Statement of the Issuer

K&H Bank Zrt. as the Issuer (represented by: Marko Voljč, CEO and Attila Gombás, Head of the Finance and Risk Management Division) hereby declare that the Year 2008 Annual Report and the Year 2008 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 enterprises involved in the consolidation, and the Annual Report shows a faithful picture of the situation, development and performance of K&H Bank Zrt. and the enterprises involved in the consolidation, including the major risks and uncertainty factors.

Budapest, April 30, 2009

Marko Voljč
CEO

Attila Gombás
Head of the Finance and Risk Management Division

K&H

K&H Bank Zrt.
610.

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

Consolidated Annual Financial Statements prepared in accordance with International Financial Reporting Standards
For the year ended 31 December 2008
with the report of Independent Auditors

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Cg. 01-09-267553

Independent auditors' report

To the shareholder of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság and its subsidiaries

We have audited the accompanying consolidated financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2008, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság and its subsidiaries as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Without qualifying our opinion we draw attention to note 25 of these consolidated financial statements. In 2003 a significant fraud was discovered at K&H Equities, a member of the Group. As at 31 December 2008 the Group has a provision of HUF 23,864 million for its potential liability to clients as a result of the fraud, and an asset of HUF 16,399 million for expected reimbursements. In addition the Group has a provision of HUF 18,206 million for litigation and pending legal disputes. The ultimate outcome of these matters cannot presently be determined and due to its fundamental uncertainty the actual loss incurred by the Group might be significantly different from the provisions and the asset created.

Szalai Gyula

Ernst & Young Kft.
Budapest, Hungary
24 March 2009

CONTENTS OF THE CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

	Notes	2008 MHUF	Reclassified 2007 MHUF
Interest income		189 133	152 732
Interest expense		(122 714)	(95 828)
Net interest income	3	66 419	56 904
Fee and commission income		43 929	43 094
Fee and commission expense (reclassified)		(17 135)	(14 515)
Net fee and commission income	4	26 794	28 579
Net gains from financial instruments at fair value through profit or loss	5	37 506	33 664
Net realised gains from available-for-sale assets	6	(49)	560
Dividend income	7	956	26
Other net income	8	4 947	11 234
Total income		136 573	130 967
Operating expenses		(87 678)	(70 101)
Staff expenses		(32 169)	(31 735)
General administrative expenses (reclassified)		(36 940)	(31 207)
Depreciation and amortisation of fixed assets		(8 043)	(7 870)
Provisions for risks and charges		(10 526)	711
Impairment:	10	(7 812)	(11 607)
on loans and receivables		(7 759)	(10 838)
on available-for-sale assets		2	(209)
on other		(55)	(560)
Share in results of associated companies	11	587	597
Profit before tax		41 670	49 856
Income tax expense	12	(15 687)	(13 309)
Profit after tax		25 983	36 547
Earnings per share (HUF)	13	0.39	0.67

Approved by the Management on 24 March 2009.

Marko Voljč
Chief Executive Officer

Attila Gombás
Chief Financial Officer

For changes in the presentation of the consolidated income statement see note 2.

CONSOLIDATED BALANCE SHEET

	Notes	2008 MHUF	Reclassified 2007 MHUF
ASSETS			
Cash and cash balances with central banks		124 624	176 853
Financial assets	14	2 977 829	2 172 570
Held for trading (reclassified)	19	228 267	74 074
Designated at fair value through profit or loss (reclassified)	16	9 411	12 109
Available for sale (reclassified)	17	884 326	361 308
Loans and receivables	18	1 854 786	1 723 167
Hedging derivatives	19	1 039	1 912
Tax assets		3 402	2 973
Current tax assets		3 166	2 658
Deferred tax assets	21	236	315
Investments in associated companies	22	2 212	2 065
Property and equipment	23	30 385	28 649
Other intangible assets	24	4 437	5 015
Other assets	20	39 602	33 525
Total assets		3 182 491	2 421 650
LIABILITIES AND EQUITY			
Financial liabilities	14	2 890 365	2 104 526
Held for trading	19	92 995	29 947
Designated at fair value through profit or loss	16	133 563	110 909
Measured at amortised cost		2 660 790	1 963 509
Hedging derivatives	19	3 017	161
Tax liabilities		3 947	2 620
Current tax liabilities		188	132
Deferred tax liabilities	21	3 759	2 488
Provisions for risks and charges	25;18	47 644	28 725
Other liabilities	26	47 039	78 569
Total liabilities		2 988 995	2 214 440
Total equity	27;36	193 496	207 210
Total liabilities and equity		3 182 491	2 421 650

Approved by the Management on 24 March 2009.

