Kereskedelmi és Hitelbank Zrt.

CONSOLIDATED SEMI-ANNUAL REPORT

30 June 2021

Budapest, 30 August 2021

CONTENT

Statement of the Issuer

K&H Bank Zrt., as the Issuer (represented by Guy Libot, CEO and Attila Gombás, CFO) hereby declare that the Year 2021 Consolidated Semi-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 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, also including the major risks and uncertainties pertaining to the remaining six months of the financial year.

Furthermore, the Issuer hereby declares that the Semi-annual Report has not been verified by an independent auditor, thus the financial details contained therein are not audited figures.

Budapest, 30 August 2021

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Not audited 30 June 2021 MHUF	Audited 31 December 2020 MHUF
ASSETS		
Cash and cash balances with central banks	454 605	391 045
Cash	83 836	71 154
Cash balances with central banks	214 918	184 099
Other demand deposit with credit institutions	155 851	135 792
Financial assets	3 830 941	3 853 318
Held for trading	51 132	67 198
Mandatorily at fair value through profit or loss	175 725	139 570
At fair value through other comprehensive income	111 649	111 896
of which assets pledged as collateral	*22 125*	*24 226*
At amortised cost	3 464 547	3 509 189
of which assets pledged as collateral	*426 374*	*429 086*
Hedging derivatives	27 888	25 465
Fair value changes of hedged item under portfolio hedge of interest rate risk	19 000	17 841
Tax assets	1 497	3 119
Current tax assets	346	3 074
Deferred tax assets	1 151	45
Investment property	1 167	1 540
Property and equipment	45 051	46 729
Intangible assets	50 180	46 442
Non-current assets held for sale and disposal groups	1 598	1 474
Other assets	25 829	22 744
Total assets	4 429 868	4 384 252
LIABILITIES AND EQUITY		
Financial liabilities	3 928 056	3 924 958
Held for trading	40 390	64 168
Designated at fair value through profit or loss	30 215	33 051
Measured at amortised cost	3 826 302	3 803 374
Hedging derivatives	31 149	24 365
Fair value changes of hedged item under portfolio hedge of interest rate risk	20 133	14 614
Tax liabilities	792	2 014
Current tax liabilities	792	1 921
Deferred tax liabilities	0	93
Provisions for risks and charges and credit commitments	2 410	2 839
Other liabilities	53 425	39 158
Total liabilities	4 004 816	3 983 583
Share capital	140 978	140 978
Share premium	48 775	48 775
Accumulated profit	206 435	168 864
Other reserves	28 864	42 052
Total equity	425 052	400 669
Total liabilities and equity	4 429 868	4 384 252

Budapest, 30 August 2021

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory risk reserve	Revaluation reserve of securities	Revaluation reserve - Cash flow hedge	Other Revaluation reserves	Retained earnings	Total equity
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Balance as at 1 January 2020	140 978	48 775	28 422	6 707	6 048	66	128 791	359 787
Net profit for the year	-	-	-	-	-	-	3 191	3 191
Other comprehensive income for the period	-	-	-	(1 501)	1 102	(1)	-	(400)
Total comprehensive income	-	-	-	(1 501)	1 102	(1)	3 191	2 791
Total change	-	-	-	(1 501)	1 102	(1)	3 191	2 791
Balance as at 30 June 2020	140 978	48 775	28 422	5 206	7 150	65	131 982	362 578
of which								
revaluation reserve for shares	-	-	-	*1 661*	-	-	-	*1 661*
revaluation reserve for bonds	-	-	-	*3 545*	-	-	-	*3 545*
Balance as at 1 January 2021	140 978	48 775	31 072	5 756	4 530	64	168 864	400 669
Net profit for the year	-	-	-	-	-	-	37 354	37 354
Other comprehensive income for the period	-	-	-	(1 405)	(11 784)	1	-	(13 188)
Total comprehensive income	-	-	-	(1 405)	(11 784)	1	37 354	24 166
Visa Conversion	-	-	-	-	-	-	217	217
Total change	-	-	-	(1 405)	(11 784)	1	37 571	24 383
Balance as at 30 June 2021	140 978	48 775	31 702	4 351	(7 254)	65	206 435	425 052
of which								
revaluation reserve for shares	-	-	-	*1 066*	-	-	-	*1 066*
revaluation reserve for bonds	-	-	-	*3 285*	-	-	-	*3 285*

