Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

ANNUAL REPORT

31 December 2017

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 2017 Annual Report and the Year 2017 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 2018

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 2017

WITH THE REPORT OF INDEPENDENT AUDITORS

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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 "Bank") which comprise the statement of financial position as of 31 December 2017 (in which the balance sheet total is MHUF 3,041,317), the income statement, the statement of comprehensive income (in which the total comprehensive income for the year is MHUF 45,547 profit), the statement of changes in equity, the cash flows statement for the year then ended and the notes to the financial statements including a summary of the significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2017, 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 European Union (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.

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 Bank 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 Code of Ethics for Professional Accountants issued by the International Ethics Standards Board (IESBA Code of Ethics) and we also comply with further ethical requirements set out in these documents.

The non-audit services that we have provided to the Bank, in the period from 01 January 2017 to 31 December 2017, 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 Bank 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 the Regulation of the European Parliament and of the Council (the EU Regulation) No 537/2014 and the Subsections (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.

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Our audit approach

Overview

Overall materiality	Overall materiality applied was MHUF 2,472
Key Audit Matters	• Valuation of loans and receivables • Hedge Accounting

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.

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 2,472
Determination	5% of the profit before tax
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 Bank is most commonly measured by users and other stakeholders, and it is a generally accepted benchmark. We chose 5%, which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector. This is consistent with the basis for our materiality calculation in the previous year.

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*
Valuation of loans and receivables The net amount of loans and receivables was MHUF 1,776,484 as at 31 December 2017, representing 58% of the balance sheet total. Impairment recognised in the balance sheet amounted to MHUF 34,706. The management disclosed the related assumptions, balances and estimates in chapter 2.3.6 of the section of the notes to the financial statements on accounting policy, as well as in notes 13., 23. and 43.4.-43.5.	We gained an understanding of 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. We performed credit review for individually significant loans, and checked credit application / monitoring documents as well as costumer-related financial and non-financial information whether the costumer's rating is appropriate.
Impairment is determined on the basis of subjective criteria and management is required to apply significant judgement when calculating individual and collective impairment.	For a sample of individually impaired loans, we checked whether assumptions and estimations applied in calculations of the recoverable amount are reasonable and whether the calculations are correct.
In the calculation of individual impairment, the most significant uncertainty is involved in the estimation of the amounts and timing of the expected future cash flows as they include recoveries from both collections of contractual cash flows and from collaterals. The Bank applies impairment models to calculate collective impairment. These models quantify the probability of default and the loss given default as the primary parameters in the estimation of the recoverable amount. We paid considerable attention to this area during our audit due to the significance of the amounts involved and also because of the nature of the judgments and assumptions that management is required to make.	When assessing the collective impairment, we analysed the development of impairment with the assistance of our experts, checked the methodology applied to its calculation, the input data, changes of parameters, reconciled the estimations from previous periods with the actual data, and performed recalculations, on a sample basis. We reviewed points 13., 23. and 43.4.-43.5 of the notes to the financial statements to assess whether disclosures are in line with applicable regulations. We did not identify any material errors during our audit procedures performed. We found management's estimations reasonable.
Hedge accounting	
The accounting rules for hedge accounting and its accounting treatment are presented in chapter 2.3.2.3 of the section of the notes to the financial statements on accounting policy, and appendices 24 and 43.2.-43.3.	We have assessed key internal controls operated by the Group with the aim of appropriately determining the fair values of derivatives and measuring hedge effectiveness.

The Group applies derivatives to hedge risks arising from its operation and open positions, i.e. foreign currency and interest rate risks. In the absence of hedge accounting the transactions involving derivatives may be presented in the statement of financial position and the income statement differently from the transactions generating the risks. Therefore, the Group applies cash flow and fair value hedge accounting to ensure matching of accounting applied to the hedging instruments and hedged transactions. Application of hedge accounting is subject to stringent accounting rules. It is necessary to prove, among other criteria, that the values of transactions underlying open positions and the transactions conducted to hedge them react to market changes, representing hedged risks in the opposite directions. This is called hedge effectiveness test. Measuring hedge effectiveness requires complex calculations, based on highly sensitive assumptions, depending on the methodology applied to this assessment. We focused on this matter because the valuation of derivatives applied to manage market risks, and consequently, measurement of the effectiveness of hedging relationships are complex and subject to estimation uncertainty.	We have checked the valuation of derivatives and the adequacy of market prices applied on a sample basis, we have examined the documentation of hedge accounting, for consistency with the risk strategy of the Group as well as the hedged transactions designation. We have checked whether the effectiveness of the hedging relationship was measured and accounted for in line with the relevant accounting standard. As the Group's hedging strategy involves also a dynamic portfolio hedge accounting, in which case the hedged items are being adjusted and are determined by using assumptions, we checked the modelling of the hedged portfolio and the determination of the portfolio's maturity structure. We assessed whether disclosures of hedge accounting in the financial statements are in line with the regulations. We did not detect any material errors as a result of the procedures we performed.

Other information: the business report

Other information comprises the business report of the Bank. 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 business report of the Bank is consistent with the 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.

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

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 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 Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank'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 Bank'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 Bank'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 Bank 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, related safeguards.

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 Bank on 28 April 2016. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 2 years.

Budapest, 13 April 2018

Árpád Balázs
Partner
Statutory auditor
Licence number: 006931
PricewaterhouseCoopers Könyvvizsgáló Kft.
1055 Budapest, Bajcsy-Zsilinszky út 78.
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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	2017 MHUF	2016 MHUF
Interest income		92 722	93 609
Interest expense		(20 749)	(24 355)
Net interest income	4;39	71 973	69 254
Fee and commission income		69 167	64 896
Fee and commission expense		(17 693)	(15 915)
Net fee and commission income	5	51 474	48 981
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	6	18 299	20 940
Net realised gains / (losses) from available-for-sale assets	7	534	5 288
Dividend income	8	2 225	2 575
Other income	9	4 330	12 263
Other expense	9	(971)	(2 127)
Total income		147 864	157 174
Operating expenses		(98 346)	(96 633)
Staff expenses	12;39	(32 309)	(31 329)
General administrative expenses	10	(52 432)	(49 996)
Depreciation and amortisation of tangible and intangible assets	30;31	(8 280)	(7 865)
Bank tax	11	(5 325)	(7 443)
Impairment:	4;13	(75)	(5 703)
Loans and receivables	23	763	(4 733)
Available-for-sale assets		3	(17)
Other		(841)	(953)
Profit / (loss) before tax		49 443	54 838
Income tax expense	14	(7 774)	(15 438)
Profit / (loss) after tax		41 669	39 400

For the transition from Hungarian Accounting Standards to International Accounting Standards see Note 3.

Approved by the Board of Directors on 13 April 2018.

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

STATEMENT OF COMPREHENSIVE INCOME

	Notes	2017 MHUF	2016 MHUF
Profit / (loss) after tax according to International Accounting Standards		41 669	39 400
Other comprehensive income			
Items that may be reclassified to the profit or loss			
Available-for-sale equity instruments			
Amounts to be reclassified subsequently to the income statement:			
Net gain / (loss) from fair value changes	15	298	292
Deferred tax impact on fair value changes	27	(32)	(32)
Transfer from available for sale reserve to net profit:			
(Losses)/ gains on disposal	7	-	(4 565)
Deferred income tax	27	-	494
Available for sale debt instruments			
Amounts to be reclassified subsequently to the income statement:			
Net gain / (loss) from fair value changes	15	5 229	3 118
Deferred tax impact on fair value changes	27	(566)	(337)
Transfer from available for sale reserve to net profit:			
(Losses)/ gains on disposal	7	(534)	(723)
Amortisation of reclassified assets		(571)	(31)
Deferred income tax	27	120	82
Cash flow hedge			
Amounts to be reclassified subsequently to the income statement:			
Net gain / (loss) from fair value changes		(273)	1 145
Deferred tax impact on fair value changes	27	25	(103)
Transfer from cash flow hedge reserve to net profit:			
Ineffective part	24	233	272
Gross amount	24	(129)	(100)
Deferred income tax	27	(9)	(16)
Items that will not be reclassified to the profit or loss			
Own credit risk adjustments	6	51	-
Deferred income tax	27	(5)	-
Actuarial result on defined benefit plans	39	45	-
Deferred income tax	27	(4)	-
Other	27	-	2 133
Total other comprehensive income		3 878	1 629
Total comprehensive income		45 547	41 029

Other includes the impact of the expected change of the applied income tax rate in 2017 (see Note 14).
For the transition from Hungarian Accounting Standards to International Accounting Standards see Note 3.

Approved by the Board of Directors on 13 April 2018.

David Moucheron
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer
Member of the Board

STATEMENT OF FINANCIAL POSITION

	Notes	2017	31 December 2016	1 January 2016
		MHUF	MHUF	MHUF
ASSETS				
Cash and cash balances with central banks and other demand deposits with credit institutions		437 846	239 786	117 666
Cash		36 789	35 457	33 148
Cash balances with central banks	15,18-22	201 542	186 562	35 567
Other demand deposit with credit institutions	15,18-22	199 515	17 767	48 951
Financial assets	15	2 515 451	2 537 436	2 403 678
Held for trading	24	98 194	95 279	81 744
of which assets pledged as collateral	*15*	-	-	*4 674*
Available for sale	15	194 209	193 110	163 245
of which assets pledged as collateral	*15*	*69 859*	*79 868*	*51 081*
Loans and receivables	15,18-23	1 776 484	1 806 357	1 719 295
of which assets pledged as collateral	*15*	*15 852*	*7 049*	*13 900*
Held to maturity	15	423 500	426 237	428 371
of which assets pledged as collateral	*15*	*214 648*	*225 838*	*235 747*
Hedging derivatives	24	23 064	16 453	11 023
Tax assets		2 633	2 485	13 454
Current tax assets		2 633	2 274	7 707
Deferred tax assets	27	-	211	5 747
Investments in subsidiaries and associated companies	28	10 619	10 616	7 206
Investment property	29	1 476	1 010	740
Property and equipment	30	37 909	38 306	37 608
Intangible assets	31	14 521	12 469	11 681
Non-current assets held for sale and disposal groups	25	1 921	-	-
Other assets	26	18 941	14 021	17 363
Total assets		3 041 317	2 856 129	2 609 396
LIABILITIES AND EQUITY				
Financial liabilities	15	2 686 541	2 527 614	2 298 009
Held for trading	24	36 474	31 806	35 859
Designated at fair value through profit or loss	19	120 509	200 131	216 315
Measured at amortised cost	15	2 525 455	2 292 557	2 045 824
Hedging derivatives	24	4 103	3 120	11
Fair value changes of hedged item under portfolio hedge of interest rate risk	24	12 560	6 185	3 164
Tax liabilities		942	1	12
Current tax liabilities		-	1	12
Deferred tax liabilities	27	942	-	-
Provisions for risks and charges and credit commitments	32	1 559	2 434	7 755
Other liabilities	33	73 691	60 530	82 920
Total liabilities		2 775 293	2 596 764	2 391 860
Share capital	34	140 978	140 978	140 978
Share premium		48 775	48 775	48 775
Accumulated profit		36 657	38 043	2 556
Other reserves		39 614	31 569	25 227
Total equity	44	266 024	259 365	217 536
Total liabilities and equity		3 041 317	2 856 129	2 609 396

For the transition from Hungarian Accounting Standards to International Accounting Standards see Note 3.
Approved by the Board of Directors on 13 April 2018.

David Moucheron
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer
Member of the Board

For breakdown of assets and liabilities by remaining maturity see Note 22.

STATEMENT OF CHANGES IN EQUITY

	Share capital MHUF	Share premium MHUF	Statutory risk reserve MHUF	Available for sale reserve MHUF	Cash flow reserve MHUF	Other revalue-ation reserves MHUF	Retained earnings MHUF	Total equity MHUF
Balance at 31 December 2015 according to Hungarian accounting rules	140 978	14 393	8 750	-	-	-	47 374	211 495
Reclassification of the equity components allowed by International Accounting Standards effective at the date of merger in previous years	-	34 382	-	-	-	-	(34 382)	-
Transition to the International Accounting Standards (Note 3)	-	-	-	12 211	4 266	-	(10 436)	6 041
Balance at 31 December 2015 according to International Accounting Standards	140 978	48 775	8 750	12 211	4 266	-	2 556	217 536
2016								
Balance at the beginning of the period	140 978	48 775	8 750	12 211	4 266	-	2 556	217 536
Net profit for the year	-	-	-	-	-	-	39 400	39 400
Other comprehensive income for the period (Note 6)	-	-	-	(194)	1 823	-	-	1 629
Total comprehensive income	-	-	-	(194)	1 823	-	39 400	41 029
Additional payment to the subsidiaries in previous years, repaid by the entities in the current year	-	-	-	-	-	-	800	800
Transfer from retained earnings to statutory risk reserve (Note 44)	-	-	4 713	-	-	-	(4 713)	-
Total change	-	-	4 713	(194)	1 823	-	35 487	41 829
Balance at the end of the period	140 978	48 775	13 463	12 017	6 089	-	38 043	259 365
of which revaluation reserve for shares (Note 15)	-	-	-	68	-	-	-	68
of which revaluation reserve for bonds (Note 15)	-	-	-	11 949	-	-	-	11 949

STATEMENT OF CHANGES IN EQUITY (continued)

	Share capital MHUF	Share premium MHUF	Statutory risk reserve MHUF	Available for sale reserve MHUF	Cash flow reserve MHUF	Other revalu-ation reserves MHUF	Retained earnings MHUF	Total equity MHUF
2017								
Balance at the beginning of the period	140 978	48 775	13 463	12 017	6 089	-	38 043	259 365
Early application of IFRS9	-	-	-	-	-	11	(11)	-
Net profit for the year	-	-	-	-	-	-	41 669	41 669
Other comprehensive income for the period (Note 6)	-	-	-	3 944	(153)	76	-	3 867
Total comprehensive income	-	-	-	3 944	(153)	87	41 658	45 536
Dividend paid	-	-	-	-	-	-	(38 877)	(38 877)
Transfer from retained earnings to statutory risk reserve (Note 44)	-	-	4 167	-	-	-	(4 167)	-
Total change	-	-	4 167	3 944	(153)	87	(1 386)	6 659
Balance at the end of the period	140 978	48 775	17 630	15 961	5 936	87	36 657	266 024
of which revaluation reserve for shares (Note 15)	-	-	-	334	-	-	-	334
of which revaluation reserve for bonds (Note 15)	-	-	-	15 627	-	-	-	15 627

Other revaluation reserves include own credit risk adjustments and the actuarial result on defined benefit plans. The dividend paid on ordinary shares was 38 877 HUF million – 0.275766 HUF/share in 2017 (no dividend was paid in 2016). There is no dividend proposed on ordinary shares in 2018.
For the transition from Hungarian Accounting Standards to International Accounting Standards see Note 3.

Approved by the Board of Directors on 13 April 2018.

David Moucheron
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer
Member of the Board

STATEMENT OF CASH FLOWS

	Notes	2017 MHUF	2016 MHUF
OPERATING ACTIVITIES			
Profit / (loss) before tax		49 443	54 838
Adjustments for:			
Interest income	4	(92 722)	(93 609)
Interest expense	4	20 749	24 355
Net transfer from available for sale reserve	7	(1 105)	(5 319)
Net transfer from cash flow hedge reserve	6	104	172
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	30;31	9 138	8 781
(Profit)/Loss on the disposal of property and equipment	9	(46)	(1)
(Profit)/Loss on the disposal of investment property	9	(121)	(20)
Change in impairment on loans and advances and Held-to maturity assets*	13;23	(763)	4 802
Change in other provisions	32	(8)	(1 343)
Unrealised valuation differences	6	2 916	(364)
Cash flows from operating profit / (loss) before tax and before changes in operating assets and liabilities		(12 415)	(7 708)
Changes in financial assets held for trading		(4 005)	(13 093)
Changes in financial assets held to maturity		3 136	2 699
Reclassification of assets from available-for-sale to held-to-maturity portfolio		-	(27 821)
Changes in financial assets available for sale		3 034	(34 172)
Changes in loans and receivables		(100 161)	178 421
Changes in other assets		(5 193)	8 793
Changes in operating assets		(103 189)	114 827
Changes in financial liabilities held for trading		6 139	(3 103)
Changes in financial liabilities designated at fair value through profit or loss		(72 974)	(15 315)
Changes in financial liabilities measured at amortised cost		238 507	255 856
Changes in other liabilities		13 163	(22 622)
Changes in operating liabilities		184 835	214 816
Income taxes paid		(7 082)	(7 682)
Interest received		94 918	94 904
Interest paid		(26 387)	(24 689)
Net cash from/(used in) operating activities		130 680	384 468

* Including impairments on loans and receivables and loan commitments.

STATEMENT OF CASH FLOWS (continued)

	Notes	2017 MHUF	2016 MHUF
INVESTING ACTIVITIES			
Purchase of held-to-maturity securities		(43 409)	(75 800)
Proceeds from the disposal of held-to-maturity securities		-	23 404
Proceeds from the repayment of held-to-maturity securities at maturity		41 602	77 558
Proceeds from the disposal of a subsidiary or business unit, net of cash disposed	7	-	4 598
Purchase of intangible fixed assets	31	(6 048)	(4 266)
Purchase of property, plant and equipment	30	(6 713)	(5 964)
Proceeds from the sale of property, plant and equipment	30	46	-
Purchase of investment property	29	(1 031)	(501)
Proceeds from the sale of investment property	29	644	228
Net cash from/(used in) investing activities		(14 909)	19 258
FINANCING ACTIVITIES			
Proceeds from or repayment of subordinated liabilities	15	10 765	-
Additional payment repaid by subsidiaries		-	800
Dividend paid		(38 877)	-
Net cash from/(used in) financing activities		(28 112)	800
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents		87 659	404 526
Net foreign exchange difference		(2 993)	(2 202)
Cash and cash equivalents at beginning of the period		601 009	198 685
Cash and cash equivalents at end of the period		685 675	601 009

STATEMENT OF CASH FLOWS (continued)

	Notes	2017 MHUF	2016 MHUF
OPERATING CASH FLOWS FROM DIVIDENDS			
Dividends received	8	2 225	2 575
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash		36 789	35 457
Cash balances with central banks and		201 542	186 562
other demand deposits with credit institutions		199 515	17 767
Loans and advances to banks repayable on demand and term loans to banks < 3 months	15	283 399	412 676
Deposits from banks repayable on demand and redeemable at notice	15	(35 570)	(51 453)
Total cash and cash equivalents		685 675	601 009

For the transition from Hungarian Accounting Standards to International Accounting Standards see Note 3.

The difference between the interest cash flow and the interest result is immaterial. The interest cash flow results from the Bank's banking activity and is part of the operating cash flow. For further information see Note 4.

Loans and advances to banks repayable on demand and term loans to banks < 3 months are recorded as Loans and receivables 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 13 April 2018.

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

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 207 branches. As at 31 December 2017 the Bank's registered office was at Lechner Ödön fasor 9, Budapest.

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

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 on a historical cost basis, except for held-for trading financial instruments, financial instruments designated at fair value through profit or loss, available-for-sale financial assets and hedging derivatives, which have been measured at fair value. 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.

Statement of compliance

On 1 January 2017 the Bank implemented IFRSs for statutory purposes instead of Hungarian Accounting Standards.

For further details on the transition from Hungarian Accounting Standards to International Accounting Standards see Note 3.

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 Bank's 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:

Fair value of financial instruments

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

Allowance for impairment of loans and receivables and provision for commitments and contingent liabilities

The Bank regularly reviews its loans and receivables, its commitments and contingent liabilities to assess impairment. 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 loans and receivables. Refer to note 23 for further details.

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

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 as a hedging instrument is involved in a cash flow hedge relationship and in accordance with the hedging documentation the foreign exchange translation difference of the hedging instrument is recognized as other comprehensive income. 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 consolidated income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.2 Financial instruments

Financial instruments are classified for measurement purposes as either financial instruments at fair value through profit or loss, financial assets and financial liabilities measured at amortised cost or available-for-sale financial instruments, as appropriate. When financial instruments are recognized initially, they are measured at fair value, plus, in the case of financial instruments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial instruments after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

2.3.2.1 Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognized on the settlement date, i.e. the date the asset is delivered to the counterparty. Regular way purchases or sales are those that require delivery of assets within the time frame generally established by regulation or convention in the market place.

