricing – 924 EU regulation.
- Planning and further developments for the paperless and tellerless branch operation is ongoing.
- Implementation of the MVP solution in order to be compliant with the issuer (Receiving Part) related VISA Fast Funds and the MasterCard MoneySend mandate.
- Within the Digitalization programme the following major developments were in progress or delivered:
    - Multibank application: we moved on with the preparation of further API connection in connection with account information and payment initiation service provision.
    - Apple pay – VISA an InApp related certification process was finished and the solution went live.
    - We made loan and investment data available in our mobile application.
    - For the corporate clients the function of “Show Blocked Amount” via digital channels went live.
    - Travel and home insurance products are now available in e-Bank and MobileBank applications.
    - We made Third party vehicle/motor insurance contracting available in our K&H MobileBank application.
    - Onboarding mobile journey – pilot: solution for online account opening is lauched.
    - K&H plus: option of ticket buy for BKK and Volán has been built into K&H mobile bank application.

5. Non-financial statement

<u>K&H sustainability strategy</u>

Sustainability is organically embedded in the four pillars of the corporate reference strategy (bank-insurance, sustainable profitable growth, client centricity, corporate social responsibility) and our day-to-day business activities. Sustainability is only possible if we also succeed in maintaining the trust of the society in which we operate.

We aim to achieve this by acting as a responsible company: being aware at all times of the impact of our operations on society, and responding to society’s needs and expectations in a balanced, relevant and transparent way.

<u>The core of the K&H Group sustainability strategy</u>

5.1

K&H follows strict policies for our activities regarding business ethics, socially sensitive issues, human rights, and reducing our environmental and ecological footprint.

Related policies at K&H

Business ethics:
K&H Bank Code of Conduct - Code of Ethics

Socially sensitive issues:
Retail Credit Risk regulations
Personal bankruptcy
Corporate Credit Policy (part of Corporate Decisions regulations)
Accessibility Policy based on Equal access strategy in client relationships

Human Rights:
Collective Agreement (§ 6A and 6B)

Environment:
Environmental Policy for the K&H Group and KBC Group affiliates in Hungary
Energy Policy for the K&H Group and KBC Group affiliates in Hungary

5.2

We strive to increase our positive impact on the society, which includes four focus domains close to our core business: financial literacy, environmental responsibility, stimulating entrepreneurship and health.

Financial literacy domain

Our financial education programme & contest for primary school children entitled “K&H Ready, Steady, Money!” was organised for the tenth time in the 2019-2020 school year to encourage children to learn the basics of everyday household finance, thus helping them make smart financial decisions later. The online competition platform was introduced in 2019 in order to digitize the semi-finals. Under the special conditions of the coronavirus pandemic, the finale was also held online in 2020. These digitalization innovations play an important role in arousing children’s interest in competitions for many years to come, while they also provide up-to-date knowledge to the generation growing up now. Over the past decade, approximately 55 thousand elementary and secondary schoolchildren, i.e. teams from over 1700 schools from almost 800 settlements, submitted their applications for the „K&H Ready, Steady, Money” financial quiz.

Environmental responsibility domain and K&H ecological footprint

Besides helping our clients make smart decisions, we are also responsible for the community and the environment in which we, our retail and business clients as well as our colleagues operate. Through our financial intermediary role we have a great influence on the environment our society lives in. Hence, we aim to respond to the environmental needs of the society and contribute to the ability of the members of the society to live a full life today as well as tomorrow. We are engaged to build a sustainable agriculture supporting young agricultural scientists, who design new procedures and may thus change both our future and the general image of the profession. The award is intended to financially support those students in pursuing their studies and research who at the same time wish to focus on the long-term, healthy and sustainable development of the agricultural sector. Results: 303 participants, 45 awards, from 18 universities.
Besides its financial activities, K&H Group lays special emphasis on improving the efficiency of its energy use as part of its sustainable operations. At the end of 2016 K&H Group successfully obtained certification for its integrated environmental and energy management system, becoming the first Hungarian financial institution to operate audited and certified ISO 14001 and ISO 50001 systems.
Completed in 2011, K&H’s head office was the first office building in Central Europe to earn LEED Gold environmental protection certification for the entire project. K&H Group reduced its per-capita carbon emissions by 60% compared to 2015. In addition, the Group now uses 33% less drinking water, 21% less energy annually, and it produces 11% less waste ending up in landfills and incinerators than in 2015.
We started selective waste collection in the branch network in 2019 (11 branches) and in 2020 we continued with further 10 branches, compared to the base year of 2015 our paper consumption was 40% less, we generated 102.000 kWh electricity with solar panels (63% more than in the previous year). The large increase in the production of renewable electricity was caused by the fact that a solar