Budapest, 30 August 2021

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

CONSOLIDATED INCOME STATEMENT

	Not audited 1st half of year 2021 MHUF	Not audited 1st half of year 2020 MHUF
Interest and similar income	65 506	53 891
Interest income calculated using the effective interest method	53 684	45 637
Other similar income	11 822	8 254
Interest and similar expense	(14 753)	(11 258)
Net interest and similar income	50 753	42 633
Fee and commission income	44 548	43 164
Fee and commission expense	(11 663)	(10 912)
Net fee and commission income	32 885	32 252
Net gains / (losses) from financial instruments at fair value through profit or loss	12 956	(7 321)
Foreign exchange differences	(196)	15 455
Net realised gains / (losses) from financial assets at fair value through other comprehensive income	8	156
Dividend income	0	10
Gains on the disposal of assets at amortised cost	1 149	1 843
Other income	908	1 223
Other expense	(322)	(398)
Total income	98 141	85 853
Operating expenses	(60 134)	(55 456)
Staff expenses	(17 033)	(15 497)
General administrative expenses	(29 186)	(28 154)
Depreciation and amortisation of tangible and intangible assets	(7 536)	(6 168)
Bank tax	(6 379)	(5 637)
Impairment on assets	6 487	(20 985)
At amortised cost	6 673	(20 434)
At fair value through other comprehensive income	2	(12)
Other	(188)	(539)
Modification losses on financial assets at amortized cost	(800)	(3 600)
Profit / (loss) before tax	43 694	5 812
Income tax expense	(6 340)	(2 621)
Profit / (loss) after tax	37 354	3 191

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Not audited 1st half of year 2021 MHUF	Not audited 1st half of year 2020 MHUF
Profit after tax	37 354	3 191
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	(1 570)	(1 813)
Deferred tax impact on fair value changes	172	196
Transfer from revaluation reserve to net profit:		
(Losses)/gains on impairment	(2)	12
(Losses)/ gains on disposal	(8)	(156)
Deferred income tax	1	16
Cash flow hedge		
Net gain / (loss) from fair value changes	(12 862)	1 407
Deferred tax impact on fair value changes	1 158	(127)
Transfer from cash flow hedge reserve to net profit:		
Ineffective part	36	63
Gross amount	(124)	(259)
Deferred income tax	8	18
Items that will not be reclassified to the profit or loss		
Revaluation reserve of equity instruments		
Net gain / (loss) from fair value changes	5	274
Deferred tax impact on fair value changes	(1)	(30)
Actuarial result on defined benefit plans	(1)	(1)
Deferred income tax	-	-
Total other comprehensive income	(13 188)	(400)
Total comprehensive income	24 166	2 791

Budapest, 30 August 2021

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CASH FLOWS

	Not audited 1st half of year 2021	Not audited 1st half of year 2020
	MHUF	MHUF
OPERATING ACTIVITIES		
Profit before tax	43 694	5 812
Adjustments for:		
Interest and similar income	(65 506)	(53 891)
Interest and similar expense	14 753	11 258
Net transfer from revaluation reserve of securities	10	144
Net transfer from cash flow hedge reserve	88	196
Depreciation and impairment of property, plant and equipment, intangible assets, financial assets at fair value through other comprehensive income and other assets	7 709	6 726
(Profit)/Loss on the disposal of property and equipment	(62)	(1)
(Profit)/Loss on the disposal of investment property	(217)	(220)
Change of modification result on financial assets at amortized cost	800	3 600
Change in impairment on assets valued at amortised cost*	(6 673)	20 434
Change in other provisions	(25)	(1)
Unrealised valuation differences	(23 234)	(74 238)
Cash flows from operating profit before tax and before changes in operating assets and liabilities	(28 663)	(80 182)
Changes in financial assets held for trading	23 716	7 811
Changes in financial assets mandatorily valued at fair value through profit or loss	(39 299)	(20 789)
Changes in financial assets at fair value through other comprehensive income	(1 272)	(20 164)
Changes in financial assets valued at amortised cost	(265 241)	55 659
Changes in other assets	(5 834)	(4 685)
Changes in operating assets	(287 930)	17 832
Changes in financial liabilities held for trading	(14 668)	(5 349)
Changes in financial liabilities designated at fair value through profit or loss	5 480	5 284
Changes in financial liabilities measured at amortised cost	5 815	249 373
Changes in other liabilities	18 079	5 607
Changes in operating liabilities	14 706	254 915
Income taxes paid	(6 204)	(2 653)
Interest received	45 762	40 125
Interest paid	(13 117)	(1 751)
Net cash from/(used in) operating activities	(275 446)	228 286