2.3.2.2 Financial instruments at fair value through profit or loss

Financial assets and financial liabilities classified in this category are designated by Management on initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- the assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial instruments classified as held-for-trading instruments are also included in the category 'financial instruments at fair value through profit or loss'. Financial instruments are classified as held-for-trading instruments if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments.

Instruments classified as financial instruments at fair value through profit or loss subsequently are measured at fair value, whereby in case of interest-bearing assets the change of the difference between the fair value and the amortised cost is recorded in the income statement as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange. The interest component is recognized as interest income using the effective interest rate method.

The change in the fair value of non-interest-bearing assets is recorded in the income statement as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange.

2.3.2.3 Held-for-trading and hedging derivatives

The Bank enters into derivative instruments including FRA's, forwards, swaps and options in the foreign exchange and money markets. Derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive fair values (unrealised gains) are included in assets and derivatives with negative fair values (unrealised losses) are included in liabilities in the statement of financial position.

Derivatives are classified as either trading or hedging. 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. The Bank applies fair value hedge accounting both at micro and macro level.

NOTE 2 – ACCOUNTING POLICIES (continued)

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.

In relation to fair value hedges which meet the conditions for hedge accounting, any gains or losses from re-measuring the hedging instrument to fair value are recognized immediately in the income statement. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognized in the income statement.

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 and the ineffective portion is recognized in the income statement. The gains or losses on effective cash flow hedges recognized initially in the other comprehensive income are either transferred to the income statement in the period in which the hedged transaction impacts the income statement or included in the initial measurement of the cost of the related non-financial asset or liability.

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.

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. Also at that time an item subject to a fair value hedge ceases to be revalued.

Cash flows from hedging activities are classified in the same line in the statement of cash flows as the item being hedged. When a forecasted transaction is no longer expected to occur, the cumulative gain or loss on the hedging instrument is recognized immediately in the income statement in Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange.

The Bank assesses whether an embedded derivative needs to be separated from the host contract and accounted for as a derivative when it first becomes a party to a contract. There is no subsequent reassessment.

2.3.2.4 Financial assets and financial liabilities measured at amortised cost

2.3.2.4.1 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognized in the income statement when the loans and receivables are derecognized or impaired, as well as through the amortisation process.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.2.4.2 Financial liabilities at amortised cost

All money market and customer deposits are initially recognized at fair value plus transaction costs. After initial recognition, all interest bearing deposits, other than liabilities held for trading and other than financial liabilities designated at fair value through profit or loss, are subsequently measured at amortised cost, less amounts repaid. Amortised cost is calculated by taking into account any discount or premium on settlement. Premiums and discounts are amortised on a systematic basis to maturity using the effective interest method and taken to interest expense. For liabilities carried at amortised cost (which are not part of a hedging relationship), any gains or losses from revaluation to fair value are recognized in the income statement when liability is derecognized.

2.3.2.4.3 Held-to-maturity instruments

Non-derivative financial instruments with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold to maturity. Instruments intended to be held for an undefined period are not included in this classification. Held-to-maturity instruments are subsequently measured at amortised cost. This cost is computed as the amount initially recognized minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognized amount and the maturity amount. This calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts.

For instruments carried at amortised cost, gains and losses are recognized in the income statement when the instruments are derecognized or impaired, as well as through the amortisation process.

The Bank is not allowed to classify any financial assets as held to maturity if the Bank has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

- are so close to maturity or the financial asset's call date (less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;

- occur after the Bank has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or

- are attributable to an isolated event that is beyond the Bank's control, is non-recurring and could not have been reasonably anticipated by the Bank.

Sales out of held-to-maturity instruments can be considered insignificant if on a yearly basis, the sales do not exceed 5% of the carrying amount of held-to-maturity instruments on 1 January of that financial year.

2.3.2.5 Available-for-sale financial instruments

Available-for-sale financial instruments are those non-derivative financial instruments that are designated as available-for-sale or are not classified as:

- financial instruments at fair value through profit or loss, or
- loans and advances and financial liabilities measured at amortised cost, or
- held-to-maturity instruments.

After initial recognition available-for sale financial instruments are measured at fair value with gains or losses being recognized as a separate component of equity until the instrument is derecognized or until the instrument is determined to be impaired at which time the cumulative gain or loss previously reported in the other comprehensive income is included in the income statement. However, interest calculated using the effective interest method is recognized in the income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

The fair value of instruments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the statement of financial position date. For instruments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current fair value of another instrument, which is substantially the same and discounted cash flow analysis.

Available-for-sale investments include investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured. These investments are measured at cost less impairment.

2.3.2.6 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.

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).

The above examples illustrate that 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.

2.3.2.7 Determination of asset classes for the purpose of the disclosures required by IFRS7

The management did not define special asset classes for the purposes of the disclosures required by IFRS7 therefore the Bank uses the accounting portfolios if standards require presentation by asset classes.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.3 Day 1 profit

For financial instruments at fair value fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.
For other financial instruments, for which the transaction price is calculated using a valuation technique with level 3 inputs, the difference is initially recognised within (other) assets or (other) liabilities and are subsequently amortised on a straight line basis over the term of the instrument.

2.3.4 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 loans and receivables. The difference between purchase and resale price is treated as interest income and accrued over the life of the reverse repo agreement.

2.3.5 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 and from foreign exchange.

2.3.6 Allowances for impairment of financial assets

The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Impairment of financial assets shall be utilized at derecognition due to uncollectibility or transfer of ownership.

In case of equity instruments objective evidence of impairment exists if the fair value is significantly or permanently lower than the cost of the instrument. “Significant” means generally 15% or more and “permanent” means more than 1 year.

NOTE 2 – ACCOUNTING POLICIES (continued)

Once interests are overdue for more than three months, the interest accruals are reversed and interest is recognized using the effective interest rate to discount the future cash flows for the purpose of measuring the impairment loss (unwinding).

2.3.6.1 Financial assets measured at amortised cost

The Bank first assesses whether objective evidence of impairment exists for financial assets.

If there is objective evidence that an impairment loss on individually significant financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced through use of an allowance account. The amount of the loss shall be recognized in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not the foreclosure is probable.

If there is objective evidence that an impairment loss on individually not significant financial assets at amortised cost has been incurred or no objective evidence of impairment exists, whether the asset is significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is assessed collectively for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Impairment on a group of financial assets that are evaluated collectively for impairment is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is applied on current observable data to reflect the effect of current conditions not existing in the past.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of allowance for loan impairment in the income statement.

2.3.6.2 Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognized in the income statement, is transferred from equity to the income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognized in the income statement. Reversals of impairment losses on debt instruments are reversed through the income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment losses were recognized in the income statement.

Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of the interest income.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.6.3 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 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).

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 derecognition, the impact of modification will be presented as change in the assets' effective interest rate or change in gross carrying amount.

Derecognition of renegotiated loans

For the 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.

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.

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.7 Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and the Bank intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

2.3.8 Derecognition of financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and
- either (a) the Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Bank's continuing involvement in the 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.

2.3.9 Derecognition of financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

2.3.10 Leases

Determination of whether an arrangement contains a lease

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.3.10.1 Where the Bank is the lessee

Finance leases, which effectively transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the present value of the minimum lease payments at the inception of the lease term. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in the income statement.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where the lessor effectively retains substantially all the risks and benefits of ownership of the leased asset, are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.10.2 Where the Bank is the lessor

When assets held are subject to a finance lease, the present value of lease payments and the unguaranteed residual value are recognized as a receivable. The difference between the gross receivable and the present value of the receivable is recognized as unearned finance income.

Lease income is recognized over the term of the lease so as to achieve a constant rate of interest on the remaining balance of the receivable.

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.

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.

2.3.11 Revenue recognition

Net interest income falls under the scope of IAS39. Interest income and expense are calculated and recognised based on the effective interest rate method. 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, and fees related to the origination of the asset).

The Bank presents the revenue of different transaction as Net fee and commission income. Most of these cover services and goods provided by the Group to its customers while certain lending related fees are reported here if not parts of the effective interest rate.

Dividend income is recognized when the right to receive payment is established.

2.3.12 Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange

Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange include net realised gains from buying and selling financial assets and financial liabilities at fair value excluding available-for-sale investments, changes in their fair value and the effect of foreign currency translation.

2.3.13 Cash and cash equivalents

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.

2.3.14 Investment property

Real estate, received in debt settlement is classified as investment property. The investment property is measured initially at cost, including transaction costs, and subsequently measured at cost less any accumulated depreciation and any accumulated impairment losses. It is depreciated according to the straight-line method over the economic life of the investment property concerned. The useful life of investment properties generally is 33 years, except if the consideration of certain special circumstances results different useful lifetime.

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NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.15 Bank premises and equipment

Bank premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of bank premises and equipment, other than freehold land which is deemed to have an indefinite life. The useful lives of bank premises and equipment are presented below:

Buildings	10-50 years
Leasehold improvements	3-20 years
Furniture, fixtures and equipment	3-7 years
System software	5 years
Leasehold rights	10-50 years

Replacements and improvements, which prolong the useful life or significantly improve the condition of the asset, are capitalized. Repairs and maintenance are charged to the income statement as incurred. The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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.

2.3.16 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.

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Typically the staff expenses and the cost related to the infrastructure needed for the software development are directly attributable to the internally generated software.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life; the amortisation expense is recorded as operating expense in the income statements. The impairment assessment of intangible assets with finite lives is the same as tangible assets. The intangible assets owned by the Bank are classified as assets with finite lives.

Intangible assets are stated at cost less accumulated amortisation. Amortisation is computed using the straight-line method over the estimated useful lives of the assets:

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

Core systems are types of standard/customized software, which are data applications for processing all transactions that have occurred during the day and generating postings. Core systems typically include current account, deposit and credit processing applications, interfaces to the general ledger and reporting tools.

NOTE 2 – ACCOUNTING POLICIES (continued)

By ‘customized software‘ is meant purchased software and software models that are customized before being delivered or taken into use, with software having been developed in addition to existing standard software.

2.3.17 Commitments, 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.

Financial guarantees are initially recognized in the financial statement at fair value, in ‘Other liabilities’, being the premium received. Subsequent to initial recognition, the Bank liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the income statement in ‘Impairment on loans and receivables’ including provisions for credit commitments. The premium received is recognized in the income statement in ‘Net fee and commission income’ on a straight line basis over the life of the guarantee.

Taking into account that IAS 39 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.

The allowance for losses on commitments and contingent liabilities reflects Management’s best estimate of incurred losses on this portfolio. Management determines the adequacy of the allowance based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors.

2.3.18 Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event, and 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. 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.

2.3.19 Taxation

Current taxation is provided for in accordance with the fiscal regulations of Hungary.

Deferred taxation is provided using the balance sheet method on all temporary differences at the reporting date. It is calculated at the tax rates that are expected to apply to the period when it is anticipated that the asset will be realised or the liabilities will be settled, and it is based on tax rates (and laws) that have been enacted or substantively enacted at the statement of financial position date.

2.3.20 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.

2.3.21 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.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3.22 Equity reserves

The reserves recorded in equity on the Bank's statement of financial position include:

Available-for-sale reserve which comprises changes in fair value of available-for-sale investments.

Cash flow hedge reserve which comprises the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge.

Statutory risk reserve which is set aside as 10% of the profit calculated in accordance with Hungarian Accounting standards for use against future losses.

Other reserve includes own credit risk content of fair value of financial liabilities measured at fair value through profit or loss and actuarial gain and losses of defined benefit plans.

2.3.23 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.

2.3.24 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.
A government grant is not recognised until there is reasonable assurance that the Bank will comply with the conditions attaching to it, and that the grant will be received. Government grants are recognised in profit or loss on a systematic basis over the periods in which the Bank recognises as expenses the related costs 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.

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

Non-current assets or groups of assets and liabilities held for sale are those whose carrying amount the Bank will recover from a sale transaction that is expected to qualify as a sale within a year, instead of through continuing use. Non-current assets held for sale and liabilities held for sale are reported separately from the other assets and liabilities in the balance sheet 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.

2.3.26 Employee benefits

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 in the income statement under the '*Personal Expense*' line.

NOTE 2 – ACCOUNTING POLICIES (continued)

Post-employment benefits

A number of employees of the Group 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 consolidated financial statements:

- vested benefits and costs arising from the change of the program's conditions as personal expenses in the consolidated income statement
- interest expenses related to the defined benefit plan as interest expense in the consolidated 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.

2.3.27 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 IAS 39: such equity instruments are measured at fair value.

2.4 Future changes in accounting policies

IASs, IFRSs and IFRIC interpretations not yet effective

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. K&H Bank will apply these standards when they become mandatory.

IFRS 9 Financial instruments

In July 2014, the IASB issued IFRS 9 Financial Instruments on the classification and measurement of financial instruments, as a replacement for the relevant requirements of the present IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date for IFRS 9 is 1 January 2018.

A project relating to IFRS 9 had been running for some time at the Bank and the system and process implementation was finalised in 2017. The Bank will make use of transition relief as regards disclosing comparative information at the date of initial application.

NOTE 2 – ACCOUNTING POLICIES (continued)

Classification and measurement

Classification and measurement of financial assets under IFRS 9 depends on the specific business model in place and the assets' contractual cash flow characteristics. The impact of first time application is due primarily to a rebalancing of part of the treasury bond portfolio (reclassification from 'Available-for-sale' to 'Amortised cost') and the reversal of frozen available-for-sale reserves. These frozen reserves existed under IAS 39 due to historical reclassifications out of the 'Available-for-sale' category to the 'Held-to-maturity' or 'Loans and receivables' categories, but need to be reversed on transition to IFRS 9. The conditions of certain loan contracts are not in line with the requirements of amortised cost measurement, therefore these assets will be presented at fair value in the financial statements.

Impairment of financial instruments

Financial instruments that are subject to impairment will be classified into three stages, namely

- stage 1: performing;
- stage 2: underperforming (where lifetime expected credit losses are required to be measured); and
- stage 3: non-performing.

The Bank has established policies and processes to assess whether credit risk has increased significantly at the end of each reporting period and, therefore, whether 'staging' is required (i.e. moving from one stage to another).

For the loan portfolio, a multi-tier approach has been adopted to staging, based on internal credit ratings, forbearance measures, collective assessment and days past due as a backstop. A similar multi-tier approach is used for the investment portfolio, except that the Bank will use the low credit risk exemption, meaning that all investment grade bonds in scope are considered to be in 'stage 1', unless any of the other triggers indicate otherwise.

For 'stage 1' and 'stage 2' – under IAS 39 – the Bank records incurred-but-not-reported (IBNR) impairment losses, which are influenced by emergence periods. Under IFRS 9, impairment of financial assets is calculated on a 12-month expected credit loss (ECL) basis for 'stage 1' and on a lifetime ECL basis for 'stage 2'.

Forward looking information is incorporated into the staging criteria and measurement of ECL. Different macroeconomic factors are taken into consideration and the Bank applies three scenarios to evaluate a range of possible outcomes.

Certain loan contracts of the Bank under IFRS9 will be qualified as "purchased or originated credit impaired" financial assets (POCI).

NOTE 2 – ACCOUNTING POLICIES (continued)

Hedge accounting

The Bank will use the option to continue with hedge accounting under IAS 39 and will await further developments at the IASB regarding macro hedging.

The Bank will not make use of any transitional arrangements with regard to the impact of IFRS 9 on capital, as it wants to provide full transparency. Consequently, own funds, capital and the leverage ratio will reflect the full impact of IFRS 9.

Overall, the first time application of IFRS 9 will have a negative impact of HUF 15 billion on the total equity from which the major part relates to the restructuring of the accounting portfolios (available for sale and held to maturity) and the reversal of frozen available for sale reserves.

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 concerning the recognition of revenue. The new standard will become effective on 1 January 2018.

The Bank has identified the relevant contracts and assessed them using the new five-step model for revenue recognition. The main focus related to the

- identification of the performance obligations
- variable consideration in certain asset management contracts.

No major impact was identified.

IFRS 16 Leases

In January 2016, the IASB issued IFRS 16, which will become effective on 1 January 2019. Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. This will typically produce a front-loaded expense profile as an assumed linear depreciation of the right-of-use asset and the decreasing interest on the liability will lead to an overall decrease of expense over the reporting period. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease.

For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis.

The new standard does not significantly change the accounting treatment of leases for lessors and, therefore, its impact is expected to be limited for the Bank. An analysis of its impact is ongoing.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRS 17

In May 2017, the IASB issued IFRS 17 (Insurance contracts), which will become effective on 1 January 2021. 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 impact was identified.

Other changes

The IASB published several limited amendments to existing IFRSs in the course of 2017. They will be applied when they become mandatory, but their impact is currently estimated to be negligible.

The list of amendments:

- Amendments to IFRS 2, Share-based Payment
  Effective from: 1 January 2018

- Annual Improvements to IFRSs 2014-2016 cycle - Amendments to IFRS 1 and IAS 28
  Effective from: 1 January 2018

- IFRIC 22 - Foreign Currency Transactions and Advance Consideration
  Effective from: 1 January 2018

- Transfers of Investment Property - Amendments to IAS 40
  Effective from: 1 January 2018

- IFRIC 23 Uncertainty over Income Tax Treatments
  Effective from: 1 January 2019

- Long-term Interests in Associates and Joint Ventures - Amendments to IAS 28
  Effective from: 1 January 2019

- Annual Improvements to IFRSs 2015-2017 cycle
  Effective from: 1 January 2019

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 11).

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 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.

NOTE 2 – ACCOUNTING POLICIES (continued)

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 3 – THE FIRST TIME APPLICATION OF IFRS

The Bank implemented IFRSs for statutory purposes instead of Hungarian Accounting Standards (HAS) as of 1 January 2017.

Valuation of assets and liabilities

Based on IFRS 1, in the separate financial statements the carrying amounts of assets and liabilities of a parent entity, that becomes first-time adopter of IFRSs for the separate financial statements later than for the consolidated financial statements, must be measured in the same way as in the consolidated financial statements apart from modifications originating from consolidation.

The Bank has prepared its first separate IFRS financial statement in accordance with IFRS 1.

Valuation of participations

The Bank in its separate opening IFRS financial statements applied the carrying amount according to the previous accounting rules (Hungarian Accounting Act) as deemed cost to the valuation of participations in subsidiaries and affiliated undertakings.

The tables below present the impact of the transition on total equity, total comprehensive income, total assets and total liabilities.

Transition of total equity

	Notes	31 December 2016 MHUF	1 January 2016 MHUF
Total equity according to HAS		259 428	211 495
Capitalization of software and revaluation of real estates	a	(2 959)	(3 121)
Portfolio-based allowance for loan losses	b	(1 502)	(1 621)
Specific allowance for loan losses	c	929	1 122
Carrying amount of securities	d	1 548	(2 614)
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	e	(11 323)	(8 403)
Fair valuation of AFS portfolio	f	11 370	15 143
Amortisation of loan origination fees	i	1 213	810
Defined benefit plans	j	358	(848)
Income tax	k	303	5 573
Total equity according to IFRS		259 365	217 536

NOTE 3 – THE FIRST TIME APPLICATION OF IFRS (continued)

Transition of total comprehensive income

	Notes	2016 MHUF
Profit after tax according to HAS		47 133
Capitalization of VAT, finance leases and revaluation of real estates	a	163
Portfolio-based allowance for loan losses	b	169
Specific allowance for loan losses	c	(193)
Carrying amount of securities	d	4 147
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	e	(2 921)
Fair valuation of AFS portfolio	f	(1 869)
Cash flow hedge	g	(1 320)
Amortisation of loan origination fees	i	369
Defined benefit plans	j	1 405
Income tax	k	(7 683)
Profit after tax according to International Accounting Standards		39 400
Other comprehensive income		1 629
Total comprehensive income according to IFRS		41 029

Transition of total assets

	Notes	31 December 2016 MHUF	1 January 2016 MHUF
Total assets according to HAS		2 863 253	2 607 217
Capitalization of VAT, finance leases and revaluation of real estates	a	(2 951)	(3 102)
Portfolio-based allowance for loan losses	b	(1 195)	(1 368)
Specific allowance for loan losses	c	775	850
Carrying amount of securities	d	(8 046)	(6 348)
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	e	1 902	2 818
Fair valuation of AFS portfolio	f	11 371	15 143
Cash flow hedge	g	-	-
Funding for Growth Scheme launched by the National Bank of Hungary (see Note 15.)	h	(10 164)	(12 604)
Amortisation of loan origination fees	i	1 122	873
Defined benefit plans	j	-	-
Income tax	k	62	5 917
Total assets according to IFRS		2 856 129	2 609 396

NOTE 3 – THE FIRST TIME APPLICATION OF IFRS (continued)

Transition of total liabilities

	Notes	31 December 2016 MHUF	1 January 2016 MHUF
Total liabilities according to HAS		2 603 825	2 395 722
Capitalization of VAT, finance leases and revaluation of real estates	a	8	19
Portfolio-based allowance for loan losses	b	307	253
Specific allowance for loan losses	c	(154)	(272)
Carrying amount of securities	d	(9 594)	(3 734)
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	e	13 225	11 221
Fair valuation of AFS portfolio	f	1	-
Funding for Growth Scheme launched by the National Bank of Hungary (see Note 15.)	h	(10 164)	(12 604)
Amortisation of loan origination fees	i	(91)	63
Defined benefit plans	j	(358)	848
Income tax	k	(241)	344
Total liabilities according to IFRS		2 596 764	2 391 860

IFRS adjustments

a) Capitalization of software and revaluation of real estates

The Bank applied different rules and limits for capitalization of costs arising from software developments according to HAS and IFRS in previous years, therefore certain expenses were capitalized under HAS and recorded as costs under IFRS. The different accounting treatment results in a lower asset value under IFRS.