Marko Voljč
Chief Executive Officer

Attila Gombás
Chief Financial Officer

For breakdown of assets and liabilities by remaining maturity see Note 35.2.

For changes in the presentation of the consolidated balance sheet see note 2.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital MHUF	Share premium MHUF	Statutory risk reserve MHUF	Available for sale reserve MHUF	Cash flow hedge reserve MHUF	Accumu-lated profit MHUF	Total MHUF
2007							
Balance at the beginning of the period	52 507	48 775	6 118	449	1 189	59 854	168 892
Fair value adjustments before tax	-	-	-	(1 507)	1 440	-	(67)
Deferred tax on fair value changes	-	-	-	326	(311)	-	15
Transfer from available for sale reserve to net profit							
Impairment losses	-	-	-	34	-	-	34
Net gains/losses on disposal	-	-	-	(290)	-	-	(290)
Deferred income taxes	-	-	-	46	-	-	46
Transfer from cash flow hedge reserve to net profit							
Gross amount	-	-	-	-	(1 175)	-	(1 175)
Deferred income taxes	-	-	-	-	230	-	230
Subtotal, recognised directly in equity	-	-	-	(1 391)	184	-	(1 207)
Net profit for the year	-	-	-	-	-	36 547	36 547
Capital increase	13 800	-	-	-	-	-	13 800
Dividend	-	-	-	-	-	(10 822)	(10 822)
Transfer from accumulated profit to statutory risk reserve	-	-	3 240	-	-	(3 240)	-
Total change	13 800	-	3 240	(1 391)	184	22 485	38 318
Balance at the end of the period	66 307	48 775	9 358	(942)	1 373	82 339	207 210
of which revaluation reserve for equity instruments	-	-	-	286	-	-	286
of which revaluation reserve for bonds	-	-	-	(1 228)	-	-	(1 228)

The dividend paid on ordinary shares was HUF 10 822 million – 0.145112 HUF/share in 2007.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

	Share capital	Share premium	Statutory risk reserve	Available for sale reserve	Cash flow hedge reserve	Accumu-lated profit	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
2008							
Balance at the beginning of the period	66 307	48 775	9 358	(942)	1 373	82 339	207 210
Fair value adjustments before tax	-	-	-	(10 358)	(1 273)	-	(11 631)
Deferred tax on fair value changes	-	-	-	2 237	275	-	2 512
Transfer from available for sale reserve to net profit							
Impairment losses	-	-	-	-	-	-	-
Net gains/losses on disposal	-	-	-	(227)	-	-	(227)
Deferred income taxes	-	-	-	49	-	-	49
Transfer from cash flow hedge reserve to net profit							
Gross amount	-	-	-	-	(1 578)	-	(1 578)
Deferred income taxes	-	-	-	-	341	-	341
Subtotal, recognised directly in equity	-	-	-	(8 299)	(2 235)	-	(10 534)
Net profit for the year	-	-	-	-	-	25 983	25 983
Dividend	-	-	-	-	-	(29 163)	(29 163)
Transfer from accumulated profit to statutory risk reserve	-	-	1 346	-	-	(1 346)	-
Total change	-	-	1 346	(8 299)	(2 235)	(4 526)	(13 714)
Balance at the end of the period	66 307	48 775	10 704	(9 241)	(862)	77 813	193 496
of which revaluation reserve for equity instruments	-	-	-	(36)	-	-	(36)
of which revaluation reserve for bonds	-	-	-	(9 205)	-	-	(9 205)

The dividend paid on ordinary shares was HUF 29 163 million – 0.439816 HUF/share in 2008.