* Including also provisions on loan commitments.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Not audited 1st half of year 2021 MHUF	Not audited 1st half of year 2020 MHUF
INVESTING ACTIVITIES		
Purchase of securities at amortised cost	(50 321)	(142 585)
Proceeds from the repayment of securities at amortised cost at maturity	-	-
Proceeds from the sale of securities at amortised cost	-	9 010
Dividends received from associated companies	-	10
Purchase of intangible assets	(7 724)	(5 833)
Purchase of property, plant and equipment	(2 352)	(2 337)
Proceeds from the sale of property, plant and equipment	100	68
Proceeds from the sale of non-current assets held for sale and disposal groups	-	-
Purchase of investment property	(109)	(144)
Proceeds from the sale of investment property	725	606
Net cash from/(used in) investing activities	(59 681)	(141 205)
FINANCING ACTIVITIES		
Proceeds from issuance of mortgage bonds	(13 500)	-
Repayment of principal of lease liabilities	(1 455)	(1 379)
Dividend paid	-	-
Net cash from/(used in) financing activities	(14 955)	(1 379)
CHANGE IN CASH AND CASH EQUIVALENTS		
Net increase/(decrease) in cash and cash equivalents	(350 082)	85 702
Net foreign exchange difference	(4 257)	69 238
Cash and cash equivalents at beginning of the period	832 398	295 735
Cash and cash equivalents at end of the period	478 060	450 675

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Not audited 1st half of year 2021 MHUF	Not audited 1st half of year 2020 MHUF
OPERATING CASH FLOWS FROM DIVIDENDS		
Dividends received	-	10
COMPONENTS OF CASH AND CASH EQUIVALENTS		
Cash and cash balances with central banks and other demand deposits with credit institutions	454 605	263 789
Loans and advances to banks repayable on demand and term loans to banks < 3 months	335 685	347 218
Deposits from banks repayable on demand and redeemable at notice	(312 230)	(160 332)
Total cash and cash equivalents	478 060	450 675

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

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

Budapest, 30 August 2021

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Management Report

On 30 June 2021, the consolidated total assets of K&H Bank Group (hereunder “the Group”) stood at 4,430 billion. As a financial institution which offers banking and insurance products alike and has a nation-wide branch network of 202 branches, the Group offers the full range of financial services to its clients.

1. Economic environment

The economic outlook improved significantly in the first half of the year (with a positive surprise for the economic growth figures since Q4 2020) due to several factors:

i) fiscal and monetary policy stimulus measures were introduced during the crisis
ii) individual sectors were able to adapt favourably to the second and third waves of the pandemic and
iii) as the vaccination program progressed, economic opening could begin earlier.

Although the level of gross domestic product output was still lower compared to the same period of the previous year, the economy has been growing dynamically compared to previous quarters since the lowest point was recorded in the second quarter of 2020. However, the pace of recovery varies widely among sectors: while industry and construction were able to reverse their last year's downturn, some sub-sectors of the service sector that were more affected by the pandemic will be able to return to their previous growth trends only in the longer term.
Loose fiscal policy has been continued, the Parliament has modified the 2021 deficit target upward. On the other hand, due to the more favorable growth and more favourable tax revenues, the balance of state budget may turn out better than the revised plans at the end of the year. Public debt may return to a declining path in 2021 – after rising above 80 percent of GDP at the end of 2020 – partly thanks to the still low interest rate environment and the accelerating inflation. The pick-up in external demand has boosted export growth, so the country's foreign trade balance improved in the first half of the year, which is expected to push up the current account surplus. Neverthelesss, international tourism is still lagging behind the pre-pandemic level, and the disbursement of European Union funds is delayed. In spite of these negative effects, the country still has positive funding capability.