The Bank applies paragraph D17 of IFRS1 and measures the assets and liabilities in its separate IFRS financial statements in the same way as in its consolidated IFRS financial statements. Some of the Bank's buildings were measured at fair value in the IFRS consolidated financial statements and were measured at cost according to HAS. The carrying amount of the buildings under IFRS was higher than the carrying amount under HAS.

b) Portfolio-based allowance for loan losses

The Bank did not record any allowance for the expected losses of the performing loans and debt securities according to HAS. The additional impairment losses decrease the carrying amount of loans and debt securities and increase the value of provisions on loan commitments and guarantees according to IFRS.

c) Specific allowance for loan losses

The National Bank of Hungary prescribed an additional fix rate-based allowance for certain types of loan granted by the banks referring to the higher credit risk embedded in those products. This specific impairment was reversed according to IFRS which caused an increase in the assets.

The Bank calculates the amortised cost of financial assets using the effective interest rate method under IFRS which results in a higher carrying amount in case of some non-performing loan and a lower provision amount in case of given loan commitments and guarantees.

NOTE 3 – THE FIRST TIME APPLICATION OF IFRS (continued)

d) Carrying amount of securities

In previous years delivery repos were accounted as sale of securities under HAS and were derecognised. Derecognition and recognition of the securities at the maturity date of the repo transactions caused a difference between the acquisition value of the securities under HAS and IFRS.

The securities' premium accrual was presented as a liability under HAS whereas it is included in the asset's carrying amount under IFRS. The different presentation of premiums caused a material decrease in the value of assets and liabilities under IFRS.

e) Fair valuation of financial instruments (excluding AFS and cash flow hedge)

The fair value adjustments of financial liabilities designated at fair value through profit or loss increase the amount of liabilities under IFRS.

The Bank also applies portfolio fair value hedge of interest rate risk under IFRS and records an additional liability as the fair value changes of hedged item in the statement of financial position.

The presentation of the fair value of derivatives slightly differed under HAS and IFRS, this caused a minor increase both in the amount of financial assets and financial liabilities.

f) Fair valuation of AFS portfolio

The fair value adjustments of available for sale debt securities are recorded directly in other comprehensive income according to IFRS. Some of these securities were measured at amortised cost under HAS, this caused a material increase in the carrying amount of the financial assets.

g) Cash flow hedge

The revaluation result of cash flow hedge derivatives is accounted directly in other comprehensive income under IFRS, whereas the same result is recorded in the profit or loss according to HAS. The transition caused a reclassification between the profit or loss and other comprehensive income and had no impact on the assets or liabilities.

h) Funding for Growth Scheme launched by the National Bank of Hungary

Refinancing loans borrowed by the National Bank of Hungary and loans granted to clients in the frame of Funding for Growth Scheme launched by the National Bank of Hungary (see Note 15.) bear an off-market interest rate. The Bank recognised a fair value adjustment on both of the refinancing credits and loans granted to clients at initiation according to IAS39. The initial fair value adjustments decrease the carrying amount of financial assets and financial liabilities significantly, but has no impact on the total equity.

i) Amortisation of loan origination fees

A part of financial assets and financial liabilities was measured at cost under HAS and is measured at amortised cost under IFRS. The difference is the result of applying the effective interest rate method which causes the increase of assets and decrease of liabilities.

j) Defined benefit plans

Defined benefit plans recorded according to IAS19 cause difference in the amount of other liabilities between HAS and IFRS.

NOTE 3 – THE FIRST TIME APPLICATION OF IFRS (continued)

k) Income tax

The Bank calculated deferred tax on all temporary differences under the balance sheet method according to IFRS. Deferred tax assets and deferred tax liabilities were not recorded according to HAS.

Transition of the cash flow statement

The definition of cash and cash equivalents has changed compared to the definition used previously in the Bank's separate financial statements according to HAS. For the definition used in this financial statement see the Cash flow statement and Note 2.3.13.

With the implementation of IFRS the Bank has changed the presentation of the cash flow statement from direct method to indirect method. Since the presentation of the transition between the methods is not possible the following table includes the figures according to HAS in the indirect way applying the IFRS classifications and uses the above prescribed definition of cash and cash equivalents.

NOTE 3 – THE FIRST TIME APPLICATION OF IFRS (continued)

	Notes	2016 HAS	2016 IFRS adjustments	2016 IFRS
		MHUF	MHUF	MHUF
OPERATING ACTIVITIES				
Profit / (loss) before tax		54 896	(58)	54 838
Adjustments for:				
Interest income		(77 355)	(16 254)	(93 609)
Interest expense		15 797	8 558	24 355
Net transfer from available for sale reserve	f	-	(5 319)	(5 319)
Net transfer from cash flow hedge reserve	g	-	172	172
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	a	9 980	(1 199)	8 781
(Profit)/Loss on the disposal of property and equipment		(1)	-	(1)
(Profit)/Loss on the disposal of investment property		(20)	-	(20)
Change in impairment on loans and advances and Held-to maturity assets*	b,c	(5 067)	9 869	4 802
Change in other provisions		(1 343)	-	(1 343)
Unrealised valuation differences	e,g	(2 197)	1 833	(364)
Cash flows from operating profit / (loss) before tax and before changes in operating assets and liabilities		(5 310)	(2 398)	(7 708)
Changes in financial assets held for trading	e	(13 093)	-	(13 093)
Changes in financial assets held to maturity	b,d	154	2 545	2 699
Reclassification of assets from available-for-sale to held-to-maturity portfolio		(27 821)	-	(27 821)
Changes in financial assets available for sale	d,f	(44 892)	10 720	(34 172)
Changes in loans and receivables	b,c,h,i	191 008	(12 582)	178 421
Changes in other assets	a,e,k	9 594	(772)	8 822
Changes in operating assets		114 856	(94)	114 856
Changes in financial liabilities held for trading	e	(3 103)	-	(3 103)
Changes in financial liabilities designated at fair value through profit or loss	e	(15 315)	-	(15 315)
Changes in financial liabilities measured at amortised cost	h,i	259 430	(3 574)	255 856
Changes in other liabilities	b,c,e,j,k	(20 990)	(1 630)	(22 620)
Changes in operating liabilities		220 022	(5 204)	214 818
Income taxes paid		(7 682)	-	(7 682)
Interest received		78 650	16 254	94 904
Interest paid		(16 131)	(8 558)	(24 689)
Net cash from/(used in) operating activities		384 499	-	384 499

NOTE 3 – THE FIRST TIME APPLICATION OF IFRS (continued)

		2016		
	Notes	**HAS**	**IFRS adjustments**	**IFRS**
		MHUF	**MHUF**	**MHUF**
Net cash from/(used in) investing activities		19 227	-	19 227
Net cash from/(used in) financing activities		800	-	800
Net increase/(decrease) in cash and cash equivalents		404 526	-	404 526
Net foreign exchange difference		(2 202)	-	(2 202)
Cash and cash equivalents at beginning of the period		198 685	-	198 685
Cash and cash equivalents at end of the period		601 009	-	601 009

NOTE 4 – NET INTEREST INCOME

	2017	2016
	MHUF	MHUF
Loans and receivables	53 871	57 445
Held to maturity	19 566	20 921
Available-for-sale assets	5 427	6 528
Subtotal, interest income from financial assets not measured at fair value through profit or loss	78 864	84 894
Financial assets held for trading	1 612	2 120
Asset/liability management derivatives	722	832
Hedging derivatives	11 524	5 763
Total interest income	92 722	93 609
Financial liabilities measured at amortised cost	(11 977)	(13 047)
Other liabilities not measured at fair value through profit or loss	(703)	(921)
Subtotal, interest income from financial assets not measured at fair value through profit or loss	(12 680)	(13 968)
Financial liabilities held for trading	(30)	(24)
Asset/liability management derivatives	(181)	(773)
Hedging derivatives	(3 838)	(2 804)
Other financial liabilities at fair value through profit or loss	(4 004)	(6 755)
Interest expense of defined benefit plans	(16)	(31)
Total interest expenses	(20 749)	(24 355)
Net interest income	71 973	69 254

The Bank recorded HUF 147 million interest income (unwinding discount effect) on impaired assets in 2017 (HUF 183 million in 2016).

NOTE 5 – NET FEE AND COMMISSION INCOME

	2017 MHUF	2016 MHUF
Brokerage services	1 558	1 707
Trust and fiduciary activities	6 601	7 373
Credit and guarantee fee income	3 472	3 239
Structured finance	81	269
Payment services	43 058	39 997
Card services	11 949	10 515
Other	2 448	1 796
Fee and commission income	69 167	64 896
Brokerage services	(714)	(751)
Credit and guarantee fee expense	(1 964)	(1 865)
Commissions to agents	(214)	(205)
Structured finance	(5)	-
Payment transactions	(5 060)	(5 291)
Card services	(6 700)	(5 329)
Insurance commissions	(2 993)	(2 399)
Other	(43)	(75)
Fee and commission expense	(17 693)	(15 915)
Net fee and commission income	51 474	48 981

Front-end fees related to 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 loan or receivable.

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

	2017 MHUF	2016 MHUF
Trading securities	(1 054)	1 313
Interest rate derivatives (including interest and fair value changes in trading derivatives)	2 138	3 828
Other financial instruments designated at fair value through profit or loss at initial recognition	1 355	31
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	15 964	15 940
Fair value adjustments in hedge accounting*	(104)	(172)
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	18 299	20 940

*Results of cash flow hedge derivatives transferred from other comprehensive income to the income statement amounted to HUF 129 million gain in 2017 (HUF 100 million gain in 2016) and HUF 233 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 272 million loss in 2016).

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 9 million gain in 2017 (HUF 93 million gain in 2016).

HUF 805 million income was accounted for in 2017 due to the lending activity related interest rate swap deals linked to the National Bank of Hungary's Market Lending Scheme (HUF 902 million income in 2016) according to the accounting treatment of government grants described in Note 2.

NOTE 7 – NET REALISED GAINS FROM AVAILABLE-FOR-SALE

	2017 MHUF	2016 MHUF
Fixed-income securities	534	723
Shares	-	4 565
Net realised gains from available for sale	534	5 288

The gain of HUF 4 565 million presented as net realised gains from available-for-sale shares in 2016 results from the sale of Visa Europe.

NOTE 8 – DIVIDEND INCOME

The Bank recognised HUF 2 198 million dividend income in 2017 (HUF 2 575 million in 2016).

	2017 MHUF	2016 MHUF
K&H Befektetési Alapkezelő Zrt.	2 078	2 529
K&H Csoportszolgáltató Kft	27	44
K&H Ingatlanlízing Zrt.	80	-
HAGE Zrt.	27	-
VISA inc	13	2
Total dividend income	2 225	2 575

NOTE 9 – OTHER INCOME AND EXPENSE

	2017 MHUF	2016 MHUF
Gain on property, plant and equipment	168	24
Gain on disposal of associated, joint ventures and subsidiaries	-	129
Gain on sale of goods	204	220
Gain on the disposal of held-to -maturity debt instruments	100	374
Gain on other services	375	271
Recoveries related to operational risk	108	911
Other income - other	3 375	10 334
Other income	4 330	12 263

The income of HUF 375 million reported as revenue on other services in 2017 (HUF 271 million 2016) 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.

In case of impaired loans and advances converted to HUF the subsequent increase in future cash-flow estimation due to credit quality improvement recorded within “Other net income / (expense)” resulted in a HUF 2 737 million gain in 2017 (HUF 9 358 million in 2016). The subsequent decrease in future cash-flow estimation due to credit quality worsening is recorded as part of impairments for all loans and receivables.

	2017 MHUF	2016 MHUF
Losses on property, plant and equipment	-	(3)
Losses on the disposal of held-to -maturity debt instruments	-	(36)
Losses due to operational risks	(659)	(1 430)
Other expense - other	(312)	(658)
Other expense	(971)	(2 127)

NOTE 10 – GENERAL ADMINISTRATIVE EXPENSES

	2017	2016
	MHUF	MHUF
IT expenses	(8 839)	(8 557)
Rental expenses	(2 475)	(2 583)
Repair and maintenance	(1 314)	(1 131)
Marketing expenses	(1 455)	(1 407)
Professional fees	(3 213)	(3 035)
Other facilities expenses	(4 882)	(4 877)
Communication expenses	(343)	(273)
Travel expenses	(113)	(88)
Training expenses	(594)	(467)
Personnel related expenses	(180)	(216)
Financial transaction levy	(23 407)	(21 403)
Other administrative expenses	(5 617)	(5 961)
Other provision	-	2
Total general administrative expenses	(52 432)	(49 996)

NOTE 11 – BANK TAX

The Bank paid a bank tax of HUF 5 325 million in 2017 (HUF 7 443 million in 2016). The basis of the tax amounted to HUF 2 511 401 million for 2017 and HUF 2 888 110 million for 2016. The effective tax rate was 0.212 percent in 2017 (0.258 percent in 2016).

The bank tax payable by the Bank for the year 2017 is calculated as follows.

For credit institutions the tax base includes the total asset value as at 31 December 2015, 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 2016 the tax base of credit institutions is the total asset value as at 31 December 2009 adjusted by the above mentioned decreasing items.

The bank tax for credit institutions is payable at 0.15% on tax base below HUF 50 000 million and 0.214% on tax base above HUF 50 000 million in 2017 (0.24% in 2016).

The bank tax for the Bank is expected to be HUF 5 715 million in 2018. The increase of the bank tax expected in 2018 is caused by the change of the tax base. In 2018 the tax base of credit institutions is the total asset value as at 31 December 2016 adjusted by the above mentioned decreasing items.

For the Bank the liability of HUF 5 715 million is established on January 1, 2018.

NOTE 12 – AVERAGE NUMBER OF PERSONNEL AND STAFF EXPENSES

	2017	2016
White-collar staff	3 442	3 592
Blue-collar staff	-	23
Management	35	39
Total average number of persons employed	3 477	3 654

The Bank changed the calculation method of the average number of employees compared to the method used in the separate financial statements of previous years.

	2017 MHUF	2016 MHUF
Wages and salaries	22 684	21 546
Social security charges	6 648	7 448
Defined benefit plan	(36)	(562)
Share based payments	68	63
Other staff expenses	2 945	2 834
Total staff expenses	32 309	31 329

NOTE 13 – IMPAIRMENT (income statement)

	2017 MHUF	2016 MHUF
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for loans and receivables	(361)	(5 610)
Specific provisions on credit commitments	875	735
Portfolio-based impairments and provisions	249	142
Total impairments and provisions on loans and receivables and credit commitments	763	(4 733)

For more detailed information on changes in the impairment loss see Note 23.

NOTE 13 – IMPAIRMENT (income statement) (continued)

	2017 MHUF	2016 MHUF
Impairment on other		
Intangible assets	(575)	(149)
Investment property	(26)	(7)
Property and equipment	(251)	(724)
Held-to-maturity assets	-	(69)
Other	11	(4)
Total impairment on other	(841)	(953)

NOTE 14 – INCOME TAXES

The components of income tax expense for the year ended 31 December 2017 and 2016 are:

	Notes	2017 MHUF	2016 MHUF
Statutory income tax expense		(3 169)	(4 460)
Statutory income tax from self-revision of prior years		(42)	1 134
Local business tax expense		(3 871)	(3 145)
Investment services tax		-	(1 211)
Deferred taxes on income	27	(692)	(7 756)
Income tax (expense) / benefit		(7 774)	(15 438)

Statutory income tax expense

In 2017 corporate income tax is payable at 9% on yearly profits (10% yearly profits below a limit of HUF 500 million and 19% on profits above the limit in 2017).

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.

In 2016 income tax (expense) / benefit includes investment services tax which was payable at 5.6% on the result of investment services. Investment services tax is not payable as of 1 January 2017.

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 2013. 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.

NOTE 14 – INCOME TAXES (continued)

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

	2017 MHUF	2016 MHUF
Profit / (loss) before tax	49 443	54 838
Income tax rate	9.00%	19.00%
Income tax calculated	(4 450)	(10 419)
Plus/minus tax effects attributable to:		
Tax base decreasing items	673	717
Adjustments related to prior years	(42)	1 134
Adjustment on opening balance of deferred taxes due to change in tax rate	-	(2 818)
Local taxes and investment services tax	(3 871)	(4 125)
Tax base increasing items	(84)	73
Total tax effects	(3 324)	(5 019)
Income tax expense (income tax calculated + total tax effects)	(7 774)	(15 438)

The effective income tax rate for 2017 is 15.72% (2016: 28.15%).

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

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets and cash balances with central banks and other demand deposit as at 31 December 2017							
Loans and advances to central banks*	201 542	-	-	6 903	-	-	208 445
Current account advances	201 542	-	-	-	-	-	201 542
Term loans	-	-	-	6 903	-	-	6 903
Loans and advances to credit institutions and investment firms**	199 515	-	-	424 426	-	-	623 941
Loans and advances to customers	-	-	-	1 331 007	-	-	1 331 007
Trading receivables	-	-	-	4 116	-	-	4 116
Consumer credit	-	-	-	35 176	-	-	35 176
Credit card	-	-	-	5 888	-	-	5 888
Mortgage loans	-	-	-	482 823	-	-	482 823
Term loans	-	-	-	633 710	-	-	633 710
Finance leasing	-	-	-	57 104	-	-	57 104
Current account advances	-	-	-	111 872	-	-	111 872
Other	-	-	-	318	-	-	318
Equity instruments	-	504	1 857	-	-	-	2 361
Debts instruments	-	58 538	192 352	14 148	423 500	-	688 538
issued by public bodies	-	58 538	192 352	14 148	423 500	-	688 538
issued by financial corporations	-	-	-	-	-	-	-
Derivatives	-	39 152	-	-	-	23 064	62 216
Total carrying value	401 057	98 194	194 209	1 776 484	423 500	23 064	2 916 508

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

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets and cash balances with central banks and other demand deposit as at 31 December 2016							
Loans and advances to central banks*	186 562	-	-	86 206	-	-	272 768
Current account advances	186 562	-	-	-	-	-	186 562
Term loans	-	-	-	86 206	-	-	86 206
Loans and advances to credit institutions and investment firms**	17 767	-	-	503 484	-	-	521 251
Loans and advances to customers	-	-	-	1 200 598	-	-	1 200 598
Trading receivables	-	-	-	5 448	-	-	5 448
Consumer credit	-	-	-	24 568	-	-	24 568
Credit card	-	-	-	5 444	-	-	5 444
Mortgage loans	-	-	-	449 579	-	-	449 579
Term loans	-	-	-	578 148	-	-	578 148
Finance leasing	-	-	-	42 104	-	-	42 104
Current account advances	-	-	-	94 572	-	-	94 572
Other	-	-	-	735	-	-	735
Equity instruments	-	559	1 558	-	-	-	2 117
Debts instruments	-	54 450	191 552	16 069	426 237	-	688 308
issued by public bodies	-	54 450	191 552	1 176	426 237	-	673 415
issued by financial corporations	-	-	-	14 893	-	-	14 893
Derivatives	-	40 270	-	-	-	16 453	56 723
Total carrying value	204 329	95 279	193 110	1 806 357	426 237	16 453	2 741 765

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

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets and cash balances with central banks and other demand deposit as at 1 January 2016							
Loans and advances to central banks*	35 567	-	-	523 338	-	-	558 905
Current account advances	35 567	-	-	-	-	-	35 567
Term loans	-	-	-	523 338	-	-	523 338
Loans and advances to credit institutions and investment firms**	48 951	-	-	24 637	-	-	73 588
Loans and advances to customers	-	-	-	1 155 367	-	-	1 155 367
Trading receivables	-	-	-	9 399	-	-	9 399
Consumer credit	-	-	-	21 094	-	-	21 094
Credit card	-	-	-	4 884	-	-	4 884
Mortgage loans	-	-	-	432 627	-	-	432 627
Term loans	-	-	-	561 081	-	-	561 081
Finance leasing	-	-	-	34 547	-	-	34 547
Current account advances	-	-	-	90 898	-	-	90 898
Other	-	-	-	837	-	-	837
Equity instruments	-	1 013	4 995	-	-	-	6 008
Debts instruments	-	40 555	158 250	15 953	428 371	-	643 129
issued by public bodies	-	40 555	158 250	1 430	428 371	-	628 606
issued by financial corporations	-	-	-	14 523	-	-	14 523
Derivatives	-	40 176	-	-	-	11 023	51 199
Total carrying value	84 518	81 744	163 245	1 719 295	428 371	11 023	2 488 196

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

Instruments issued by public bodies include Hungarian government and Hungarian municipality bonds.