For dividend proposed on ordinary shares see Note 36.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2008 MHUF	Reclassified 2007 MHUF
OPERATING ACTIVITIES			
Profit before tax		41 670	49 856
Adjustments for:			
Net transfer from available for sale reserve		(227)	(256)
Net transfer from cash flow hedge reserve		(1 578)	(1 175)
Depreciation and impairment of property, plant and equipment, intangible assets, available for sale financial assets and other assets	23;24	8 096	8 639
(Profit)/Loss on the disposal of subsidiaries and associated companies	8	-	(8 664)
(Profit)/Loss on the disposal of property and equipment	8	(178)	(158)
Change in impairment on loans and advances[1]	10;18	7 759	10 838
Change in other provisions	25	10 526	(1 034)
Unrealised valuation differences	30	3 414	(570)
Income from associated companies	33	(587)	(597)
Cash flows from operating profit before tax and before changes in operating assets and liabilities		68 895	56 879
Operating assets:			
Financial assets held for trading (reclassified)		(93 533)	(36 557)
Financial assets designated at fair value through profit or loss (reclassified)		903	(12 755)
Financial assets available for sale (reclassified)		(533 602)	(228 954)
Financial assets held to maturity		-	127 442
Loans and receivables		(194 455)	(76 722)
Other assets		7 305	5 660
Changes in operating assets		(813 382)	(221 886)
Operating liabilities:			
Financial liabilities held for trading		(3 481)	(1 955)
Financial liabilities designated at fair value through profit or loss		27 420	111 636
Financial liabilities measured at amortised cost		419 439	104 541
Other liabilities		(31 531)	20 454
Changes in operating liabilities		411 847	234 676
Income taxes paid[2]	33	(11 435)	(11 706)
Net cash from/(used in) operating activities		(344 075)	57 963

1. Including impairments on Loans and receivables and loan commitments.
2. Excluding deferred tax expenses.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2008 MHUF	Reclassified 2007 MHUF
INVESTING ACTIVITIES			
Proceeds from the repayment of held-to-maturity securities at maturity		-	5 210
Proceeds from the disposal of a subsidiary or business unit, net of cash disposed		-	9 112
Proceeds from the disposal of shares in associated companies		42	-
Dividends received from associated companies	7	398	600
Purchase of intangible fixed assets	24	(2 010)	(1 855)
Proceeds from the sale of intangible fixed assets		-	4
Purchase of property, plant and equipment	23	(8 256)	(8 045)
Proceeds from the sale of property, plant and equipment		1 192	947
Net cash from/(used in) investing activities		(8 634)	5 973
FINANCING ACTIVITIES			
Proceeds from the issuance of share capital		-	13 800
Dividends paid		(29 163)	(10 822)
Net cash from/(used in) financing activities		(29 163)	2 978
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents		(381 872)	66 914
Cash and cash equivalents at beginning of the period		235 754	168 840
Cash and cash equivalents at end of the period		(146 118)	235 754
ADDITIONAL INFORMATION			
Interest received	3	189 133	152 732
Interest paid	3	(122 714)	(95 828)
Dividend received		956	26
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash and cash balances with central banks		124 624	176 853
Loans and advances to banks repayable on demand and term loans to banks < 3 months		59 776	111 575
Deposits from banks repayable on demand and redeemable at notice (reclassified)		(330 518)	(52 674)
Total cash and cash equivalents (reclassified)*		(146 118)	235 754

*More details related to the change in the definition of cash and cash equivalents can be found under heading 2.3 Changes in accounting policies.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

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

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

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – GENERAL

Kereskedelmi és Hitelbank Zrt. ("the Bank") is a limited liability company incorporated in the Republic of Hungary. K&H Bank and its subsidiaries ("the Group") provide a full range of banking services through a nation-wide network of 231 branches. K&H Bank's registered office is at Vigadó tér 1, Budapest.

The parent company of K&H 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 consolidated 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 amortized cost, are adjusted to record changes in fair value attributable to the risk that are being hedged.

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

2.1.1 Statement of compliance

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

Effective 1 January 2005, the change in the Hungarian Accounting Act allows the Group to prepare its consolidated financial statements in accordance with IFRS that have been adopted by the EU. At this particular time, due to the endorsement process of the EU, and the activities of the Group, there is no difference in the policies applied by the Group between IFRS and IFRS that have been adopted by the EU.

Certain accounting principles prescribed for statutory purposes are different from IFRS. In order to present the financial position and results of operations of the Group in accordance with IFRS certain adjustments have been made to the Group's Hungarian consolidated statutory accounts. Details on these adjustments are presented in note 34.

2.1.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and all entities it controlled as at 31 December 2008. The Bank and the entities which it controls are referred to collectively as "the Group". Control is presumed to exist where the Bank holds, directly or indirectly, more than 50% of the registered capital or where the Bank can exercise more than 50% of the voting rights or where the Bank can appoint or dismiss a majority of the members of the Board of Directors. The effects of all material intercompany balances and transactions are eliminated.