	2020 actual	2021 forecast*
GDP growth	-5.0%	+6.7%
CPI (average)	+3.3%	+4.5%
Investments	-7.3%	+8.0%
Unemployment rate	4.1%	3.8%
Balance of state budget (in % of GDP)	-8.1%	-7.5%
Balance of payments (in % of GDP)	+0.1%	+1.5%

**source: K&H Bank Zrt*

In contrast to the world’s leading central banks, the National Bank of Hungary (MNB) has tightened its tone in the second quarter and even launched a cycle of monetary tightening. The main reasons for this are the faster-than-expected economic recovery, loose fiscal policy and soaring inflation and rising inflation expectations. As a first step it raised the base rate from 0.6 per cent to 0.9 per cent and changed the one-week deposit rate from 0.75 per cent to 0.9 per cent in June (which was followed by an another 30-30bps base rate increases in July and August). According to the MNB's guidelines, the level of the base rate and the one-week deposit rate will be the same and further monetary tightening is expected in the coming months. Following the expiry of the Funding for Growth Scheme (NHP Hajrá), several new government loan and guarantee programs were introduced in the first half of 2021 to support the reopening of the economy (restructured Széchenyi Card program, EXIM’s new investment program etc.).

2. The Strategic Objectives of the Group

K&H Bank Group is a universal bank-insurer, providing banking, leasing, asset management and insurance services for individuals and corporate (focusing on SME and Mid-cap) customers with a strong emphasis on introducing innovative solutions.

In order to fulfil our mandate by our shareholder and our clients:

- we put the client at the centre of all our activities
- we provide our clients with easy & smooth access
- we strive to maintain long-term relationship by making the difference through superior service and personal bond
- we combine the best international practice with sound local knowledge.

We want to be the reference in bank-insurance.

Customer strategy:

We help our clients realise their dreams and protect them.

Retail: customers are served based on the different segments' special needs providing convenient banking and insurance services and superior client experience.

Corporate clients: as a stable and independent advisor, building on personal relationship management and deep customer knowledge, we deliver tailor made and convenient financial solutions that best suit our clients' needs.

Product strategy:

Retail:

- Innovative saving products and advisory services to keep up our market leader status.
- Growth in lending, based on a good understanding of real client needs and credit risk.
- Strong focus on convenient daily banking services and primary banking relationships.
- Fast and simple processes.

Small and medium-sized enterprises (SME):

- Reliable and convenient transactional banking services.
- More standard products fitting client needs with simple, easy to access services.
- Fast and simple lending process to support financing SME businesses.

Corporate:

- Full service provider, emphasis on advisory to provide tailored solutions to our clients.

Strategy on distribution channels:

Omni-channel distribution approach – best fit combination of:

- e-bank, mobile bank
- extensive branch network with high level of cash automation and focus on advisory
- TeleCenter, remote advisory
- tied agents and brokers.

Key differentiators of the Bank Group:

- being close to our clients: easy access both physically (via our large branch network) and digitally (via remote channels)
- K&H Group acts as a full service provider for our clients in banking and insurance (universal financial institution)
- expertise and advice in the whole spectrum of financial services
- innovation: we continuously adopt to the changes in client behaviour and in the environment, aiming at being the best innovator in the market.

During 2019, the Bank reviewed its strategy and decided to continue pursuing our strategic aims while also speed up digital transformation in each business line. Therefore, we sped up activities aiming at developing our mobile banking app so that it would be capable of not just managing accounts and bankcards, but also to fulfil sales functions: in 2020 we were the first and only bank in the Hungarian market to introduce the sale of certain insurance products in the mobile banking application, and we also enabled our clients to buy e-tickets to the public transport system of 70 cities. This was followed by the introduction of regular investments in the mobile app in 2021, and we were the first of the Hungarian banks to introduce the comfortable payment solutions of Google Pay.

3. The Group's consolidated activities

3.1 Balance sheet

The Group's total assets amounted to 4,430 bln at 30 June 2021.

HUF Bln	30 Jun 2020	31 Dec 2020	30 Jun 2021	Variance (Jun 21/ Jun 20)
Total assets	3,858	4,384	4,430	+14.8%
Loans and advances to customers	1,665	1,819	1,875	+12.6%
Deposits from customers	2,859	3,242	3,182	+11.3%
Equity	363	401	425	+17.2%

The most important elements in the evolution of the consolidated balance sheet are as follows:

- *Loans and advances to customers:* with a yoy growth rate of 13%, K&H Bank increased its loan portfolio in both retail and corporate segments compared to the same period in last year. In the first half of 2021 the loan portfolio growth was fuelled primarily by the strong retail demand, whereas, similarly to the banking sector, the expansion of corporate sector has slowed down somewhat.
- *Deposits from customers* increased by 11% compared to June 2020 (the 1.9% drop in the first half of 2021 is related to the corporate sector).
- *Shareholders' equity* increased by 24 bln (+6.1%) compared to 31 Dec 2020, main components: profit of 1H 2021 (+37.4 bln), lower cash flow hedge reserves (-11.8 bln) and revaluation reserve of securities (-1.4 bln).