*The maturity of loans and advances to central banks is less than 90 days.
**From the total balance of loans and advances to credit institutions and investment firms HUF 283 399 million is either repayable on demand or is maturing in less than 90 days in 2017 (HUF 412 676 million as at 31 December 2016 and HUF 1 908 million as at 1 January 2016). Loans and advances to credit institutions, investment firms and customers include reverse repo transactions of HUF 8 206 million in 2017 (HUF 384 116 million as at 31 December 2016 and HUF 13 413 million as at 1 January 2016).

	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 2017					
Deposits from central banks	-	-	-	117 154	117 154
Deposits from credit institutions and investment firms*	-	-	-	185 839	185 839
Deposits from customers and debt certificates	-	120 509	-	2 221 934	2 342 443
Deposits from customers	-	110 973	-	2 182 339	2 293 312
Demand deposits	-	-	-	1 743 180	1 743 180
Time deposits	-	110 973	-	146 820	257 793
Savings deposits	-	-	-	292 339	292 339
Debt certificates	-	9 536	-	39 595	49 131
Certificates of deposits	-	-	-	233	233
Non-convertible bonds	-	9 536	-	-	9 536
Non-convertible subordinated liabilities	-	-	-	39 362	39 362
Derivatives	27 637	-	4 103	-	31 740
Short positions	7 964	-	-	-	7 964
In debt instruments	7 964	-	-	-	7 964
Other	873	-	-	528	1 401
Total carrying value	36 474	120 509	4 103	2 525 455	2 686 541

*Of which HUF 35 570 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 11 124 million.

NOTE 15 – FINANCIAL ASSETS AND 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 2016					
Deposits from central banks	-	-	-	172 500	172 500
Deposits from credit institutions and investment firms*	-	-	-	143 444	143 444
Deposits from customers and debt certificates	-	200 131	-	1 976 321	2 176 452
Deposits from customers	-	191 512	-	1 948 128	2 139 640
Demand deposits	-	-	-	1 414 466	1 414 466
Time deposits	-	191 512	-	241 189	432 701
Savings deposits	-	-	-	292 473	292 473
Debt certificates	-	8 619	-	28 193	36 812
Certificates of deposits	-	-	-	236	236
Non-convertible bonds	-	8 619	-	-	8 619
Non-convertible subordinated liabilities	-	-	-	27 957	27 957
Derivatives	24 295	-	3 120	-	27 415
Short positions	4 626	-	-	-	4 626
In debt instruments	4 626	-	-	-	4 626
Other	2 885	-	-	292	3 177
Total carrying value	31 806	200 131	3 120	2 292 557	2 527 614

*Of which HUF 51 453 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 1 035 million.

NOTE 15 – FINANCIAL ASSETS AND 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 1 January 2016					
Deposits from central banks	-	-	-	188 096	188 096
Deposits from credit institutions and investment firms*	-	-	-	165 149	165 149
Deposits from customers and debt certificates	-	216 315	-	1 692 053	1 908 368
Deposits from customers	-	209 820	-	1 663 671	1 873 491
Demand deposits	-	-	-	1 035 516	1 035 516
Time deposits	-	209 820	-	351 632	561 452
Savings deposits	-	-	-	276 523	276 523
Debt certificates	-	6 495	-	28 382	34 877
Certificates of deposits	-	-	-	241	241
Non-convertible bonds	-	6 495	-	-	6 495
Non-convertible subordinated liabilities	-	-	-	28 141	28 141
Derivatives	25 971	-	11	-	25 982
Short positions	9 888	-	-	-	9 888
In debt instruments	9 888	-	-	-	9 888
Other	-	-	-	526	526
Total carrying value	35 859	216 315	11	2 045 824	2 298 009

*Of which HUF 60 914 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 5 456 million.

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

Assets pledged as collateral for liabilities and contingent liabilities

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Assets pledged for:			
Repo liabilities	10 534	1 006	5 407
Refinancing credits with EIB	-	11 213	34 892
Funding for Growth Scheme launched by the National Bank of Hungary	124 200	182 600	196 500
Derivative transactions	4 838	7 915	14 738
Clearing transactions	167 504	110 021	53 865
Total assets pledged as collateral	307 076	312 755	305 402

For the terms and conditions of assets pledged as collateral for repo liabilities see Note 16.

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).

Under clearing transactions securities pledged to ensure the safety of the Continuous Linked Settlement (CLS) system are presented.

Details of financial instruments

Equity and debt instruments

The breakdown of equity and debt instruments is presented in the tables below.

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Held for trading			
Hungarian Treasury bills	16 405	14 543	558
Hungarian government bonds issued in HUF	28 953	28 843	38 545
Hungarian government bonds issued in foreign currency	13 180	11 064	1 452
Hungarian Listed equity instruments	504	559	551
Unlisted equity instruments	-	-	462
Total held for trading securities	59 042	55 009	41 568

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

	2017 MHUF	31 December 2016 MHUF	1 January 2016 MHUF
Available for sale securities			
Hungarian government bonds issued in HUF	171 196	169 485	147 437
Hungarian government bonds issued in foreign currency	21 156	22 067	10 813
Unlisted equity instruments	1 857	1 558	4 995
Total available for sale	194 209	193 110	163 245

Available-for-sale equity instruments contain as at 31 December 2017 unlisted equity instruments in a value of HUF 646 million (HUF 646 million at the as at 31 December 2016 and as at 1 January 2016) 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.

Available-for-sale investments disclosed on their net carrying amount are:

	2017 MHUF	31 December 2016 MHUF	1 January 2016 MHUF
Garantiqa Hitelgarancia Zrt.	640	640	640
SWIFT S.C.	6	6	6
	646	646	646

The Bank recorded HUF 4 664 million gain after tax in other comprehensive income as a result of the fair value revaluation of available-for-sale debt instruments in 2017 (HUF 2 781 million gain after tax in 2016).

The unrealised result of available-for-sale debt instruments is cumulatively HUF 15 627 million gain after tax as at 31 December 2017 (HUF 11 948 million gain as at 31 December 2016 and HUF 8 759 million gain as at 1 January 2016).

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

	2017 MHUF	31 December 2016 MHUF	1 January 2016 MHUF
Loans and receivables			
Bonds issued by municipality – issued in HUF	924	1 176	1 430
Bonds issued by financial corporations in HUF	13 224	14 893	14 523
Total loans and receivables debt instruments	14 148	16 069	15 953

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

	2017 MHUF	31 December 2016 MHUF	1 January 2016 MHUF
Held to maturity			
Hungarian government bonds issued in foreign currency	28 122	15 347	34 216
Hungarian government bonds issued in HUF	395 378	410 890	394 155
Total held to maturity	423 500	426 237	428 371

Refinancing credits

The Bank has entered into several refinancing credit facilities with financial institutions (such as EIB, FHB – Mortgage Bank, 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.

At 31 December 2017, Management believes that the Bank is in compliance with all significant covenants. Refinancing credits are presented as financial liabilities at amortised cost in the statement of financial position.

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

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Refinancing credits in the frame of the Funding for Growth Scheme	117 154	172 500	98 800
Other refinancing credits	138 829	87 335	188 096
Total refinancing credits	255 983	259 835	286 896

Non-convertible subordinated liabilities

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Subordinated loan from KBC Group	39 362	27 957	28 141
	39 362	27 957	28 141

In June 2006, the Bank borrowed EUR 60 million (HUF 18 577 million in 2017, HUF 18 624 million as at 31 December 2016 and HUF 18 744 million as at 1 January 2016) 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 9 306 million in 2017, HUF 9 333 million as at 31 December 2016 and HUF 9 397 million as at 1 January 2016) 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 11 479 million) 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.

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.

	2017		31 December 2016		1 January 2016	
	Carrying amount of transferred asset	Carrying amount of associated liability	Carrying amount of transferred asset	Carrying amount of associated liability	Carrying amount of transferred asset	Carrying amount of associated liability
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Held-for-trading debt instruments	-	-	-	-	4 674	4 718
Held-to-maturity debt instruments	10 534	11 124	1 006	1 035	733	738
Total transferred assets and associated liabilities	10 534	11 124	1 006	1 035	5 407	5 456

NOTE 16 – TRANSFERRED FINANCIAL ASSETS (continued)

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 fair value of securities accepted as collateral in connection with reverse repo transactions as at 31 December 2017 was HUF 8 131 million, of which HUF 7 964 million (reported as short positions in the statement of financial position) has been sold (31 December 2016 HUF 376 220 million and HUF 4 626 million, 1 January 2016 HUF 13 233 million and HUF 9 888 million respectively).

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 2017:

	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	62 216	-	62 216	29 740	23 278	-	9 198
Reverse repurchase agreements	8 206	-	8 206	-	-	8 131	75
Total financial assets subject to offsetting or master netting agreements	70 422	-	70 422	29 740	23 278	8 131	9 273

	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	31 740	-	31 740	29 740	350	9	1 641
Repurchase agreements	11 124	-	11 124	-	-	10 534	590
Total financial liabilities subject to offsetting or master netting agreements	42 864	-	42 864	29 740	350	10 543	2 231

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 2016:

	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	56 723	-	56 723	22 939	25 475	-	8 309
Reverse repurchase agreements	384 116	-	384 116	-	-	376 210	7 906
Total financial assets subject to offsetting or master netting agreements	440 839	-	440 839	22 939	25 475	376 210	16 215

	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	27 416	-	27 416	22 939	1 027	107	3 343
Repurchase agreements	1 035	-	1 035	-	-	1 006	29
Total financial liabilities subject to offsetting or master netting agreements	28 451	-	28 451	22 939	1 027	1 113	3 372

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 1 January 2016:

	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	51 199	-	51 199	21 573	14 311	-	15 315
Reverse repurchase agreements	13 413	-	13 413	-	-	13 233	180
Total financial assets subject to offsetting or master netting agreements	64 612	-	64 612	21 573	14 311	13 233	15 495

	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	25 982	-	25 982	21 573	2 811	11	1 587
Repurchase agreements	5 456	-	5 456	-	-	5 407	49
Total financial liabilities subject to offsetting or master netting agreements	31 438	-	31 438	21 573	2 811	5 418	1 636

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 statements 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 statements of financial position. Securities collaterals pledged are recognised in the statements 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 2017:

	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	Unrecognised gain/(loss)	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	36 789	401 057	-	437 846	437 846	-	-	-
Financial assets	661 036	575 000	1 333 539	2 569 575	2 515 451	54 124	299	2 057
Held for trading	50 679	45 113	2 402	98 194	98 194	-	-	2 057
Designated at fair value through profit or loss	-	-	-	-	-	-	-	-
Available for sale	161 664	30 689	1 856	194 209	194 209	-	-	-
Loans and receivables	-	449 453	1 329 281	1 778 734	1 776 484	2 250	299	-
Held to maturity	448 693	26 681	-	475 374	423 500	51 874	-	-
Hedging derivatives	-	23 064	-	23 064	23 064	-	-	-
Total financial assets and cash and cash balances with central banks and other demand deposits with credit institutions	697 825	976 057	1 333 539	3 007 421	2 953 297	54 124	299	2 057
Financial liabilities								
Held for trading	7 973	26 108	2 393	36 474	36 474	-	-	(2 047)
Designated at fair value through profit or loss	-	120 509	-	120 509	120 509	-	-	-
Measured at amortised cost	-	120 132	2 407 070	2 527 202	2 525 455	(1 747)	-	-
Hedging derivatives	-	4 103	-	4 103	4 103	-	-	-
Total financial liabilities	7 973	270 852	2 409 463	2 688 288	2 686 541	(1 747)	-	(2 047)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange 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 as at 31 December 2016:

	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	Unrecognised gain/(loss)	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	35 457	204 329	-	239 786	239 786	-	-	-
Financial assets	628 745	745 208	1 209 111	2 583 064	2 537 436	45 628	1 161	3 030
Held for trading	54 294	37 542	3 443	95 279	95 279	-	-	3 030
Designated at fair value through profit or loss	-	-	-	-	-	-	-	-
Available for sale	160 399	31 153	1 558	193 110	193 110	-	-	-
Loans and receivables	-	604 358	1 204 110	1 808 468	1 806 357	2 111	1 161	-
Held to maturity	414 052	55 702	-	469 754	426 237	43 517	-	-
Hedging derivatives	-	16 453	-	16 453	16 453	-	-	-
Total financial assets and cash and cash balances with central banks and other demand deposits with credit institutions	664 202	949 537	1 209 111	2 822 850	2 777 222	45 628	1 161	3 030
Financial liabilities								
Held for trading	4 733	23 723	3 350	31 806	31 806	-	-	(2 937)
Designated at fair value through profit or loss	-	200 131	-	200 131	200 131	-	-	-
Measured at amortised cost	-	101 387	2 192 978	2 294 365	2 292 557	(1 808)	-	-
Hedging derivatives	-	3 120	-	3 120	3 120	-	-	-
Total financial liabilities	4 733	328 361	2 196 328	2 529 422	2 527 614	(1 808)	-	(2 937)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange 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 as at 1 January 2016:

	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	Unrecognised gain/(loss)	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	33 148	84 518	-	117 666	117 666	-	-	-
Financial assets	526 685	761 467	1 157 156	2 445 308	2 403 678	41 630	4 349	2 027
Held for trading	39 986	39 378	2 380	81 744	81 744	-	-	2 027
Designated at fair value through profit or loss	-	-	-	-	-	-	-	-
Available for sale	127 535	30 715	4 995	163 245	163 245	-	4 349	-
Loans and receivables	-	574 076	1 149 781	1 723 857	1 719 295	4 562	-	-
Held to maturity	359 164	106 275	-	465 439	428 371	37 068	-	-
Hedging derivatives	-	11 023	-	11 023	11 023	-	-	-
Total financial assets and cash and cash balances with central banks and other demand deposits with credit institutions	559 833	845 985	1 157 156	2 562 974	2 521 344	41 630	4 349	2 027
Financial liabilities								
Held for trading	9 899	23 580	2 380	35 859	35 859	-	-	(2 032)
Designated at fair value through profit or loss	-	216 315	-	216 315	216 315	-	-	-
Measured at amortised cost	-	118 492	1 932 776	2 051 268	2 045 824	(5 444)	-	-
Hedging derivatives	-	11	-	11	11	-	-	-
Total financial liabilities	9 899	358 398	1 935 156	2 303 453	2 298 009	(5 444)	-	(2 032)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange 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 2017 held-for-trading debt instruments in an amount of HUF 2 614 million were transferred from Quoted market price to Valuation techniques-market observable inputs category due to this change in valuation (HUF 181 million in 2016).

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	Available-for-sale equity instruments	Total
	MHUF	MHUF	MHUF
Balance as at 31 December 2016	3 443	912	4 355
Net gains / (losses)			
In profit or loss	(244)	-	(244)
In other comprehensive income	-	299	299
Settlement	(797)	-	(797)
Balance as at 31 December 2017	2 402	1 211	3 613

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

Financial assets	Held-for trading-derivatives	Available-for-sale equity instruments	Total
	MHUF	MHUF	MHUF
Balance as at 31 December 2015	2 380	4 349	6 729
Net gains / (losses)			
In profit or loss	1 857	-	1 857
In other comprehensive income	-	1 161	1 161
Settlement	(794)	(4 598)	(5 392)
Balance as at 31 December 2016	3 443	912	4 355

Financial liabilities	Held-for-trading derivatives
	MHUF
Balance as at 31 December 2016	3 350
Net (gains) / losses	
In profit or loss	(383)
Settlement	(574)
Balance as at 31 December 2017	2 393

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

Financial liabilities	**Held-for-trading derivatives**
	MHUF
Balance as at 31 December 2015	2 380
Net (gains) / losses	
In profit or loss	1 578
Settlement	(608)
Balance as at 31 December 2016	3 350

Fair value of financial instruments

Financial instruments at fair value

Held-for-trading instruments, financial instruments designated at fair value through profit or loss, available-for-sale instruments 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.

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.

The difference between the fair value and the transaction price of financial instruments not recognised in profit or loss as at the beginning and the end of the period was immaterial in 2017 and 2016.

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.

Available-for-sale equity instruments held at cost

Available-for-sale equity instruments contain as at 31 December 2017 equity instruments in a value of HUF 646 million (HUF 646 million as at 31 December 2016 and as at 1 January 2016) 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.

Held-to-maturity instruments

Held-to-maturity instruments include Hungarian government bonds issued in HUF and EUR. The fair value of held-to-maturity 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 held-to-maturity premium Hungarian government bonds are held at the price quoted at issuance in the 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.

Loans and receivables and financial liabilities measured at amortised cost

For financial assets 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 loans and receivables, 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.

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

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.

Municipality bonds in the Loans and receivables portfolio 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.

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.

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

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Financial liabilities designated at fair value through profit or loss			
Term deposits:			
-general government	31	-	-
- retail	332	3 060	7 432
- corporate	2 284	6 688	9 425
- investment funds	108 326	181 764	192 963
Other issued bonds	9 536	8 619	6 495
	120 509	200 131	216 315

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.

NOTE 19 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

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 2 124 million higher than the fair value of the deposits and issued bonds (HUF 2 877 million higher as at 31 December 2016 and HUF 6 152 million higher as at 1 January 2016).