An investment in an associate is one in which the Bank holds, directly or indirectly, 20% to 50% of the voting rights and over which the Group exercises significant influence but which it does not control. Associates are accounted for under the equity method of accounting, and the pro-rata share of their income (loss) is included in the consolidated income statement. The Group's interest in an associate is carried in the balance sheet at an amount that reflects its share of the net assets of the associate.

NOTE 2 – ACCOUNTING POLICIES (continued)

Joint ventures are companies where the Bank and another party exercise joint control. Joint ventures are accounted for using the proportionate consolidation method.

A list of subsidiary and associated companies is provided in Note 32.

2.2 Significant accounting judgements and estimates

In the process of applying the Group's accounting policies, Management has used its judgements and made estimates in determining the amounts recognized in the consolidated 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 consolidated balance sheet 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.

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

The Group regularly reviews its loans and receivables its commitments and contingent liabilities to assess impairment. The Group 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 Group 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 group. 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.

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 25 for further details.

Allowance for impairment of available-for-sale investments

The Group treats available-for-sale investments as impaired if the fair value is significantly and permanently lower than the cost of the instrument or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires judgement. "Significant" means generally 15% or more and "permanent" means more than 1 year.

Deferred tax assets

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies

Cash and cash equivalents

The definition of cash and cash equivalents has been changed in comparison with the definition used in consolidated financial statements prepared in the previous years. Treasury bills maturing in less than 90 days are excluded from cash and cash equivalents, but deposits from other banks repayable on demand decrease the balance of cash and cash equivalents. This change makes the Group's Consolidated Financial Statement more consistent with the Financial Statements prepared by the parent company.

Changes in IFRSs

The International Accounting Standards Board (IASB) has issued new accounting Standards and has introduced numerous changes to the Standards that became effective in 2008.

The changes in accounting policies result from adoption of the following new or revised standards:

IFRS 7 Financial Instruments: Disclosures;
IAS 39 Financial Instruments: Recognition and Measurement;
IFRIC 11 IFRS 2 - Group and Treasury Share Transactions;
IFRIC 12 Service Concession Arrangements;
IFRIC 14 IAS 19 - The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Where transition provisions in IFRSs adopted give an entity a choice of whether to apply the new standard prospectively or retrospectively the Group has elected to apply the standard prospectively from the date of transition.

The principal effects of these changes are as follows:

IFRS 7 Financial Instruments: Disclosures
IAS 39 Financial Instruments: Recognition and Measurement

An amendment to the Standards, issued in October 2008, permits an entity to reclassify non-derivative financial assets out of the fair value through profit or loss category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category a financial asset that would have met the definition of loans and receivables.
The amendment has had no major impact on the consolidated financial statement, because the bank had not reclassified any financial instruments due to the particular circumstances of current crisis.

IFRIC 11 IFRS 2—Group and Treasury Share Transactions

IFRIC interpretation 11 requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity.
The interpretation has had no major impact on the consolidated financial statement.

IFRIC 12 Service Concession Arrangements

IFRIC interpretation 12 outlines an approach to account for contractual arrangements arising from entities providing public services. It provides that the operator should not account for the infrastructure as property, plant and equipment, but recognise a financial asset and/or an intangible asset.
As the Group does not provide public services, this interpretation has had no impact on the consolidated financial statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRIC 14 IAS 19 - The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

IFRIC interpretation 14 gives detailed guidance on the registration of post-employment and other long-term defined employee benefit plans.
The interpretation has had no major impact on the consolidated financial statement.

2.4 Summary of significant accounting policies

2.4.1 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 balance sheet. 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.

2.4.2 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 amortized 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 Group determines the classification of its financial instruments after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

2.4.2.1 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.

2.4.2.2 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 and loss subsequently measured at fair value, whereby in case of interest-bearing assets the change of the difference between the fair value and the amortized cost is recorded in the consolidation income statement as net gains from financial instruments at fair value. 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 consolidation income statement as net gains from financial instruments at fair value.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2.3 Derivatives

The Group 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 balance sheet.

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.

At inception of the hedge relationship, the Group 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 each month. 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 Group 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 gain or loss from remeasuring the hedging instrument to fair value is recognized immediately in the consolidated income statement. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognized in the consolidated 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 equity in the cash flow hedge reserve and the ineffective portion is recognized in the consolidated income statement. The gains or losses on effective cash flow hedges recognized initially in equity are either transferred to the consolidated income statement in the period in which the hedged transaction impacts the consolidated 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 consolidated 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 equity remains in equity until the forecasted transaction occurs, when it is than transferred to the consolidated 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 consolidated 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 consolidated income statement in net gains from financial instruments at fair value.