	30 Jun 2020	31 Dec 2020	30 Jun 2021
Guarantee capital (bln HUF)	374	417	407
Capital adequacy ratio (%)	17.6	19.2	17.9

3.2 Profit & loss

HUF Bln	2020 H1	2021 H1
Profit after tax	3.2	37.4

The Bank Group's profit was impacted by several one-off items in both 2020 and 2021:

- Modification loss from the moratorium: -0.8 bln in H1 2021 (-3.6 bln in H1 2020) [1]
- Updated assessment of the impact of Covid-19 resulted in a Covid-19 related IFRS9 based collective impairments release of 4.3 bln in 2021 mainly due to update of the macro scenario probabilities and

[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 Group 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. The combined loss of the moratorium and its extension was calculated to amount to approximately HUF 4 400 million at 31 December 2020. According to the government decree of 317/2021 the moratorium was extended with unchanged conditions until 30 September 2021, and as a result the Bank increased its estimation from the previous HUF 4 400 million to HUF 5 200 million in June 2021 (resulted in a loss of 0.8 bln in 1H 2021).
The estimated negative impact is recognized as a modification to the gross carrying amount of the related loans in the Group's consolidated statement of financial position. Detailed description on the Covid19 related financial moratorium is included in the 2020 consolidated financial statements (Note 3).

change in sector stress applied on vulnerable sectors (whereas 1H 2020 included 19.0 bln estimated expected loss on Covid-19 accounted for in IFRS9 as collective impairments)
- Revaluation of the financial instruments' fair value attributable to the change in the credit, market and funding value adjustments and model impact: +3.2 bln in 1H 2021 (-2.1 bln in H1 2020).

Disregarding these items, net result of 1H 2021 would amount to 31.2 bln (corresponding to a 22% yoy growth compared to 1H 2020 on a comparable basis excluding one-offs).

The evolution of the main P&L items in the first half of 2021:

- *Net interest income* increased by 19.0% yoy (1H20: 42.6 bln, 1H21: 50.8 bln) related to the increasing loan and deposit volumes, impact of higher interest rate environment and the Bank's active participation in the government and central bank's programs (state subsidized retail lending, and NHP Hajrá program).
- Within *net fee and commission income* (1H20: 32.3 bln, 1H21: 32.9 bln) investment services went down by 15% yoy related to the transfer of activities/operations of K&H Fund Management (K&H Alapkezelő Zrt.) to the Hungarian Branch of KBC Asset Management on 1 July 2020.
- *Net gains from financial instruments at fair value & foreign exchange differences* increased (1H20: 8.1 bln, 1H21: 12.8 bln) driven primarily by the above mentioned gain on financial instruments' revaluation.
- The *operating expenses* of the Group amounted to 60.1 bln in the first half of 2021. The growth compared to 1H 2020 (55.5 bln) is partially due to the higher IT costs (significant digitalization and regulatory investments), higher banktax and also due to the fact that 1H 2020 included the impact of several savings efforts (implemented to mitigate the temporary negative economic impact of pandemic).
- There was a 6.7 bln positive P&L impact of *impairment* on financial assets at amortised cost of which 4.3 bln was due to the partial release of the significant (19.7 bln) Covid-19 related IFRS9 based collective impairment created last year.
  Portfolio quality remained stable in all segments.