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 2017 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	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets									
Hungary	202 600	71 146	-	192 993	1 362 245	423 500	-	-	2 252 484
EMU countries	187 127	24 548	-	6	407 896	-	18 286	-	637 863
East-European countries	651	17	-	-	2 690	-	-	-	3 358
Russia	1 263	-	-	-	3 249	-	-	-	4 512
Other European countries	950	2 483	-	-	163	-	4 778	-	8 374
Non-European countries	8 466	-	-	1 210	241	-	-	-	9 917
Total	401 057	98 194	-	194 209	1 776 484	423 500	23 064	-	2 916 508
Financial liabilities									
Hungary	-	13 136	120 478	-	-	-	-	2 375 516	2 509 130
EMU countries	-	22 209	-	-	-	-	3 684	126 522	152 415
East-European countries	-	54	31	-	-	-	-	7 128	7 213
Russia	-	-	-	-	-	-	-	1 627	1 627
Other European countries	-	1 075	-	-	-	-	419	9 686	11 180
Non-European countries	-	-	-	-	-	-	-	4 976	4 976
Total	-	36 474	120 509	-	-	-	4 103	2 525 455	2 686 541

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

The geographical breakdown of financial assets and financial liabilities as at 31 December 2016 is presented below:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets									
Hungary	186 799	66 753	-	192 192	1 314 956	426 237	-	-	2 186 937
EMU countries	6 378	26 501	-	6	482 919	-	15 276	-	531 080
East-European countries	202	81	-	-	2 727	-	-	-	3 010
Russia	536	-	-	-	5 313	-	-	-	5 849
Other European countries	2 889	1 944	-	-	193	-	1 177	-	6 203
Non-European countries	7 525	-	-	912	249	-	-	-	8 686
Total	204 329	95 279	-	193 110	1 806 357	426 237	16 453	-	2 741 765
Financial liabilities									
Hungary	-	14 405	199 755	-	-	-	-	2 128 660	2 342 820
EMU countries	-	15 558	-	-	-	-	2 551	143 370	161 479
East-European countries	-	47	376	-	-	-	-	4 412	4 835
Russia	-	-	-	-	-	-	-	4 685	4 685
Other European countries	-	1 796	-	-	-	-	569	6 767	9 132
Non-European countries	-	-	-	-	-	-	-	4 663	4 663
Total	-	31 806	200 131	-	-	-	3 120	2 292 557	2 527 614

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

The geographical breakdown of financial assets and financial liabilities as at 1 January 2016 is presented below:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets									
Hungary	36 051	56 663	-	158 798	1 690 718	428 371	-	-	2 370 601
EMU countries	34 594	23 534	-	88	19 383	-	10 867	-	88 466
East-European countries	3 582	9	-	-	1 006	-	-	-	4 597
Russia	1 224	-	-	-	7 818	-	-	-	9 042
Other European countries	4 210	1 538	-	4 359	88	-	156	-	10 351
Non-European countries	4 857	-	-	-	282	-	-	-	5 139
Total	84 518	81 744	-	163 245	1 719 295	428 371	11 023	-	2 488 196
Financial liabilities									
Hungary	-	15 992	215 700	-	-	-	-	1 876 328	2 108 020
EMU countries	-	16 890	30	-	-	-	4	151 875	168 799
East-European countries	-	1 019	55	-	-	-	-	4 237	5 311
Russia	-	-	-	-	-	-	-	4 808	4 808
Other European countries	-	1 958	160	-	-	-	7	3 917	6 042
Non-European countries	-	-	370	-	-	-	-	4 659	5 029
Total	-	35 859	216 315	-	-	-	11	2 045 824	2 298 009

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, 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 2017:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Performing assets	401 070	98 003	194 209	1 739 333	423 500	23 064	2 879 179
Non-performing assets	-	191	-	70 483	-	-	70 674
Impairment	(13)	-	-	(33 332)	-	-	(33 345)
Total carrying value	401 057	98 194	194 209	1 776 484	423 500	23 064	2 916 508

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

The credit quality of assets as at 31 December 2016 can be presented as follows:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Performing assets	204 363	95 264	193 110	1 759 233	426 237	16 453	2 694 660
Non-performing assets	-	15	-	89 767	-	-	89 782
Impairment	(34)	-	-	(42 643)	-	-	(42 677)
Total carrying value	204 329	95 279	193 110	1 806 357	426 237	16 453	2 741 765

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

The credit quality of assets as at 1 January 2016 can be presented as follows:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Performing assets	84 547	81 643	163 245	1 648 653	428 371	11 023	2 417 482
Non-performing assets	-	101	-	120 691	-	-	120 792
Impairment	(29)	-	-	(50 049)	-	-	(50 078)
Total carrying value	84 518	81 744	163 245	1 719 295	428 371	11 023	2 488 196

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

The balances of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2017 are shown in the following table.

	Loans and receivables	Commitments and contingent liabilities	Total
	MHUF	MHUF	MHUF
Individually impaired assets	19 620	2 251	21 871
Individually assessed impairment	(12 459)	(1 097)	(13 556)
Total	7 161	1 154	8 315

The balance of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2016 are presented in the table below.

	Loans and receivables	Commitments and contingent liabilities	Total
	MHUF	MHUF	MHUF
Individually impaired assets	27 062	8 518	35 580
Individually assessed impairment	(19 457)	(1 978)	(21 435)
Total	7 605	6 540	14 145

The balance of individually impaired financial assets and commitments and contingent liabilities as at 1 January 2016 are presented in the table below.

	Loans and receivables	Commitments and contingent liabilities	Total
	MHUF	MHUF	MHUF
Individually impaired assets	31 108	12 345	43 453
Individually assessed impairment	(29 725)	(5 960)	(35 685)
Total	1 383	6 385	7 768

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

Aging analysis of past due but not impaired loans per class of financial assets

Aging analysis of past due but not impaired financial assets as at 31 December 2017 is as follows:

	Less than 30 days	30 days or more, but less than 90 days	Total
	MHUF	MHUF	MHUF
Loans to customers			
- Corporate	4 077	558	4 635
- Retail	21 883	3 587	25 470
Total	25 960	4 145	30 105

Aging analysis of past due but not impaired financial assets as at 31 December 2016 is as follows:

	Less than 30 days	30 days or more, but less than 90 days	Total
	MHUF	MHUF	MHUF
Loans to customers			
- Corporate	6 338	271	6 609
- Retail	28 170	6 067	34 237
Total	34 508	6 338	40 846

Aging analysis of past due but not impaired financial assets as at 1 January 2016 is as follows:

	Less than 30 days	30 days or more, but less than 90 days	Total
	MHUF	MHUF	MHUF
Loans to customers			
- Corporate	2 519	177	2 696
- Retail	30 875	8 387	39 262
Total	33 394	8 564	41 958

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

Collaterals behind impaired or past due financial assets amounted to HUF 92 334 million as at 31 December 2017 (HUF 114 408 million as at 31 December 2016). The amount of the collaterals includes the indexed or reviewed collateral value limited to the carrying amount of the related asset.

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, 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.

	2017	2016
	MHUF	MHUF
Debt instruments*	688 538	688 308
Loans and advances	2 200 182	2 030 074
Derivatives*	62 216	56 723
Other assets	18 941	14 021
Total assets	2 969 877	2 789 126
Commitments to extend credit	585 668	537 207
Guarantees	213 406	167 334
Letters of credit	16 152	9 031
Total commitments and contingent liabilities	815 226	713 572
Total credit exposure	3 785 103	3 502 698

*For more information see Note 15.

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 2017 was HUF 32 880 million (HUF 29 941 million as of 31 December 2016) before taking account of any collateral or other credit enhancements.

NOTE 22 – REMAINING MATURITY OF ASSETS AND LIABILITIES

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2017:

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial assets					
Cash balances with central bank and other demand deposits with credit institutions	401 057	-	-	-	401 057
Held for trading	35 086	53 822	8 782	504	98 194
Available for sale	8 615	64 312	119 425	1 857	194 209
Loans and receivables	794 199	556 664	425 621	-	1 776 484
Held to maturity	34 906	189 253	199 341	-	423 500
Hedging derivatives	1 658	14 242	7 164	-	23 064
Total financial assets and cash balances with central banks and other demand deposits with credit institutions	1 275 521	878 293	760 333	2 361	2 916 508

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial liabilities					
Held for trading	14 589	21 381	504	-	36 474
Designated at fair value through profit or loss	41 362	79 147	-	-	120 509
Hedging derivatives	9	429	3 665	-	4 103
Measured at amortised cost	2 220 211	220 290	84 954	-	2 525 455
Fair value changes of hedged item under portfolio hedge of interest rate risk	12 560	-	-	-	12 560
Total financial liabilities	2 288 731	321 247	89 123	-	2 699 101
Commitments and contingent liabilities	812 680	-	-	-	812 680
Total financial liabilities, commitments and contingent liabilities	3 101 411	321 247	89 123	-	3 511 781

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

NOTE 22 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2016:

	<=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	204 329	-	-	-	204 329
Held for trading	28 251	62 971	3 498	559	95 279
Designated at fair value through profit or loss	-	-	-	-	-
Available for sale	3 188	77 106	111 258	1 558	193 110
Loans and receivables	915 152	496 972	394 233	-	1 806 357
Held to maturity	50 120	167 532	208 585	-	426 237
Hedging derivatives	663	13 413	2 377	-	16 453
Total financial assets and cash balances with central banks and other demand deposits with credit institutions	1 201 703	817 994	719 951	2 117	2 741 765

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial liabilities					
Held for trading	15 328	15 978	500	-	31 806
Designated at fair value through profit or loss	92 855	106 989	287	-	200 131
Hedging derivatives	-	255	2 865	-	3 120
Measured at amortised cost	2 007 076	199 156	86 325	-	2 292 557
Fair value changes of hedged item under portfolio hedge of interest rate risk	6 185	-	-	-	6 185
Total financial liabilities	2 121 444	322 378	89 977	-	2 533 799
Commitments and contingent liabilities	708 156	-	-	-	708 156
Total financial liabilities, commitments and contingent liabilities	2 829 600	322 378	89 977	-	3 241 955

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

NOTE 22 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 1 January 2016:

	<=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	84 518	-	-	-	84 518
Held for trading	14 627	47 906	18 198	1 013	81 744
Designated at fair value through profit or loss	-	-	-	-	-
Available for sale	2 880	69 664	85 706	4 995	163 245
Loans and receivables	887 771	437 803	393 721	-	1 719 295
Held to maturity	88 113	207 374	132 884	-	428 371
Hedging derivatives	60	5 678	5 285	-	11 023
Total financial assets and cash balances with central banks and other demand deposits with credit institutions	1 077 969	768 425	635 794	6 008	2 488 196

	<=1 year MHUF	1-5 year MHUF	>5 year MHUF	Without maturity MHUF	Total MHUF
Financial liabilities					
Held for trading	17 770	8 138	9 951	-	35 859
Designated at fair value through profit or loss	79 812	132 186	4 317	-	216 315
Hedging derivatives	-	7	4	-	11
Measured at amortised cost	1 714 940	241 003	89 881	-	2 045 824
Fair value changes of hedged item under portfolio hedge of interest rate risk	3 164	-	-	-	3 164
Total financial liabilities	1 815 686	381 334	104 153	-	2 301 173

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

NOTE 22 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The remaining maturity of non-financial assets and liabilities held as at 31 December 2017 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	2 633	-	2 633
Investments in subsidiaries and associated companies	-	10 619	10 619
Investment property	-	1 476	1 476
Property and equipment	-	37 909	37 909
Intangible assets	-	14 521	14 521
Non-current assets held for sale and disposal groups	1 921	-	1 921
Other assets	18 941	-	18 941
Total assets	23 495	64 525	88 020
Tax liabilities	-	942	942
Provisions for risks and charges	1 443	116	1 559
Other liabilities	73 691	-	73 691
Total liabilities	75 134	1 058	76 192

The remaining maturity of non-financial assets and liabilities held as at 31 December 2016 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	2 274	211	2 485
Investments in subsidiaries and associated companies	-	10 616	10 616
Investment property	-	1 010	1 010
Property and equipment	-	38 306	38 306
Intangible assets	-	12 469	12 469
Other assets	14 021	-	14 021
Total assets	16 295	62 612	78 907
Tax liabilities	1	-	1
Provisions for risks and charges	2 327	107	2 434
Other liabilities	60 530	-	60 530
Total liabilities	62 858	107	62 965

NOTE 22 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The remaining maturity of non-financial assets and liabilities held as at 1 January 2016 is presented in the table below.

	< 1 year	> 1 year	Total
	MHUF	MHUF	MHUF
Tax assets	7 707	5 747	13 454
Investments in subsidiaries and associated companies	-	7 206	7 206
Investment property	-	740	740
Property and equipment	-	37 608	37 608
Intangible assets	-	11 681	11 681
Other assets	17 363	-	17 363
Total assets	25 070	62 982	88 052
Tax liabilities	12	-	12
Provisions for risks and charges	7 282	473	7 755
Other liabilities	82 920	-	82 920
Total liabilities	90 214	473	90 687

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

NOTE 23 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position)

	2017 MHUF	31 December 2016 MHUF	1 January 2016 MHUF
Breakdown by type			
Specific impairment for loans and receivables	30 121	39 159	46 502
Specific provision on credit commitments	1 097	1 978	5 960
Portfolio-based impairment and provision	3 488	3 741	3 800
Total Impairment and provision on loans and receivables and credit commitments	34 706	44 878	56 262

	2017 MHUF	31 December 2016 MHUF	1 January 2016 MHUF
Breakdown by counterparty			
Impairment for loans and advances to customers (excluding banks)	33 331	42 640	50 049
Impairment for debt instruments issued by municipalities	1	3	-
Specific and portfolio based provision, credit commitments	1 374	2 235	6 213
Total impairment and provision on loans and receivables and credit commitments	34 706	44 878	56 262

For the definitions of specific and portfolio based impairments and provisions see Impairment assessment in Note 43.4.

NOTE 23 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

	Specific impairment for loans and receivables MHUF	Specific provision on credit commitments MHUF	Portfolio-based impairments and provisions MHUF	Total MHUF
Opening balance as at 1 January 2017	39 159	1 978	3 741	44 878
Movements with an impact on results				
Loan loss expenses	15 255	436	7 216	22 907
Loan loss recoveries	(14 894)	(1 311)	(7 465)	(23 670)
Discount effect	(147)	1	-	(146)
Movements without an impact on results	-	-	-	-
Write-offs	(8 683)	-	-	(8 683)
Other	(569)	(7)	(4)	(580)
Closing balance as at 31 December 2017	30 121	1 097	3 488	34 706

NOTE 23 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

	Specific impairment for loans and receivables	Specific provision on credit commitments	Portfolio-based impairments and provisions	Total
	MHUF	MHUF	MHUF	MHUF
Opening balance as at 1 January 2016	46 502	5 960	3 800	56 262
Movements with an impact on results				
Loan loss expenses	21 163	479	7 614	29 256
Loan loss recoveries	(15 553)	(1 214)	(7 756)	(24 523)
Discount effect	(183)	14	-	(169)
Movements without an impact on results	-	-	-	-
Write-offs	(12 863)	(3 212)	-	(16 075)
Other	93	(49)	83	127
Closing balance as at 31 December 2016	39 159	1 978	3 741	44 878

The Bank realised HUF 13 861 million loss and HUF 5 338 gain on loans and advances sold (HUF 12 533 million loss and HUF 6 221 gain in 2016). The net loss was presented as write-offs in the tables above.

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS

	Year ended 31 December 2017				Year ended 31 December 2016			
	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	63 267	63 558	306	(460)	66 014	67 142	145	(1 095)
Currency futures	20 456	20 471	15	(9)	29 355	29 361	96	(107)
Currency swaps	476 339	474 893	2 979	(1 490)	280 544	280 633	1 441	(1 553)
Currency options	221 397	221 397	3 093	(2 725)	284 900	284 900	3 974	(3 934)
Total foreign exchange derivatives	781 459	780 319	6 393	(4 684)	660 813	662 036	5 656	(6 689)
Interest rate derivatives								
Interest rate swaps	651 219	651 219	30 604	(19 740)	687 761	687 761	33 591	(14 659)
Cross currency interest rate swaps	159 363	159 545	1 864	(2 922)	266 602	267 426	795	(2 715)
Interest rate options	7 018	7 018	25	(25)	8 228	8 228	36	(36)
Forward rate agreements	6 203	-	-	-	-	-	-	-
Total interest rate derivatives	823 803	817 782	32 493	(22 687)	962 592	963 415	34 422	(17 410)
Equity options	-	228	-	-	-	228	-	-
Commodity swaps	1 167	1 167	41	(41)	2 924	2 924	120	(124)
Commodity options	3 325	3 325	225	(225)	1 110	1 109	72	(72)
Total derivatives held for trading	1 609 754	1 602 821	39 152	(27 637)	1 627 438	1 629 712	40 270	(24 295)
Derivatives designated as cash flow hedges								
Interest rate swaps	222 811	222 811	6 389	(193)	110 606	110 606	7 838	(133)
Derivatives designated as portfolio fair value hedges								
Interest rate swaps	591 602	591 602	16 675	(3 910)	495 589	495 589	8 615	(2 987)
Total derivatives held for hedging	814 413	814 413	23 064	(4 103)	606 195	606 195	16 453	(3 120)
Total derivative financial instruments	2 424 167	2 417 234	62 216	(31 740)	2 233 633	2 235 907	56 723	(27 415)

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

	1 January 2016			
Derivatives held for trading	**Notional amount Assets MHUF**	**Notional amount Liabilities MHUF**	**Positive fair value Assets MHUF**	**Negative fair value Liabilities MHUF**
Foreign exchange derivatives				
Currency forwards	91 803	93 077	299	(1 079)
Currency futures	21 229	21 223	16	(11)
Currency swaps	448 177	448 455	1 538	(1 977)
Currency options	194 555	194 555	3 036	(3 110)
Total foreign exchange derivatives	755 764	757 310	4 889	(6 177)
Interest rate derivatives				
Interest rate swaps	526 460	526 460	32 025	(15 962)
Cross currency interest rate swaps	268 360	268 068	1 917	(2 456)
Interest rate options	51 730	51 730	299	(299)
Forward rate agreements	51 312	-	-	(29)
Total interest rate derivatives	897 862	846 258	34 241	(18 746)
Equity options	-	448	-	(2)
Commodity swaps	7 802	7 802	833	(833)
Commodity options	3 780	3 780	213	(213)
Total derivatives held for trading	1 665 208	1 615 598	40 176	(25 971)
Derivatives designated as cash flow hedges				
Interest rate swaps	86 878	86 878	6 482	-
Derivatives designated as portfolio fair value hedges				
Interest rate swaps	158 100	158 100	4 541	(11)
Total derivatives held for hedging	244 978	244 978	11 023	(11)
Total derivative financial instruments	1 910 186	1 860 576	51 199	(25 982)

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 and from foreign exchange, 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 transferred HUF 129 million gain to the net profit from other comprehensive income excluding the ineffective part (HUF 100 million gain in 2016). In 2017 the Bank transferred HUF 233 million loss to the net profit due to ineffectiveness (HUF 272 million loss in 2016). The result of the transfers were recorded as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange in the income statement.

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

	2017		31 December 2016		1 January 2016	
	Expected cash flows		Expected cash flows		Expected cash flows	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
	MHUF	MHUF	MHUF	MHUF		
< 3 months	174	(11)	226	(150)	208	(213)
3-6 months	388	14	258	-	206	(83)
6 months - 1 year	1 041	28	1 435	(32)	1 191	(276)
1-2 years	1 660	(136)	1 920	(228)	1 697	(557)
2-5 years	3 061	(1 353)	4 681	(1 890)	4 605	(2 324)
> 5 years	759	(913)	164	(157)	971	(572)
Total	7 083	(2 371)	8 684	(2 457)	8 878	(4 025)

Forecast transactions for which hedge accounting had previously been used but which is no longer expected to occur amounted to HUF 38 million as at 31 December 2017 (HUF 8 million as at 31 December 2016 and no transaction as at 1 January 2016).

NOTE 24 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Portfolio fair value hedge of interest rate risk

The risk to be hedged under portfolio fair value hedge of interest rate risk is interest rate risk, arising from changes in fair value of portfolio 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 12 560 million loss in 2017 (HUF 6 185 million loss as at 31 December 2016 and HUF 3 164 million loss as at 1 January 2016). 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 and from foreign exchange in the income statement.

Fair value hedge of fixed rate available-for-sale bonds

The Bank usually ensures the sufficient level of liquid assets by purchase of available-for-sale government bonds. The Bank defines the risk to be hedged as the interest rate risk arising from changes in fair value of available-for-sale 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 available-for-sale 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 gain of HUF 1 504 million in 2017 (a loss of HUF 1 961 million in 2016).

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

Non-current assets held for sale and disposal groups include a building located in Budapest. In 2017 the Bank decided to sell the asset in a short term and reclassified it from property and equipment to non-current assets held for sale and disposal groups.

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

The Bank sold the Building in January 2018.

NOTE 26 – OTHER ASSETS

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Prepayments	518	146	2 986
Trade receivables	1 150	643	546
Receivables from bankcard service	10 832	7 140	4 521
Items in transit due to payment services	217	652	138
Items in transit due to trading in securities	20	50	53
Income accruals and cost prepayments	5 113	4 144	3 801
Inventories	544	671	4 773
Other receivables	547	575	545
	18 941	14 021	17 363

NOTE 26 – OTHER ASSETS (continued)

Trade receivables and receivables from bankcard and payment services are performing short term receivables without any delay. Other receivables include a HUF 258 million non-performing other claim due to retail clients (HUF 307 million as at 31 December 2016 and HUF 303 million as at 1 January 2016) for which a HUF 236 million impairment charge is recorded in the income statement (HUF 254 million as at 31 December 2016 and as at 1 January 2016).