park installed on our BCP building started its operation in 2020, and we also installed solar panels in two more of our bank branches. Exceeding the 25% CO2 emission cut undertaken by 2020, the group has actually halved its emission. This is partly attributable to 25 branches across the country that emit no carbon-dioxide directly. Meanwhile, water usage and the production of communal waste have also been lowered by 50%. The headquarters of K&H are cooled and heated with 170 solar panels and three geothermal wells, and new branches opened from this year (will) use so-called green power generated with heat pumps.
K&H has received a “Green Bank/financial institution” award from the National Bank of Hungary for exemplary efforts at environmentally sustainable growth in the financial sector in 2019. In 2020, K&H received Mastercard’s „The Sustainable Bank of the Year” award. The accolades are attributable to K&H’s decreasing ecological footprint and the launch of digital services that utilise modern technology bringing largely paperless transactions and bank branches.

Stimulating entrepreneurship domain

In Hungary, about 70% of the companies are family-owned small and medium enterprises which produce more than half of the country’s GDP and provide jobs to half of the Hungarian employees.

1. K&H Family-Owned Business (FOB) Excellence Award provides substantial media coverage for the winners in order to promote and recognize their family-owned businesses’ contribution to the Hungarian economy and employer market as well as commitment to the local society. The five award periods concluded 105 applications.
2. K&H Family-Owned Business events: we organize these to reach family-owned businesses’ owners and succeeding family members to help them in the future growth and sustainability of the company.
3. FOB Clubs: events for customers structured to inspire and facilitate peer networking (22 events were organized with 900-1000 participating clients).
4. Next Generation (NextGen) roundtables are organized to inspire and provide insight into business management.

Start it @K&H:

- leading corporate incubator programme currently at 2 locations, in Budapest and in Győr
- since its launch in 2017, start-ups participated in 78 programmes
- 6-18 month long incubation period
- since the launch of the programme, our teams won a total of 15 Hungarian and international awards, and attracted a combined capital investment of more than 5.5 million EUR
- community office in downtown Budapest and Győr
- experienced professional mentoring team, with more than 35 mentors representing different industries

Health domain

Research shows that the Hungarian society deems healthcare as one of the most important areas in the country needing support beyond state financing. Our 16-year-old K&H MediMagic programme has been a committed supporter of child healthcare. We purchase paediatric equipment for hospitals from funding by K&H. Our long-term commitment is demonstrated by the fact that over the past 16 years, on 477 occasions, we have made a total contribution of 686 million HUF to help children recover fast and return to a full life in health.
Thanks to K&H's CSR program, two objectives were achieved as part of its 2020 donation campaign: the support of the healing and research work at key epidemiological hospitals, and the prevention of the spread of the epidemic through digital banking.
During the one-month donation campaign, through K&H foundations’ supplementary contributions we supported the National Korányi Pulmonology Institute and the South Pest Central Hospital with a total of HUF 50 million, helping the healing and research work of employees at these healthcare institutions. With this HUF 50 million donation K&H contributed toward the purchase of 10,000 m2 of special antiviral flooring material and to research into immunotherapies supporting the fight against viral infections. We motivated our retail and SME customers by media campaigns and PR activities. We underlined the importance of digital solutions with press releases, social media “Bank digitally and help” posts, and television commercials. After each online credit card payment and/or transfer by our retail and SME customers, we donated HUF 10 to flagship epidemiological hospitals.
In addition to the specific goals and implementation of our donation program, K&H Bank and Insurance adapted and digitalized their services to match the requirements of the pandemic. During

the pandemic as well, we helped our customers to manage their finances quickly and securely through mobile banking, we issued bankcard e-PIN codes via video calls, the services provided by 3,000 employees working from their home, digitalized loan disbursements and account discounts. We provided financial security to our customers, by offering package fee discount to half or zero fee for more than 400,000 retail customers between April and June. When applying for a home loan, only a single visit to a bank branch was required. K&H Insurance paid compensation for loss events and damages caused by the pandemic by diverting from the relevant contractual terms and conditions in favour of our customers, and we have also reduced the health-related and financial losses caused by the virus by assuming loan repayments in case of death, hospital stay, inability to work, or unemployment related to the pandemic.