Non-performing loans ratio	31 Dec 2020	30 June 2021
Retail	3.9%	2.9%
Corporate & SME	1.7%	1.7%
Total	**2.7%**	**2.3%**

The financial performance of the Bank Group is illustrated by the following indicators:

	2020 H1	**2021 H1**	**variance**
Cost / income	64.6%	61.3%	-3.3%
Cost / income *	50.8%	47.4%	-3.4%
Non-interest type income/ total income	50.3%	48.3%	-2.0%
Fee and commission income / total income	37.6%	33.5%	-4.1%
Operating income / average headcount	25.0	29.9	+19.9%
Operating costs ** / average headcount	14.5	16.4	+13.2%
Operating profit ** / average headcount	10.5	13.5	+29.2%
Credit cost ratio	1.0%	-0.5%	-1.5%
Non-performing loans	3.0%	2.3%	-0.8%
Loan / deposit ratio	61.9%	61.7%	-0.2%
Capital ***/total liabilities	9.4%	9.6%	+0.2%
Capital adequacy ratio (consolidated)	17.6%	17.9%	+0.3%
LCR	250%	205%	-45%
NSFR	174%	161%	-13%

ROE (based on average balance of equity)	1.8%	18.5%	+16.8%
ROE (based on average balance of equity) ****	14.1%	15.5%	+1.4%
ROA (based on average balance sheet total)	0.2%	1.8%	+1.6%
ROA (based on average balance sheet total) ****	1.4%	1.5%	+0.1%

* excluding bank tax, net of FTL
** excluding bank tax
*** in addition to equity it also includes subordinated debt capital
**** excluding modification result on financial assets at amortized cost and Covid-19 related IFRS9 based collective impairments, revaluation of financial instruments

On comparable basis, the financial performance of the Group shows considerable improvement in 1H21. Next to the profitability and efficiency also in terms of risk, liquidity and capital adequacy ratios K&H Bank (as the 2nd largest bank based on total assets and customer–deposit volumes) is considered as one of the banks with the most favourable financial position in the banking sector.

4. Introduction of the important subsidiaries

Leasing operation

At the end of June 2021, the Leasing operation consisted of two legal entities next to the leasing operations performed by the bank (three entities were merged with K&H Bank Zrt. in previous years).

Name	Main profile
K&H Autópark Kft.	Operative leasing, fleet management
K&H Ingatlanlízing Zrt.	Financial leasing (real-estate)

On 30 June 2021 the **Group's leasing** portfolio stood at 82.9 bln, which represents a 4% decrease compared to the end of the previous year.

K&H Tanácsadó Zrt.

K&H Tanácsadó Zrt. (previously K&H Alapkezelő Zrt.) is fully owned by K&H Bank Zrt. By the decision of KBC Group, the business activity of K&H Alapkezelő Zrt. was transferred into KBC Asset Management NV Hungary Branch from 1 July 2020 (delivering synergies for the KBC Group while clients will continue to enjoy the same high standard of services as before). Following that it pursues only the remaining administrate tasks and the liquidation of the company will begin during 2H2021.

K&H Csoportszolgáltató Kft. (K&H Shared Service Center Kft.)

In 2005 K&H Group decided to set up a group services centre under the management of K&H Bank, which is the 100% owner of K&H Csoportszolgáltató Kft. (KHCSK). The purpose of this unit was the centralization and efficient organization of supplementary service activities closely linked to the core activities of individual group members. Comprehensive service activities performed for the group include the management of the real estate portfolio, logistical and bank security tasks, operative business responsibilities (the booking of trade receivables and payables, fixed assets, tax accounting and payroll management) and support of business activities.

The company takes out service level agreements and contracts with individual group members for each individual services.

As part of the K&H group strategy, K&H+ app started in September 2020. This application provides digital solutions and offers beyond banking services through K&H mobile bank application, which operation is managed in close cooperation with K&H Bank.

K&H Faktor Zrt. (K&H Factoring Zrt.)

The K&H Factoring Zrt's main activity is factoring (purchase of receivables, financing, discounting). The company's business activities have started in 2010, factoring turnover has been continuously increasing since then (2021 1H: 90.1 bln, +10.4% yoy). The amount of trade receivables towards debtors was 18.0 bln on 30 June 2021.

K&H Jelzálogbank Zrt. (K&H Mortgage Bank Zrt.)

As from April 1st 2017 MNB implemented a new indicator (Mortgage Financing Adequacy Ratio) to constrain the banking sector level systemic risk of maturity transformation related to the long term HUF retail mortgage loan portfolio. According to the current rules, at least 25% of the retail HUF mortgage loan portfolio is to be financed by long-term sources with maturity of at least 3 years (be it mortgage bonds or refinancing loans taken out from mortgage credit institutions).
K&H Mortgage Bank was established in 2016. The core business activity of the Mortgage Bank is refinancing of retail mortgage loan portfolios of K&H Bank Zrt. and mortgage bond issuance, started in Q1 2017.