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 2017:

	Assets	Liabilities	Income statement	Equity
	MHUF	MHUF	MHUF	MHUF
Employee benefits	-	4	(46)	(4)
Tangibles and intangibles assets	-	(457)	(68)	-
Other provisions for risk and charges and credit commitments	-	(51)	(8)	-
Impairment for losses on loans and advances	-	-	(63)	-
Financial instruments at fair value	-	5	(1 849)	(5)
Fair value adjustments AFS	-	1 966	(29)	(479)
Cash flow hedge	-	596	(10)	17
Transition to IFRS	-	(1 079)	1 079	-
Other	-	(42)	302	-
Total	-	942	(692)	(471)

For the period ended 31 December 2016:

	Assets	Liabilities	Income statement	Equity
	MHUF	MHUF	MHUF	MHUF
Employee benefits	46	-	(153)	-
Tangibles and intangibles assets	525	-	(660)	-
Provision for expected loss in relation to the Curia Act and adjustment of carrying amount of loans and advances due to re-estimation of future cash flows	-	-	(5 128)	-
Other provisions for risk and charges and credit commitments	59	-	(92)	-
Impairment for losses on loans and advances	63	-	(98)	-
Financial instruments at fair value	1 849	-	(1 041)	-
Fair value adjustments AFS	(1 458)	-	-	1 714
Cash flow hedge	(603)	-	-	506
Other*	(270)	-	(584)	-
Total	211	-	(7 756)	2 220

NOTE 27 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (continued)

For the period ended 1 January 2016:

	Assets MHUF	Liabilities MHUF
Employee benefits	199	-
Tangibles and intangibles assets	1 185	-
Provision for expected loss in relation to the Curia Act and adjustment of carrying amount of loans and advances due to re-estimation of future cash flows	5 128	-
Other provisions for risk and charges and credit commitments	151	-
Impairment for losses on loans and advances	161	-
Financial instruments at fair value	2 890	-
Fair value adjustments AFS	(3 172)	-
Cash flow hedge	(1 109)	-
Other*	314	-
Total	5 747	-

*In 2016 Other includes the deferred tax assets and liabilities resulting from the temporary differences between the Hungarian and International Accounting Standards related to the amortisation of loan origination fees, reversal of interest income of impaired assets, financial leases and different carrying amounts of securities.

NOTE 27 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (continued)

In 2017 and 2016 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 1.82% local business tax). (Comparable data for 2015 are 20.62% consisting of 19% corporate income tax and 1.62% local business tax.)

NOTE 28 – INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED COMPANIES

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
K&H Alkusz Kft	-	-	23
K&H Autópark Kft.	410	410	410
K&H Csoportszolgáltató Kft.	60	60	60
K&H Equities Zrt.	4 757	4 754	4 771
K&H Befektetési Alapkezelő Zrt.	850	850	850
K&H Faktor Zrt.	450	450	450
K&H Ingatlanlízing Zrt.	50	50	50
K&H Jelzálogbank Zrt.	3 500	3 500	-
K&H Lízing Zrt.	-	-	50
HAGE Zrt.	542	542	542
Total	10 619	10 616	7 206

NOTE 29 – INVESTMENT PROPERTIES

	Investment properties MHUF
At 31 December 2015	
Cost	798
Accumulated depreciation	(58)
Net book value	740
Movements in 2016	
Additions	501
Disposals - net	(208)
Impairment charge	(7)
Depreciation charge	(16)
At 31 December 2016	
Cost	1 087
Accumulated depreciation	(77)
Net book value	1 010
Movements in 2017	
Additions	1 031
Disposals - net	(522)
Impairment charge	(26)
Depreciation charge	(17)
At 31 December 2017	
Cost	1 579
Accumulated depreciation	(103)
Net book value	1 476

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 difference between the fair value and the carrying amount of the assets is immaterial as at 31 December 2017 (and as at 31 December 2016).

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 AND EQUIPMENT

	Land and buildings	IT equipment	Office equipment	Other	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
At 1 January 2016					
Cost	49 189	11 419	9 787	943	71 338
Accumulated depreciation	(16 633)	(8 610)	(7 864)	(623)	(33 730)
Net book value	32 556	2 809	1 923	320	37 608
Movements in 2016					
Additions (acquired separately)	1 516	2 656	844	948	5 964
Disposals - net	-	(2)	-	-	(2)
Impairment charge	(622)	(24)	(75)	(3)	(724)
Depreciation charge	(2 485)	(1 221)	(629)	(205)	(4 540)
At 31 December 2016					
Cost	48 734	12 064	9 226	1 478	71 501
Accumulated depreciation	(17 769)	(7 846)	(7 162)	(418)	(33 195)
Net book value	30 965	4 218	2 063	1 060	38 306
Movements in 2017					
Additions (acquired separately)	2 713	3 270	77	652	6 712
Disposals - net	(60)	-	-	(19)	(79)
Transfer	(1 921)	-	-	-	(1 921)
Impairment charge	(190)	(41)	(10)	(10)	(251)
Depreciation charge	(2 612)	(1 567)	(693)	15	(4 857)
Other	-	(1)	-	-	(1)
At 31 December 2017					
Cost	46 651	14 067	8 960	2 073	71 751
Accumulated depreciation	(17 756)	(8 188)	(7 523)	(375)	(33 842)
Net book value	28 895	5 879	1 437	1 698	37 909

The reclassification of the building reported as Non-current assets held for sale and disposal groups in 2017 is presented as transfer in the table above (see Note 25).

NOTE 30 – PROPERTY AND EQUIPMENT (continued)

Expenditure on items in the course of construction amounted to HUF 5 357 million as at 31 December 2017 (HUF 4 854 million as at 31 December 2016 and HUF 4 259 million as at 1 January 2016).

Fully amortised tangible assets which were still in use amounted to HUF 12 866 million as at 31 December 2017 (HUF 12 894 million as at 31 December 2016 and HUF 15 278 million as at 1 January 2016).

NOTE 31 – INTANGIBLE ASSETS

	Acquired software MHUF	Other intangible assets MHUF	Total MHUF
At 1 January 2016			
Cost	41 146	5	41 151
Accumulated depreciation	(29 466)	(4)	(29 470)
Net book value	11 680	1	11 681
Movements in 2016			
Additions (acquired separately)	4 265	-	4 265
Impairment charge	(149)	-	(149)
Depreciation charge	(3 327)	-	(3 327)
Other	-	(1)	(1)
At 31 December 2016			
Cost	41 466	4	41 470
Accumulated depreciation	(28 997)	(4)	(29 001)
Net book value	12 469	-	12 469
Movements in 2017			
Additions (acquired separately)	6 011	37	6 048
Impairment charge	(575)	-	(575)
Depreciation charge	(3 387)	(35)	(3 422)
Other	(1)	2	1
At 31 December 2017			
Cost	46 894	45	46 939
Accumulated depreciation	(32 377)	(41)	(32 418)
Net book value	14 517	4	14 521

Fully amortised intangible assets which were still in use amounted to HUF 24 059 million as at 31 December 2017 (HUF 21 359 million as at 31 December 2016 and HUF 23 459 million as at 1 January 2016).

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 1 January 2016	24	934	584	1 542
Amounts allocated	-	93	1	94
Amounts used	(14)	(874)	(458)	(1 346)
Unused amounts reversed	-	(37)	(53)	(90)
Other (foreign exchange revaluation)	-	-	-	-
Balance as at 31 December 2016	10	116	74	200
Amounts allocated	-	111	-	111
Amounts used	(6)	-	-	(6)
Unused amounts reversed	(4)	(108)	(7)	(119)
Other (foreign exchange revaluation)	-	-	(1)	(1)
Balance as at 31 December 2017	-	119	66	185

The Bank is party to litigation and claims arising in the normal course of business, the provision of HUF 119 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2017 relates to these litigations (HUF 116 million at 31 December 2016). Management considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 1 097 million as at 31 December 2017 (HUF 1 978 million as at 31 December 2016) is presented in Note 23. The sum of HUF 185 million provision for risk and charges and HUF 1 097 million provisions for credit commitments amounts to HUF 1 282 million (HUF 2 178 million in 2016).

NOTE 33 – OTHER LIABILITIES

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Trade creditors	6 808	2 548	7 709
Lease liabilities	23 822	23 847	23 869
Items in transit due to payment services	19 085	13 588	33 190
Items in transit due to lending activity	2 201	1 439	690
Liabilities from bankcard service	5 445	3 377	2 500
Other	16 330	15 731	14 962
Total other liabilities	73 691	60 530	82 920

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 39) 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

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Ordinary shares issued and outstanding	140 978	140 978	140 978

The nominal value of the ordinary shares issued and outstanding at 31 December 2017 is HUF 1 per share (31 December 2016 and 1 January 2016: HUF 1).

Shareholders of the Bank:

	2017 Shareholding %	31 December 2016 Shareholding %	1 January 2016 Shareholding %
KBC Bank N. V.	100.00%	100.00%	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.

	2017 MHUF	2016 MHUF
Cash and cash equivalents	685 675	601 009
Subordinated liabilities (see Note 15.)	(39 362)	(27 957)
Finance lease due after 1 year	(23 822)	(23 849)
Borrowing – repayable within 1 year	(9 506)	(1 689)
Borrowing – repayable after 1 year	(257 669)	(258 146)
Net debt	355 316	289 368

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

The components of net debt changed as follows in 2017.

	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	Finance leases due after 1 year	Subordinated liabilities	Borrowing – repayable within 1 year	Borrowing – repayable after 1 year	Total net debt
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net debt as at 31 December 2016	35 457	186 562	17 767	412 676	(51 453)	(23 849)	(27 957)	(1 689)	(258 146)	289 368
Cash flows	1 398	14 995	182 265	(127 064)	15 579	743	(10 765)	(7 816)	2 106	71 441
Foreign exchange adjustments	(66)	-	(568)	(2 570)	211	-	145	-	3 356	508
Other non-cash movements	-	(15)	51	357	93	(716)	(785)	(1)	(4 985)	(6 001)
Net debt as at 31 December 2017	36 789	201 542	199 515	283 399	(35 570)	(23 822)	(39 362)	(9 506)	(257 669)	355 316

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:

	2017 MHUF	2016 MHUF
Credit commitments – undrawn amount		
Received	10 707	9 546
Given		
Irrevocable	288 309	258 768
Revocable	297 824	278 878
Total given	586 133	537 646
Collaterals		
Given	214 240	169 082
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets	125 873	200 697
Financial assets	6 772	8 843
For assets that are not impaired or past due		
Non-financial assets	1 243 521	1 313 418
Financial assets	325 041	681 171
Total guarantees received/collateral	1 701 207	2 204 129
Other commitments given – irrevocable	16 227	9 079

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

The total of collateral received to mitigate the maximum exposure to credit risk (value of the collateral as described below limited to the carrying amount of the related asset) amounts to HUF 894 561 million as at 31 December 2017 (HUF 1 217 398 million as at 31 December 2016). Collaterals include the fair value for financial instruments. The collateral value of retail mortgages comprise the indexed property value calculated from the property value at loan origination revalued via house price index. Corporate non-financial collaterals are presented based on their periodically reviewed collateral value.

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 1 180 million (HUF 1 231 million as at 31 December 2016) 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 consolidated financial statements.

NOTE 37 – FINANCE AND OPERATING LEASES

Lessor position

The Bank operates in the domestic leasing market and provides both finance and operating lease products to customers. 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.

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

	2017 MHUF	2016 MHUF
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	17 955	13 789
one to five years	40 646	27 808
more than five years	2 468	2 745
	61 069	44 342
The present value of minimum lease payments receivables*:		
less than one year	16 953	13 266
one to five years	37 783	26 368
more than five years	2 368	2 470
	57 104	42 104
Unearned finance income	3 965	2 238
Contingent rents recognized as income - gross	1 351	947
Non-guaranteed residual values	9 902	6 127

*Net of impairment.

The total impairment recorded on finance lease receivables amounted to HUF 573 million as at 31 December 2017 (HUF 1 225 million as at 31 December 2016).

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. The Bank has the following commitments for the remaining term of the contracts:

	2017	2016
	MHUF	MHUF
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	1 066	1 066
one to five years	6 742	8 063
more than five years	426	595
	8 234	9 724

	2017	2016
	MHUF	MHUF
Minimum lease payments recognized as expense	3 313	3 573

The Bank doesn't expect sublease payments in the future.

From the total future minimum lease payments HUF 711 million results from the renewable agreement related to a part of the headquarter building in 2017, which part is not owned by the Group (HUF 744 million in 2016).

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.

	2017	2016
	MHUF	MHUF
Net carrying amount of leased assets in the Statement of financial position	16 619	17 834
The present value of finance lease liabilities may be analysed		
less than one year	25	22
one to five years	137	125
more than five years	23 660	23 700
The present value of finance lease liabilities may be analysed	23 822	23 847
less than one year	676	763
one to five year	2 696	3 047
more than five years	39 041	39 041
Finance lease liabilities-minimum lease payments	42 413	42 851

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 (2016: 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.
Omnia N.V.

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	Associ-ates	Other related parties (KBC Group)	Other related parties (through key management)	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2017						
Assets						
Other demand deposit	193 418	-	-	78	-	193 496
Loans and advances	216 030	40 006	90	186 157	2 313	444 596
Current accounts	-	11 900	-	72	7	11 979
Term loans	216 030	28 106	90	186 085	2 306	432 617
Finance leases	-	-	-	-	-	-
Other receivables	77	320	-	582	-	979
Total assets	409 525	40 326	90	186 817	2 313	639 071
Liabilities						
Deposits	16 238	87 769	82	31 569	1 052	136 710
Current accounts	15 381	14 756	82	31 239	1 052	62 510
Term deposits (with agreed maturity)	857	73 013	-	330	-	74 200
Subordinated liabilities	39 362	-	-	-	-	39 362
Non-convertible bonds	-	-	-	-	-	-
Other liabilities	149	23 905	-	930	-	24 984
Total liabilities	55 749	111 674	82	32 499	1 052	201 056
Income statement						
Net interest income	(485)	(759)	4	(144)	53	(1 331)
Interest income	1 429	567	4	8	53	2 061
Interest expense	(1 914)	(1 326)	-	(152)	-	(3 392)
Net fee and commission income	(187)	(174)	4	2 195	41	1 879
Fee and commission income	359	22	4	2 561	46	2 992
Fee and commission expense	(546)	(196)	-	(366)	(5)	(1 113)
Other income	(22)	247	-	93	-	318
Other expense	54	(929)	-	(2 617)	-	(3 492)
Total income statement	(640)	(1 615)	8	(473)	94	(2 626)
Off-statement of financial position items						
Commitments and contingent liabilities	104 193	19 102	-	5 001	10	128 306
Guarantees received	2 563	-	-	-	-	2 563
Notional amount of derivatives	1 394 871	-	-	24 914	-	1 419 785

The table excludes the fair value of derivatives.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

	Parent	Subsi-diaries	Associ-ates	Other related parties (KBC Group)	Other related parties (through key management)	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2016						
Assets						
Other demand deposit	9 914	-	-	60	-	9 974
Loans and advances	432 176	37 685	181	46 698	2 517	519 257
Current accounts	-	7 323	-	45	8	7 376
Term loans	432 176	30 362	181	46 653	2 509	511 881
Finance leases	-	-	-	-	-	-
Other receivables	-	329	-	458	-	787
Total assets	442 090	38 014	181	47 216	2 517	530 018
Liabilities						
Deposits	23 512	16 909	65	29 710	1 070	71 266
Current accounts	22 744	16 909	65	29 674	1 053	70 445
Term deposits (with agreed maturity)	768	-	-	36	17	821
Subordinated liabilities	27 957	-	-	-	-	27 957
Non-convertible bonds	-	-	-	-	-	-
Other liabilities	109	23 914	-	752	-	24 775
Total liabilities	51 578	40 823	65	30 462	1 070	123 998
Income statement						
Net interest income	(918)	(173)	9	(106)	113	(1 075)
Interest income	628	816	9	7	115	1 575
Interest expense	(1 546)	(989)	-	(113)	(2)	(2 650)
Net fee and commission income	(95)	(155)	4	2 056	39	1 849
Fee and commission income	368	22	4	2 181	45	2 620
Fee and commission expense	(463)	(177)	-	(125)	(6)	(771)
Other income	17	227	-	151	-	395
Other expense	15	(1 082)	-	(3 164)	-	(4 231)
Total income statement	(981)	(1 182)	13	(1 063)	152	(3 061)
Off-statement of financial position items						
Commitments and contingent liabilities	58 951	23 288	-	5 754	10	88 003
Guarantees received	24 441	-	-	-	-	24 441
Notional amount of derivatives	1 212 633	-	-	3 156	-	1 215 789

The table excludes the fair value of derivatives.

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 -0,35 and 2.98 percent in 2017 (0 and 3.84 percent in 2016). Deposits due to related parties bear a minimum interest rates of 0 and a maximum interest rate of 2.76 percent in 2017 (0 and 2.76 in 2016). 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 interest-free loans or for loans with favourable conditions. Interest-free loans are only provided in line with relevant local laws (i.e. for housing, if the claimant and the property fit pre-defined requirements). Favourable conditions include a waiver of handling fees and lower than market interest rates.

The outstanding amount of the housing loans of key management at 31 December 2017 was HUF 386 million (HUF 370 million at 31 December 2016), 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 2017 the outstanding amount of deposits was HUF 557 million (HUF 512 million at 31 December 2016). In 2017 the Bank was not paid interest on these deposits (HUF 2 million in 2016).

Staff expenses

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

Type of benefit	2017	2016
	MHUF	MHUF
Short-term employee benefits	2 268	2 073
Other long-term benefits	29	32
Share based payment (cash settled)	103	113
Total benefits	2 400	2 218

The liability of HUF 172 million (HUF 242 million in 2016) 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 2017 variable compensation of material Key Identified Staff

	Individual variable remuneration awarded for 2017 performance year			
	Upfront part		Deferred part	
In case of KBC SGM-s	(40% of award)		(60% of award)	
In case of all KIS whose variable compensation is below the limit prescribed in the Remuneration Policy	(60% of award)		(40% of award)	
In case of all KIS whose variable compensation is equal to or exceeds the limit prescribed in the Remuneration Policy	(40% of award)		(60% of award)	
	Cash (50% of Upfront)	Non-cash instrument (50% of Upfront)	Cash (50% of Deferred)	Non-cash instrument (50% of Deferred)
Vesting schedule	fully vested at grant	fully vested at grant	3/5-year equal vesting tranches	3/5-year equal vesting tranches
Retention period		retention period ends April 2019		retention period ends one year after vesting

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)

	2017		2016	
	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	11 232	13 924	15 052	11 748
Granted	2 101	18 692	4 075	15 501
Exercised	(5 956)	13 084	(7 895)	10 121
Transferred**	(925)	13 084	-	-
Outstanding as at the end of the period	6 452	16 823	11 232	13 924

*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 2017 based on the year-end closing price of KBC shares was 22 074 HUF/share (17 459 HUF/share as at 31 December 2016).

There were no shares exercisable as at 31 December 2017(and as at 31 December 2016).

The weighted average share price of shares converted to cash as at the date of the exercise was 18 692 HUF/share in 2017 (15 501 HUF/share in 2016.

The weighted average remaining contractual life of phantom shares outstanding as at 31 December 2017 is 14 months (12 months as at 31 December 2016).

The Bank applied the share based payment plan for the 2017 performance as well.

As at 31 December 2017 the information related to the number of phantom shares for the 2017 performance is not available, since the first grant date is in April 2018.

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.

	2017 MHUF	2016 MHUF
Defined benefit obligations at the beginning of the period	516	1 047
Current service cost	-	(562)
Interest cost	16	31
Actuarial gains and losses arising from changes in financial assumptions	(45)	-
Benefits paid	(20)	-
Past service cost, including gains and losses arising from settlements	(36)	-
		-
Defined benefit obligation at end of the period	431	516

Interest cost on defined retirement benefit plans are recorded as interest 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 10). Actuarial gains and losses arising from changes in financial assumptions are accounted directly in other comprehensive income.