5.3.

Actions against corruption and bribery, respect for human rights

The Bank Group's Anti-Corruption Programme focuses on the following two main objectives:

- defining the criteria and principles that enable the Group's employees and associated persons to avoid conflicts of interest
- developing a group-wide solution for compliance with all the legal requirements arising from regulations

The Programme is managed and coordinated by the Group's Compliance Directorate. Local implementation and compliance are the shared responsibility of all stakeholders.
Regarding respect for human rights, our company's internal rules contain the general provisions.

Social responsibility

One of the country's leading consulting companies, surveyed Hungarian job choice preferences for the fourth time in 2020, aiming at mapping the needs of the entire Labour Market in addition to young people starting their careers. K&H Bank received the accolade in the Financial Category of the Most Attractive Workplace Award for its fixed predictable benefits, flexible work schedule and working hours, the possibility of teleworking and job security.
K&H - as a Family Friendly Corporate Mentor Organisation – is setting an example in family friendliness, helping its employees strike a healthy balance between private life and work while giving them an opportunity to build a fulfilling career. K&H also contributes to spreading family-friendly workplace practices. The Bank runs an HR project dedicated to atypical employment in an effort to put even more emphasis on part-time work and flexible hours. Flexible hours allow employees to adjust their working days to their family obligations, providing more room for family life. Currently, some 600 employees work in such arrangements in accordance with their employment contracts.
In 2020, the pandemic had a significant impact on our operations, the way we worked and we served our clients:

- we saw a substantial increase in the number of digitally active clients during the year supported by a continuously growing number of our banking services available via e-bank/mobile-bank applications (see also initiatives listed under „health domain") and we also put emphasis on encouraging the use of these digital applications via communication campaigns about digitalisation and innovation,
- as our branches remained open even during the period of strict lock-down measures all banking services were continuously available in our branch network enabled by extra health safety and precautionary measures (like regular intense cleansing and disinfecting of branches, strict maintenance of social distancing rules underpinned also by smaller branch refurbishments, etc.),
- we worked extensively on a technological and policy background to allow employees – to the extent the nature of their jobs permitted – to work fully or at least partially from home. We aim to provide our employees with more extensive teleworking opportunities even after lifting the coronavirus pandemic-induced emergency responses. To that end we carried out a major infrastructure development project, as working from home requires secure IT channels, and provided an opportunity for all of our colleagues to replace their desktop PCs with laptops. In addition, we provide all our colleagues with a smartphone.

In 2019, we joined the campaign „Common Interest" launched by the "WeAreOpen" non-profit organisation and Elle, in which female and male leaders stand up together supporting equal employment opportunities for women and men. The related K&H MeNŐK mentoring programme, launched in November 2019, aims to provide women with a key opportunity for development and advancement, as well as to support competent female leaders in preparing for senior management roles. We also support participants with personal mentoring and interactive workshops. In February 2020, we expanded our programme with a career school.

Digitalisation offers many opportunities to provide our colleagues with a workplace where they are given the full potential for continuous professional development and fulfilment. With this in mind, last year we spent over 205 million on training our staff in both traditional and digital formats.

Besides helping out in difficult welfare situations, subsidising loan repayments, topping up salaries lost due to illness and paying for certain expenses, Our Bank Group provides social assistance to our employees and pensioners in need. In 2020, we have spent HUF 45 million on social benefits.

Our “Welcome back” program is helping women to reintegrate into the labour market – from our 4000 employees, we have 2000 female colleagues in the age group where they might be planning for a new family or more children in the near future. We believe it is important to keep them informed about recent events at K&H Group and also wish to help them return to work in increasing numbers after child-care leave. 86% of mothers return to work, 50% of them do so part-time; this is an exceptionally high proportion under Hungarian employment conditions.

Budapest, 28 April 2021

David Moucheron Chief Executive Officer	Attila Gombás Chief Financial Officer