There were several mortgage bond issues at K&H Mortgage Bank since 2017. In the beginning the Mortgage Bank issued privately, later publicly placed mortgage bonds. The current outstanding mortgage bond volume is 160 bln on 30 June 2021, from which 145 bln fixed interest rate bond issued at the stock exchange platform.

5. Risk Management

Banks are exposed to several types of risks due to their operations. K&H Bank has a system in place for the accurate measurement and appropriate management and limitation of these risks. The system has been adjusted to the risk management system of the shareholder KBC Group both in terms of methodology and work organisation.

5.1 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.

5.2 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 (necessitated 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 its information value during the moratorium).
Looking at the figures of 2020 and 2021 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 (Expected Credit Loss) and capital (the impact of these calculations are reflected in the Bank’s consolidated financial position and updated on a quarterly basis).

The main conclusions for the first half of 2021 are:

- The performance of the corporate and SME portfolio remained stable during 2021. Although some deterioration can be observed in some more vulnerable sectors, no trendlike worsening can be seen at this time. The bank continuously evaluates the evolution of the portfolio and if necessary makes the needed risk decisions/advises to mitigate credit risk be they new limits, or other restrictions.
- The quality of the loan portfolio disbursed in the MNB’s funding for growth program is better than the existing portfolio and remains stable.
- Retail portfolio remained stable. NPL volume continues to decrease mainly due to debt sale activity, while quality of new production remains good, with very low entries into default. The bank creates an RWA and TTC EL add-on to the retail PD model due to the technical improvement of retail PDs caused by the moratorium (increasing savings, frozen late days). As with the corporate, the monitoring of retail portfolio is continuous.

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 2021. The largest client with large risk is at 46.0% of the large risk limit, and the total volume of clients with large risk is at 10.8% of the total legal lending limit. Evolution of large risk is monitored monthly, and the internal processes of the Bank are created in a way so that no breach of the legal lending limit can be made. K&H Bank did not have large risk exposure towards other banks/bank groups as of 30 June 2021.

- **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 30% 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. NSFR regulatory limit from 2021 June on is 100%

	30 Jun 2020	30 Jun 2021	Regulatory requirement
NSFR (%)	174	161	100
LCR (%)	250	205	100
FFAR* (DMM) (%)	156	234	100

* 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, human errors or external events) based on uniform principles and methodology. The methodology includes various techniques of risk identification and risk analysis such as self-assessments (top-down and bottom-up), root cause analysis of incurred losses and the assessment of key risks and implementation of key control objectives 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 the management of these risks are followed up by the Capital and Risk Oversight Committee and analyzed in details by the Operational Risk Councils that cover the entire 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 requirement according to the new SMA method, which will be introduced in the near future.

6. Operating Conditions of the Bank

Capital investments in the branch network:

- During the first half of 2021 the set-up, full or partial reconstruction of 15 branches was started or completed
- By mid 2021, altogether 481 ATMs (2020: 483) were serving our customers (incl. 218 cash-in ATMs).

The number of branches at the end of June 2021 was 202 (2020: 204).

The most important IT development projects in first half of 2021 were the followings:

- Several project size developments were initiated or completed to align with legal regulations such as: Regulatory Reporting, PSD2, HitReg, Pandemic loan moratorium, Management of Financial Data provision, NAV online data provision, Payment account Directive (PAD), FX pricing – 924 EU regulation, Real estate transaction report, Compliance with SRD2 (Shareholder Rights Directive II) legislation, Personal Data Protection Regulation (Datel), MNB decree compliance: Property declaration
- Further developments for the paperless and tellerless branch operation are ongoing.

- Within the Digitalization programme the following major developments were in progress or delivered:
  - Multibank Liquidity Portal: corporate netbank (Electra) redesign developments were going on and the complete developments integration with partner banks on the integration environment
  - Onboarding Mobile journey (online account opening)
  - Google Pay: the service was launched in 6th April 2021
  - Digital PIN delivery & Instant Digi Card: enhancement of Digital card function.

Budapest, 30 August 2021

Guy Libot	*Attila Gombás*
Chief Executive Officer	*Chief Financial Officer*