NOTE 40 – AUDITOR'S REMUNERATION

	2017 MHUF	2016 MHUF
Fees for the statutory audit services	196	147
Fees related to permitted non-audit services provided by the statutory auditor	20	-
Fee related to services provided by other audit Firms	390	3
Total fees paid to audit firms	606	150

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.

HUF 390 million fee was paid to other audit firms for the feasibility study of a new online lending solution and audit activity related to properties.

NOTE 41 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2017 %	Effective Shareholding 2016 %
Fully consolidated subsidiaries			
K&H Jelzálogbank Zrt.	Credit institution	100	100
K&H Autópark Kft.	Operating lease	100	100
K&H Eszközlízing Kft.	Operating lease	100	100
K&H Ingatlanlízing Zrt.	Finance lease	100	100
K&H Befektetési Alapkezelő Zrt.	Fund manager	100	100
K&H Csoportszolgáltató Kft.	Group service center	100	100
K&H Equities Zrt.	Business and management consultancy	100	100
K&H Faktor Zrt.	Other financial services	100	100
Not consolidated investments under control			
K&H csúcstámadás zártkörű alap	Investment fund	91	91
Associates consolidated using the equity method			
HAGE Zrt.	Meat processing	25	25

The Bank owns 91% of the equity instruments in K&H csúcstámadás zártkörű alap. The investment fund is managed by K&H Befektetési Alapkezelő Zrt., one of the Bank's subsidiaries therefore the Bank has control over the fund. The fund is recorded as held-for-trading equity instrument in the financial statements and is valued at fair value. The Bank does not consolidate the fund considering that changing the valuation (consolidation versus valuation at fair value) would have an immaterial impact on the financial figures presented in the financial statements.

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 Statement.

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 senior 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.

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 local supervisor.

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 and insurance businesses are 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), Trading Risk Councils (TRC), 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 senior management regarding value creation, risk and capital.

NOTE 43 – RISK MANAGEMENT (continued)

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 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.

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: BPV (basis point value), historic VaR (value at risk), and stress test results;
  - ALM (asset-liability management) risk: BPV, 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.

- 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 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.

NOTE 43 – RISK MANAGEMENT (continued)

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.

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.

For the expected maturity of assets and liabilities see Note 22.

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 2017. For held-for-trading derivatives fair values are disclosed in the table.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	-	-	2 044 439	2 044 439
Less than three months	2 242	7 910	9 884	163	122 992	143 191
More than three months but not more than one year	3 509	873	31 591	1 471	62 775	100 219
More than one but not more than five years	21 382	-	79 763	3 078	227 793	332 016
More than five years	504	-	-	-	89 750	90 254
Total	27 637	8 783	121 238	4 712	2 547 749	2 710 119

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	586 133	214 159	16 227	816 519
Less than three months	-	81	-	81
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	586 133	214 240	16 227	816 600

NOTE 43 – RISK MANAGEMENT (continued)

The tables below present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2016. For held-for-trading derivatives fair values are disclosed in the table.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	-	-	1 743 472	1 743 472
Less than three months	2 676	4 602	14 054	76	175 406	196 814
More than three months but not more than one year	5 141	2 885	79 202	1 662	99 538	188 428
More than one but not more than five years	15 978	-	109 261	4 483	204 973	334 695
More than five years	500	-	309	7	92 826	93 642
Total	24 295	7 487	202 826	6 228	2 316 215	2 557 051

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	537 646	169 082	9 079	715 807
Less than three months	-	-	-	-
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	537 646	169 082	9 079	715 807

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.

NOTE 43 – RISK MANAGEMENT (continued)

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 stable funding ratio is used. The Bank is also analysing liquidity stress test results.

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 day, 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 2017 and 2016, 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 141% at the end of 2017 and at 170% at the end of 2016 meeting all time the regulatory minimum requirement. NSFR's 100% regulatory compliance is postponed from beginning of 2018, but that does not restraint the Bank from monitoring it. The Bank stood at 144% at the end of 2017 and at 145% at the end of 2016.

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.

NOTE 43 – RISK MANAGEMENT (continued)

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.

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 ten-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 limits: FX concentration limits to limit FX risk stemming from a particular foreign currency position, and basis-point-value (BPV) limits for interest rate risk. BPV limits are set per currency and per time bucket.

VaR results can be presented as follows:

	Foreign exchange	Interest rate	Total VAR
	MHUF	MHUF	MHUF
2017 – 31 December	52	156	150
2017 – Average daily	71	162	189
2017 – Highest	250	374	372
2017 – Lowest	11	87	92
2016 – 31 December	39	150	153
2016 – Average daily	97	372	387
2016 – Highest	369	627	659
2016 – Lowest	16	148	151

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

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.

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.

NOTE 43 – RISK MANAGEMENT (continued)

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 2017 and 2016. 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 2017	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up	CHF	-	-	-
	EUR	(28)	(198)	(226)
	HUF	(749)	(1 275)	(2 024)
	USD	-	(1)	(1)
10 bp parallel up total		(777)	(1 474)	(2 251)
100 bp parallel up	CHF	-	-	-
	EUR	(274)	(1 936)	(2 210)
	HUF	(7 259)	(12 445)	(19 704)
	USD	-	(11)	(11)
100 bp parallel up total		(7 533)	(14 392)	(21 925)
200 bp parallel up	CHF	-	-	-
	EUR	(542)	(3 777)	(4 319)
	HUF	(14 026)	(24 235)	(38 261)
	USD	-	(21)	(21)
200 bp parallel up total		(14 568)	(28 033)	(42 601)

DOWN Scenarios, 31 December 2017	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down	CHF	-	-	-
	EUR	28	199	227
	HUF	755	1 282	2 037
	USD	-	1	1
10 bp parallel down Total		783	1 482	2 265
100 bp parallel down	CHF	-	-	-
	EUR	282	2 036	2 318
	HUF	7 793	13 151	20 944
	USD	-	10	10
100 bp parallel down total		8 075	15 197	23 272
200 bp parallel down	CHF	-	-	-
	EUR	572	4 177	4 749
	HUF	16 167	27 063	43 230
	USD	-	21	21
200 bp parallel down total		16 739	31 261	48 000

NOTE 43 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2016	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up	CHF	-	-	-
	EUR	(293)	102	(191)
	HUF	(643)	-	(643)
	USD	-	(10)	(10)
10 bp parallel up total		(936)	92	(844)
100 bp parallel up	CHF	-	-	-
	EUR	(2 856)	997	(1 859)
	HUF	(6 287)	36	(6 251)
	USD	-	(101)	(101)
100 bp parallel up total		(9 143)	932	(8 211)
200 bp parallel up	CHF	-	-	-
	EUR	(5 555)	1 938	(3 617)
	HUF	(12 272)	144	(12 128)
	USD	-	(196)	(196)
200 bp parallel up total		(17 827)	1 886	(15 941)

DOWN Scenarios, 31 December 2017	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down	CHF	-	-	-
	EUR	295	(103)	192
	HUF	646	1	647
	USD	-	10	10
10 bp parallel down Total		941	(92)	849
100 bp parallel down	CHF	-	-	-
	EUR	3 023	(1 060)	1 963
	HUF	6 615	44	6 659
	USD	-	106	106
100 bp parallel down total		9 638	(910)	8 728
200 bp parallel down	CHF	-	-	-
	EUR	6 227	(2 192)	4 035
	HUF	13 587	177	13 764
	USD	-	217	217
200 bp parallel down total		19 814	(1 798)	18 016

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 subject to the Fair Value option (adjustments impact P&L) and *AFS instruments*: Available for Sale (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.

NOTE 43 – RISK MANAGEMENT (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit grades (both on client and facility level). It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The Bank deems the client rating calculated on the basis of default-adjusted PD (probability of default) algorithm as the governing rating. The calculation of default-adjusted PD is the automatic calculation of certain criteria of the default concept listed below, based on the figures available in the internal systems of the Bank. This facilitates the partially automated default recognition within the clientele with active covenants. Bank's assets have been distributed among classes based on the Basel III PD rating for Corporate and SME counterparties, and based on the facility rating for Leasing and Retail exposures according to the table below.

<table>
<tr><th>(PD) Debtor rating category</th><th>IFRS7 asset class category</th><th>Facility rating category</th></tr>
<tr><td>1</td><td rowspan="2">High grade</td><td rowspan="2">Problem-free, low risk</td></tr>
<tr><td>2</td></tr>
<tr><td>3</td><td rowspan="2">Standard grade</td><td rowspan="2">Problem-free, medium risk</td></tr>
<tr><td>4</td></tr>
<tr><td>5</td><td rowspan="5">Sub-standard grade</td><td rowspan="3">Problem-free, high risk</td></tr>
<tr><td>6</td></tr>
<tr><td>7</td></tr>
<tr><td>8</td><td rowspan="2">Monitor</td></tr>
<tr><td>9</td></tr>
<tr><td>10</td><td rowspan="4">Non-performing</td><td>Monitor</td></tr>
<tr><td rowspan="2">11</td><td>Substandard</td></tr>
<tr><td>Doubtful</td></tr>
<tr><td>12</td><td>Bad</td></tr>
</table>

Credit risk management at transactional level

Acceptance

Credit proposals are submitted in writing by a commercial entity. Unless a small amount or a low risk is involved, a loan adviser screens the proposals and makes a recommendation. In principle, significant loan decisions are taken jointly by two or more managers. Matrices that take account of such parameters as the group risk total, the risk class, type of counterparty (private individuals, companies, etc.), loss given default rate (LGD) determine at what level decisions should be taken. The 'group risk total' is the sum of all credit and limits that all companies in the borrower or counterparty's group already have or have applied for from all KBC group entities. The 'risk class' reflects the assessment of the risk and is determined primarily on the basis of internally developed rating models.

Supervision and monitoring

How the credit is monitored is determined primarily by the risk class, determined based on the Probability of Default (PD) classification of the client. The 'normal' loan portfolio is split up into internal rating classes ranging from 1 (lowest risk) to 9 (highest non-defaulted risk). Loans to small and medium-sized enterprises and large corporations in this portfolio are reviewed periodically, at least once a year, however based on risk signals (such as a significant change in the risk class) more frequent, so called ad-hoc monitoring process is initiated. It is not only credit that is monitored, credit decisions are too, as part of the so-called ex-post monitoring procedure, i.e. a member of a credit committee will supervise decisions taken at the decision level immediately below, by checking whether the decision is consistent with the lending policy. Any exposure vis-á-vis a PD8-9 rated client must be monitored more strictly than usual.

NOTE 43 – RISK MANAGEMENT (continued)

Defaulting obligors are put into PD classes 10, 11 or 12. In case of PD class 10 at least one of the following conditions under the definition of "default" is met, but none of conditions defined under PD11-12:

- Specific provision has been raised in relation to the client (for at least one exposure item) or part of its exposure was charged off within one year.
- The credit institution consents to a distressed renegotiation of the credit obligation where this is likely to result in a diminished financial obligation caused by material forgiveness or postponement of principal, interest or –where relevant – fees.
- Forborne exposures in line with the rules of the European Banking Authority (EBA) and Regulation 39/2016 of the National Bank of Hungary.
- If K&H Bank or another KBC Bank entity has suspended one or more credit lines, or the continued drawing of a certain credit line, or if K&H Bank receives official information that any other financial institution having a relationship with the client, has suspended one or more credit lines, or the continued drawing of a certain credit line.

Class 11 groups borrowers that have any material amount payable by the client to any member of the KBC Group and that has been overdue for more than 90 days. For overdrafts days past due commence, once an obligor has breached an advised limit or has drawn credit without authorisation and the underlying amount is material. For credit cards the start date of days past due is the due date of the minimum repayment obligation.

Class 12 comprises borrowers if:

- Any member of the KBC Group has fully or partially terminated any exposure in relation with the client.
- Liquidation proceedings have been launched against the client or the Bank initiated a liquidation procedure against the client.

Credit risk management at portfolio level

Monitoring is also conducted on a portfolio basis, inter alia by means of regular reports on the credit portfolio. The largest risk concentrations are, in addition, monitored via periodic reports. Limits are in place at borrower or counterparty level and for specific activities. Whereas some limits are still in notional terms, more advanced concepts (such as 'risk weighted asset', 'expected loss' and 'loss given default') are increasingly being used.

Country risk, banking

Country risk is managed by setting limits per country and per maturity. It is calculated for each country separately according to a conservative method. Proposals for setting or changing country limits are handled centrally at KBC head office and, after independent credit advice is taken, submitted for approval at the relevant level of decision authority. Before any new transactions are entered into, availability under the country limits and, where relevant, the sub-limits concerned have to be checked.

The following risks are included:

- credit (including so-called medium- and long-term export credit, IFC 'B' loans and performance risks);
- bonds and shares in the investment portfolio;
- placements and (the weighted risk for) other transactions between professional clients (such as exchange transactions and swaps);
- short-term commercial transactions (such as documentary credit and pre-export finance).

NOTE 43 – RISK MANAGEMENT (continued)

In principle, individual transactions are charged against country limits according to the following rules:

- in case of fully fledged guarantees the guarantor's country limit is charged for the country risk;
- if a transaction is carried out with the office/branch of a company which has its head office in another country, the transaction will be assigned to the country where the office/branch is located, unless the rating of the country where the head office is located is lower, in which case the transaction will be assigned to this last country;
- exposure in the counterparty's national currency and risks in respect of countries in the euro area are not included, but are reported separately.

The industry breakdown of loans and advances is presented in the table below:

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Industry sector			
Agriculture, forestry and fishing	72 350	74 026	81 008
Mining and quarrying	1 091	7 185	1 106
Manufacturing	201 225	189 847	181 702
Electricity, gas, steam and air conditioning supply	5 399	10 982	11 736
Water supply	10 094	9 353	10 129
Construction	25 879	25 558	16 834
Wholesale and retail trade	115 327	114 310	107 860
Transport and storage	60 516	60 418	53 238
Accommodation and food service activities	18 042	19 462	23 936
Information and communication	3 071	2 841	4 085
Financial and insurance activities	45 068	40 264	73 253
Real estate activities	104 150	55 250	49 889
Professional, scientific and technical activities	38 589	35 187	33 016
Administrative and support service activities	8 273	8 190	9 088
Public administration and defence, compulsory social security	43	32 212	1
Education	876	800	741
Human health services and social work activities	5 828	3 488	2 915
Arts, entertainment and recreation	892	445	467
Central bank	208 445	272 781	558 929
Individuals	581 948	539 223	511 849
Central governments	34 522	3 128	16 130
Municipalities	14 581	8 315	9 796
Credit institutions	623 949	521 258	73 592
Other services	16 565	2 749	6 638
Gross loans and advances	2 196 723	2 037 272	1 837 938
Portfolio-based impairment for loan losses	(3 209)	(3 496)	(3 576)
Specific impairment for loan losses	(30 121)	(39 159)	(46 502)
Total impairment on loans and advances (see Note 23)	(33 330)	(42 655)	(50 078)
Total loans and advances	2 163 393	1 994 617	1 787 860

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.

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.

The carrying amount of investment properties and other assets, which were obtained by the Bank by taking possession during 2017 amounted to HUF 859 million (HUF 548 million in 2016).

The Bank sells its assets obtained as collateral instead of using them for its operation.

NOTE 43 – RISK MANAGEMENT (continued)

Credit quality of not impaired nor past due assets

The credit quality of unimpaired and not past due assets as at 31 December 2017 is presented in the table below:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	198 077	86 492	192 353	617 003	423 500	23 064	1 540 489
Standard grade	202 980	9 531	1 856	511 043	-	-	725 410
Sub-standard grade	-	1 980	-	578 128	-	-	580 108
Non-performing	-	-	-	664	-	-	664
Total carrying value	401 057	98 003	194 209	1 706 838	423 500	23 064	2 846 671

NOTE 43 – RISK MANAGEMENT (continued)

The credit quality of unimpaired and not past due assets as at 31 December 2016 is presented in the table below:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	15 039	83 373	191 552	604 580	426 237	16 344	1 337 125
Standard grade	187 933	1 739	1 558	572 479	-	-	763 709
Sub-standard grade	1 357	10 152	-	540 935	-	109	552 553
Non-performing	-	-	-	1 223	-	-	1 223
Total carrying value	204 329	95 264	193 110	1 719 217	426 237	16 453	2 654 610

NOTE 43 – RISK MANAGEMENT (continued)

The credit quality of unimpaired and not past due assets as at 1 January 2016 is presented in the table below:

	Cash balances with central banks and other demand deposits with credit institutions	Held for trading	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	46 723	65 795	158 250	148 252	428 371	10 870	858 261
Standard grade	37 587	2 947	4 995	1 026 719	-	-	1 072 248
Sub-standard grade	209	12 901	-	436 369	-	153	449 632
Non-performing	-	-	-	10 481	-	-	-
Total carrying value	84 519	81 643	163 245	1 621 821	428 371	11 023	2 380 141

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* 2017	Average unsecured share of exposure 2017	Total 2017	Historical default rates* 2016	Average unsecured share of exposure 2016	Total 2016
	%	%	MHUF	%	%	MHUF
High grade	0.00	50.77	198 149	0.00	60.97	191 516
Standard grade	0.20	57.83	660 766	0.14	53.53	625 902
Sub-standard grade	3.41	38.77	553 153	3.23	38.28	590 813
Impaired	100.00	21.38	107 879	100.00	23.14	134 193
Total			1 519 947			1 542 424

* Impaired portfolio per credit grades compared to last year's total non-impaired portfolio.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue or there are any known difficulties in the cash-flows of the counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas:

- individually assessed impairments
- collectively assessed impairments

Collectively assessed impairments

Portfolio-based impairment

Impairments are assessed collectively and on a portfolio basis for losses on loans and advances and on loan commitments if there is no objective evidence that an impairment loss has incurred individually (PD1-9 performing). For such loans and receivables impairment losses are recorded on a 'portfolio basis', using IRB Advanced parameters for calculation. This methodology is reviewed regularly.

Statistical impairment

Impairments are assessed on a portfolio basis applying statistical methods for losses on loans and advances if there is an objective evidence that an impairment loss has incurred (PD10-12 non-performing), but the loans and advances are not significant individually (including credit cards, residential mortgages and unsecured consumer lending).

NOTE 43 – RISK MANAGEMENT (continued)

Individually assessed impairments

Impairments are assessed individually on loans and advances and on loan commitments that are individually significant (> EUR 1.25 million), if there is objective evidence that an impairment loss has occurred (PD10-12 non-performing).

Items considered when determining impairment amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. The Bank records such impairments based on an estimate of the net present value of the recoverable amount.

Provisions on commitments and contingent liabilities shall be created, and impairment for loans and receivables (commitments to clients) accounted for, on the basis of a realistic assessment of the situation so that the provision created and the value of impairment do not exceed the extent of expected future loss.

In some cases no impairment is presented for non-performing loans and advances in the financial statements. In case of loans and advances converted to HUF according to the Curia Act and derecognised and recognised again under IAS 39 the decrease of the loan's carrying amount resulting from credit quality worsening before the conversion is recorded as adjustment of the carrying amount before any impairment at initial recognition instead of recording impairment.

Statistical and individually assessed impairments are mentioned together as specific impairments in the Bank's financial statements.

Internal credit risk models and Basel III

In order to quantify credit risks, the Bank has developed various rating models, both for the purpose of determining how creditworthy borrowers are and to estimate the expected loss of various types of transactions. These models support credit risk management in such areas as pricing, the credit process (acceptance and monitoring) and determining portfolio-based impairment. A number of models are uniform throughout the entire KBC Group (for instance, the models for governments, banks, international large companies and project finance), while others have been designed for specific segments (SMEs, private individuals, etc.). The same internal rating scale is used throughout the KBC Group.

From January 2011, these models are also used for calculating the regulatory capital requirements for credit risk according to the Internal Rating Based (IRB) Approach. The Bank used the IRB 'Foundation' Approach until 2015 Q3 when the IRB-Advanced license was granted by the regulator.

The far-reaching introduction of rating models in the branch network has not only stimulated risk-awareness, it has also resulted in the models themselves being constantly tested against the market. Indeed, keeping the rating models up to date is just as important as developing them. An appropriate framework for the governance of the life cycle of risk models is thus in place, with model ownership (the credit function) being separate from responsibility for model validation (the Value and Risk Management Directorate). A central validation unit at KBC Group level and the Chief Risk Officer on local level is responsible for the final validation and approval of all models.

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).

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 he borrower has financial difficulties.

The forbearance classification is discontinued when all the following conditions are met:

- 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;
- a minimum 2 year probation period has passed from the date the forborne exposure was considered as 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 classify 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 in comparison to loans, loan commitments and guarantees for which no forbearance measurement has been applied.

	2017		31 December 2016		1 January 2016	
	Forborne	Not forborne	Forborne	Not forborne	Forborne	Not forborne
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Gross loans	35 593	1 760 073	44 038	1 812 524	35 276	1 777 881
Specific impairment	(10 963)	(19 158)	(10 681)	(28 478)	(9 135)	(37 367)
Portfolio based impairment	(148)	(3 061)	(274)	(3 222)	(103)	(3 473)
Total loans and advances	24 482	1 737 854	33 083	1 780 824	26 038	1 737 041

For comparative information to the total loan portfolio see Note 23.

	2017		2016	
	Forborne	Not forborne	Forborne	Not forborne
	MHUF	MHUF	MHUF	MHUF
Commitments and guarantees	-	816 600	272	715 535
Specific impairment	-	(1 097)	(113)	(1 865)
Portfolio based impairment	-	(277)	-	(257)
Total Commitments and guarantees	-	815 226	159	713 413

The table includes the amount of forborne commitments and guarantees given to corporate clients. There were no forborne commitments and guarantees for which specific impairment was recognised as at 31 December 2017 (HUF 272 million as at 31 December 2016 and HUF 187 million as at 1 January 2016).

The following table explains the change of forborne loans.

	2017	2016
	MHUF	MHUF
Balance as at the beginning of the period	33 082	26 038
Loans which have become forborne	1 132	17 717
Loans which are no longer considered to be forborne	(4 377)	(5 458)
Repayments	(15 856)	(7 615)
Change in the impairment of forborne loans	(1 091)	1 684
Translation difference	(36)	(7)
Other	11 628	724
Balance as at the end of the period	24 482	33 083

NOTE 43 – RISK MANAGEMENT (continued)

	2017 MHUF	2016 MHUF
Balance as at the beginning of the period	159	110
Translation difference	(159)	-
Other	-	49
Balance as at the end of the period	-	159

The Bank recorded HUF 1 092 million interest income on forborne loans in the income statement in 2017 (HUF 1 612 million in 2016).

The following table includes the analysis of forborne loans as at 31 December 2017.

	Impaired MHUF	Past due but not impaired MHUF	Not impaired nor past due MHUF	Total MHUF
Gross loans	26 187	2 473	6 933	35 593
Specific impairment	(10 963)	-	-	(10 963)
Portfolio based impairment	-	(46)	(102)	(148)
Total forborne loans and advances	15 224	2 427	6 831	24 482

The table below presents the analysis of forborne loans as at 31 December 2016.

	Impaired MHUF	Past due but not impaired MHUF	Not impaired nor past due MHUF	Total MHUF
Gross loans	26 610	6 632	10 796	44 038
Specific impairment	(10 681)	-	-	(10 681)
Portfolio based impairment	-	(74)	(200)	(274)
Total forborne loans and advances	15 929	6 558	10 596	33 083

NOTE 43 – RISK MANAGEMENT (continued)

The table below presents the analysis of forborne loans as at 1 January 2016.

	Impaired	Past due but not impaired	Not impaired nor past due	Total
	MHUF	MHUF	MHUF	MHUF
Gross loans	17 653	5 762	11 861	35 276
Specific impairment	(9 135)	-	-	(9 135)
Portfolio based impairment		(11)	(92)	(103)
Total forborne loans and advances	8 518	5 751	11 769	26 038

For comparative information to the total loan portfolio see Note 21.

The disaggregation of forborne loans (net of impairment) by business segments is presented below.

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Retail	21 564	29 648	17 691
Corporate	2 918	3 435	8 347
Total forborne loans and advances	24 482	33 083	26 038

NOTE 43 – RISK MANAGEMENT (continued)

The industrial breakdown of forborne loans is included in the table below.

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Industry sector			
Agriculture, forestry and fishing	642	751	805
Manufacturing	2 437	412	102
Electricity, gas, steam and air conditioning supply	370	539	6 088
Construction	-	1 471	2 068
Wholesale and retail trade	149	378	887
Transport and storage	2	21	20
Accommodation and food service activities	1 850	1 992	2 230
Information and communication	2	9	26
Financial and insurance activities	1 450	445	-
Real estate activities	2	3	3 225
Professional, scientific and technical activities	1	4	-
Administrative and support service activities	-	-	1
Individuals	28 688	38 013	19 824
Forborne loans and advances - gross	35 593	44 038	35 276
Portfolio-based impairment for loan losses	(148)	(274)	(103)
Specific impairment for loan losses	(10 963)	(10 681)	(9 135)
Total impairment on forborne loans and advances	(11 111)	(10 955)	(9 238)
Total forborne loans and advances	24 482	33 083	26 038

For comparative information to the total loan portfolio see Note 43 – Credit risk.

The table below includes the geographical breakdown of forborne loans.

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Hungary	35 593	44 038	35 276
Total forborne loans and advances	35 593	44 038	35 276

For comparative information to the total loan portfolio see Note 20.

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

The tables below present the total equity in two different structures as prescribed by Hungarian Law (Act C of 2000, no. 114 / B. §) to help the reconciliation of the equity components presented in these IFRS financial statements and the financial statements according to HAS published in previous years.

IFRS financial statement

	2017 MHUF	2016 MHUF
Share capital	140 978	140 978
Share premium	48 775	48 775
Statutory risk reserve	17 631	13 463
Revaluation reserves	21 984	18 106
Accumulated profit	36 656	38 043
Total equity	266 024	259 365

Based on the Hungarian Law (Act C of 2000, no. 114 / B. §)

	2017 MHUF	2016 MHUF
Share capital in accordance with IFRS	140 978	140 978
Capital reserve	23 179	23 179
Tied-up reserve	17 631	13 463
Revaluation reserve	21 984	18 106
Accumulated profit	24 751	28 952
Profit for the year	37 501	34 687
Total equity	266 024	259 365
from this		
Registered capital by the Registry Court	140 978	140 978
Distributable reserves available for dividend payment	41 547	81 808

NOTE 44 – SOLVENCY AND CAPITAL (continued)

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 National Bank of Hungary (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.).

	2017	31 December 2016	1 January 2016
	MHUF	MHUF	MHUF
Tier 1 capital elements	243 706	196 643	179 829
Adjustments due to prudential filters	(6 663)	(275)	(6)
Other transitional adjustments	-	-	-
Tier 1 total	237 043	196 368	179 823
Tier 2 capital elements	39 388	27 992	27 230
Other transitional adjustments	-	-	-
Tier 2 total	39 388	27 992	27 230
Guarantee capital	276 431	224 360	207 053

According to the capital adequacy regulations, the Bank's capital adequacy ratio (tier 1 + tier 2; the latter includes subordinated debts) at 31 December 2017 was 16.01% (14.64% at 31 December 2016 and 13.01% as at 1 January 2016). The Bank fulfilled the capital requirements set by MNB continuously during years 2017 and 2016 and at 31 December 2017 (and at 31 December 2016).

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 2017 was HUF 17 629 million (HUF 13 463 million as at 31 December 2016 and HUF 8 750 million as at 1 January 2016).

The Bank had distributable reserves of HUF 36 657 million as at 31 December 2017 (HUF 81 808 million as at 31 December 2016 and HUF 38 588 million as at 1 January 2016).

No dividend is proposed on ordinary shares for 2017 (for more information on the dividend proposed for 2016 and paid off in 2017 see the Consolidated statement of changes in equity).

Approved by the Board of Directors on 13 April 2018.

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 2017

Below we summarise the business operations, the operating conditions and the financial results of K&H Bank Zrt. (hereunder "Bank") in 2017.

1. Economic environment

The pace of the economic growth in Hungary accelerated to 4.0 % in 2017 (2016: 2.2%), Household consumption and investments were the main drivers of the growth in 2017. The latter was supported by the accelerated use of EU subsidies, the low interest rate environment and the tight labor market. Construction grew the fastest, but the service sector increased also substantially. The internal and external balance positions of the Hungarian economy remained favorable, although it started to deteriorate somewhat as the consumption and investments accelerated the import. The external debt was decreasing further and its currency composition improved, contributing to the more positive risk assessment/perception of the country. Hungary received two positive rating outlook from international rating agencies in 2017 which is considered as a prelude of further potential upgrades during 2018.

	2016 actual	2017 preliminary
GDP growth	+2.2%	+4.0%
CPI (average)	0.4%	2.3%
Households' consumption	+3.8%	+4.2%
Investments	-16.0%	+25.0%
Unemployment rate	4.4%	3.8%
Budget deficit (ESA) (in % of GDP)	-1.9%	-1.9%
Debt/GDP rate	73.9%	72.1%
Balance of payments (in % of GDP)	+6.2%	+4.1%

Source: MNB, KSH, K&H

In 2017, the European Central Bank continued its aggressive asset purchasing program, while the FED has raised its base rate three more times during the year due to the improving economic figures, additionally it started to consolidate its balance sheet during the Autumn. The National Bank of Hungary (MNB) left the base rate unchanged at 0.9%, and further unconventional monetary policy tools were applied during 2017 with the aim of keeping the interbank and government bond yields at a lower level (further quantitative limitations for 3 month deposit instrument, pumping extra HUF liquidity into the market via FX swaps and reducing the interest paid on overnight deposits placed at MNB). In November further measures were announced to bring down the longer end of the interest rate curve and reduce the steepness of the curve (purchase of mortgage bonds and interest rate swaps with 5 and 10 year tenor).

2. Key balance sheet and performance data

2.1. Balance sheet

HUF Billion	31 Dec 2016	31 Dec 2017	Variance
Total assets	2,856	3,041	+6.5%
Loans and receivables	1,806	1,776	-1.7%
of which loans to customers	1,201	1,331	+10.9%
of which loans to financial institutions	590	431	-26.9%
Deposits from customers	2,139	2,293	+7.2%
Equity	259	266	+2.6%

Total assets of K&H Bank amounted to HUF 3,041 billion on 31 Dec 2017. (+6.5% growth in 2017)

- *The decrease in loans and receivables* is due to technical nature:
  - volume of non-demand deposits type of placements to MNB and other credit institutions significantly decreased during the year (2016: HUF 590 billion, 2017: 431 billion). Cash balances and other demand deposits with MNB, presented under a separate heading in the statement of financial position, increased in 2017 (2016: HUF 204 billion, 2017: HUF 401 billion).
  - disregarding this the loans to customers shows 11% growth compared to 2016: the growth rate of both corporate and retail loan portfolio (+13% and +6%, respectively) exceeded the growth rate of the banking sector both in retail and in corporate segments.
    As a consequence, K&H Bank's market position is further strengthened in lending.

Market share	31 Dec 2016	31 Dec 2017 *
Corporate loans	10.4%	10.5%
Retail loans	10.1%	10.5%
Corporate deposits	12.3%	12.9%
Retail deposits+mutual funds	11.5%	11.4%

** preliminary figures*
source: MNB, K&H

- *Deposits from customers* increased by 7.2% during the year (similarly to lending, all business segments contributed to volume growth)

- In 2017 December K&H Bank has taken an additional *subordinated loan* of 37 million EUR, approx. 11.5 bln HUF. (Total subordinated loan volume stood at HUF 39.4 billion in 2017 and HUF 28.0 billion in 2016)

- Shareholders' equity increased by HUF 6.7:
  - the result of year 2017 (HUF +41.7 billion)
  - dividend payment after year 2016 (HUF -38.9 billion)
  - cash flow hedge reserves (HUF -0.2 billion)
  - AFS revaluation reserves (HUF +3.9 billion).

  According to the shareholder's resolution there is no dividend payment from the result of 2017.

2.2. Profit

HUF billion	2016	2017
Profit after taxation	39.4	41.7

In 2017 the Bank's net result amounted to HUF 41.7 billion (2016: HUF 39.4 billion).

- In comparison with previous year *net interest income* increased by 3.9% (2017: HUF 72.0 billion; 2016: HUF 69.3 billion) due to the increased loan and deposit volumes compensating the negative impact of low interest environment
- *Net fee and commission income* increased by 5.1% compared to the previous year's level (2017: HUF 51.5 billion; 2016: HUF 49.0 billion) is primarily driven by the increased transactional income. Income from mutual funds decreased (investor's attention was shifted towards other type of savings instruments)
- The decrease in *net gains from financial instruments at fair value* (2017: HUF 18.3 billion, 2016: HUF 20.9 billion) is mainly related to the less favourable Treasury income. HUF 0.8 billion income was accounted for in 2017 due to the lending activity related interest rate swap deals (HIRS) linked to the Hungarian National Bank's Market Lending Scheme (PHP).
- *Operating expenses* increased by 1.7 billion (+1.8%) (98.3 billion in 2017, 96.6 billion in 2016) Disregarding banktax and financial transaction levy there is a 2.6% growth compared to the previous year (higher ICT expenditure due to investment in digitalization)

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 adjusted to 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), Trading Risk Councils (TRC), 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 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-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. 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.

  Management reports were further fine-tuned during 2017, and amended with additional information.

The main conclusions for 2017 are:

- Corporate and SME portfolio quality remained stable with some improvements in risk indicators in the period. Furthermore the performing portfolio showed increase during 2017, while non-performing portfolio further decreased.
- Retail portfolio continued to improve during 2017 driven by the decreasing NPL volume and also the substantial amount of new production.

The economic conditions, especially the evolution of unemployment and the level of HUF interest rates can considerably influence the future quality of the credit portfolio.

- **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's 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.

- **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, FLST 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 2016	31 Dec 2017	Regulatory requirement
NSFR (%)	147.5	143.9	n.a*
LCR (%)	175.0	165.6	100
FFAR (DMM) (%)	110.1	101.2	100

* Regulatory limit will be introduced in 2019.

- 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. K&H Bank group applies the standardized method to calculate the Pillar I. capital requirement for operational risk according to the permission of the Hungarian Financial Supervisory Authority that was granted in December 2007 (from 1 January 2008).

4. Operating Conditions of the Bank

The number of Bank employees decreased by 76 during the year and amounted to 3,439 at the end of 2017.

Capital investments in the branch network:

- During 2017 the set-up, full or partial reconstruction of 12 branches was completed or was under preparation.
- By the end of 2017 altogether 452 ATMs were serving our customers (incl. 184 Cash-in ATMs).

The number of branches at year-end 2017 was 207.

The most important IT development projects in 2017 were the followings:

- Several project size developments were initiated or completed to align with legal regulations such as: Personal Data Protection Regulation, MIFID2, IFRS transition, E-invoicing (electronic invoice acceptance), Common Reporting Standard (CRS) report for NAV, Domestic HUF Instant Payment, New AML legislation
- Single Sign On (SSO) ability prepared for corporate clients went live and further developments were realized related to the corporate front-end system.
- Within the Digitalization programme the following developments were delivered in 2017:
    - website: branch appointment booking and SME online account opening went live, testing has been started for personalized data provision
    - Mobilebank/MobilePayment: the Mobilebank application has been enhanced with new functionalities, MobilePayment application went live for MasterCard and Android platform
    - GAP in the market (Üzletet ide!): the 2nd phase went live too
    - K&H Invest: developments are ready and the new WEB based investment management application went live.

5. Non-financial statement

<u>K&H sustainability strategy</u>

Sustainability is embedded in the four pillars (bank-insurance, sustainable profitable growth, client centricity, role in society) of the corporate reference strategy and our day-to-day business activities. Sustainability is only possible if we also maintain 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 K&H Group sustainability strategy</u>

5.1

K&H follows strict policies for our activities regarding business ethics and socially sensitive issues, human rights, and reducing our environmental and ecological footprint.

<u>Related policies at K&H</u>

Business ethics:
Code of Conduct (2010 March)
Code of Ethics (2010 February)

Socially sensitive issues:
Retail Credit Risk regulations (2013 July)
Personal bankruptcy (2015 September)
Corporate Credit Policy (part of Corporate Decisions regulations)
Accessibility Policy (2016 November) based on Equal access strateg**y**

Human Rights:
Collective Agreement (6A and 6B §)

Environment:
Environmental Policy (2016 September)
Energy Policy (2016 September)

5.2

We strive to increase our positive impact on 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 program & contest for primary school children of "K&H Ready, Steady, Money!" was organised for the seventh time in the 2016-2017 school year to encourage children to learn the basics of everyday household finance, thus helping them make smart financial decisions later.
Branch mentor program for schools was also organised with the involvement of branch managers.
Results: in 7 years 533 settlements, 992 schools, 7 215 teams and more than 30 000 students participated.

Environmental responsibility domain and K&H ecological footprint

Beside helping our clients make smart decisions, we are also responsible for the community and the environment in which we, our private individual and enterprise clients as well as our employees 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 the 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: 167 participants, 21 awards, from 14 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 headquarters was the first office building in Central Europe to earn LEED Gold environmental protection certification for the entire project. The state-of-the-art environmentally friendly technological solutions used in the headquarters building have enabled K&H Group to reduce its per-capita carbon emissions by 36% between 2015 and 2017. In addition, the Group now uses 3% less drinking water, 14% less paper and 8% less energy annually, and it produces 21% less waste than in 2015.

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.

- K&H "gap in the market" program provides a free-of charge market research for sme companies about local needs, www.uzletetide.hu website can show what products and

services are needed and where by local people. Business development support tools for entrepreneurs are provided by K&H. Results: Total page views: 390 977, business ideas: 18 794, votes: 54 775, sme lead: 7 828.
- 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 two award periods concluded 35 applications.
- 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.
- FOB Clubs: events for customers structured to inspire and facilitate peer networking (10 events were organized with 400-500 participating clients)
- Next Generation (NextGen) roundtables are organized to inspire and provide insight into business management. The program was launched in 2015 (38 participants so far).
- K&H NextGen alumni: events for all NextGens (2 events were held so far)

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 15 years old K&H MediMagic program has been a committed supporter of child healthcare. We purchase paediatric equipment for hospitals from funding by K&H. We also operate K&H MediMagic story-telling doctors' volunteer program in hospitals and on youtube, which help kids' recovery with mental support. A total of 390 institutions benefited with equipment worth HUF 619 million in 14 years. 48 672 registered volunteer storytellers, 16 508 reading hours in 46 hospitals. 665 videos uploaded, 75 810 views.

5.3.

Actions against corruption and bribery, respect for human rights

The Bank Group's Anti-Corruption Program 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 Program is managed and coordinated by the Bank's Compliance Directorate. Local implementation and compliance is the shared responsibility of all the stakeholders.
Regarding the human rights our company considers the general provisions of internal regulations.

Social responsibility

K&H Bank was selected as one of the TOP10 Diverse and Family-Friendly Workplaces in 2013. In both 2014 and 2016, the Bank was awarded a prize in the Large Corporate category of the Family-Friendly Workplace competition, which is judged by the Government. In 2017 we introduced our Senior Program for employees aged over 55 years because we are confident that developing and operating such a program may help them achieve an improved work/life balance and contribute to an increase in the number of healthy and well-functioning families.
At the moment we have 340 employees older than 55 and this will rise by a further 200 in the next 3 years. Our Group provides welfare aid to its employees in need and to its pensioners. In 2017 the Bank spent HUF 45 million on welfare aid; so far, around 850 employees and retired bank employees have received such aid.
Flexible working arrangements allow our employees to manage their time, adjusting it to their family obligations, and to also enjoy greater flexibility in shaping their family lives. Currently, we have around 600 employees with contractually stipulated flexible working arrangements. Taking into account our colleagues' individual needs and job scopes, we granted part-time working arrangements to 180

employees in 2017. This arrangement is especially important for those returning from extended child-care leave or preparing for retirement.
Besides helping out in difficult welfare situations, subsidising loan repayments, topping up salaries lost due to illness and paying for certain expenses, we continued in 2017 to provide financial assistance to our employees requesting us to help finance their IVF (In vitro fertilisation) treatment.
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. 30% of mothers returning to work do so part-time; this is an exceptionally high proportion under Hungarian employment conditions.

Budapest, 26 April 2018

David Moucheron	Attila Gombás
Chief Executive Officer	Chief Financial Officer