NOTE 2 – ACCOUNTING POLICIES (continued)

The Group 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.

2.4.2.4 Financial assets and financial liabilities measured at amortized cost

2.4.2.4.1 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 amortized cost using the effective interest method. Gains and losses are recognized in the consolidated income statement when the loans and receivables are derecognized or impaired, as well as through the amortisation process.

2.4.2.4.2 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 amortized cost, less amounts repaid. Amortized cost is calculated by taking into account any discount or premium on settlement. Premiums and discounts are amortized on a systematic basis to maturity using the effective interest method and taken to interest expense. For liabilities carried at amortized cost (which are not part of a hedging relationship), any gains or losses from revaluation to fair value are recognized in the consolidated income statement when liability is derecognized or impaired.

2.4.2.4.3 Held-to-maturity instruments

Non-derivative financial instruments with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group 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 amortized 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 and points 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 amortized cost, gains and losses are recognized in the consolidated income statement when the instruments are derecognized or impaired, as well as through the amortisation process.

The Group is not allowed to classify any financial assets as held to maturity if the entity 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 (for example, 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 entity 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 entity's control, is non-recurring and could not have been reasonably anticipated by the entity.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2.5 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 amortized 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 equity is included the consolidated income statement. However, interest calculated using the effective interest method is recognized in the consolidated income statement.

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 balance sheet 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 besides publicly traded investment notes on fair value 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.

2.4.3 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 consolidated balance sheet 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 consolidated balance sheet, as the Group 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.

2.4.4 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 balance sheet 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 balance sheet, 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 from financial instruments at fair value.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.5 Allowances for impairment of financial assets

The Group assesses at each balance sheet 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.

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

2.4.5.1 Financial assets measured at amortized cost

The Group 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 amortized 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 consolidated 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 amortized 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 Group'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 consolidated income statement, to the extent that the carrying value of the asset does not exceed its amortized 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 consolidated income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.5.2 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 consolidated income statement, is transferred from equity to the consolidated income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognized in the consolidated income statement. Reversals of impairment losses on debt instruments are reversed through the consolidated income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss were recognized in the consolidated 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.

2.4.5.3 Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. Once the terms of a restructured loan have been renegotiated, the loan is no longer considered past due.

2.4.6 Offsetting

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

2.4.7 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 Group 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 Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group 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 Group’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 Group could be required to repay.

2.4.8 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 consolidated income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.9 Leases

Determination of whether an arrangement contains a lease

The determination of wether 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.

2.4.9.1 Where the Group is the lessee

Finance leases, which effectively transfer to the Group 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 consolidated 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 consolidated income statement on a straight-line basis over the lease term.

2.4.9.2 Where the Group is the lessor

When assets held are subject to a finance lease, the present value of lease payments and the unguaranteed residual value is 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 balance sheet and lease payments received are presented as income in the consolidated income statement.

2.4.10 Revenue recognition

Interest income and fees related to financial instruments are recognized as part of the effective interest of the instrument, other fees receivable or payable are recognized when earned. Dividend income is recognized when the right to receive payment is established.

2.4.11 Net gains from financial instruments at fair value

Net gains from financial instruments at fair value 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.

2.4.12 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.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.13 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	5-20 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 consolidated income statement as incurred. The Group 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 Group 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.

2.4.14 Intangible assets

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

2.4.15 Commitments, contingent liabilities

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

Financial guarantees are initially recognized in the consolidated financial statement at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group liability under each guarantee is measured at the higher of the amortized 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 'Provision for possible loan and commitment losses'. The premium received is recognized in the consolidated income statement in 'Net fee and commission income' on a straight line basis over the life of the guarantee.

NOTE 2 – ACCOUNTING POLICIES (continued)

The allowance for losses on commitments and contingent liabilities reflects Managements 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.

2.4.16 Provisions

Provisions are recognized when the Group 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.

2.4.17 Taxation

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

Deferred taxation is provided using the liability 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 balance sheet date.

2.4.18 Fiduciary assets

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

2.4.19 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.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

2.4.20 Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the net realisable value of the loans and advances and the current fair value of such assets. Gains or losses on disposal, and unrealised losses on revaluation, are recognized in the consolidated income statement.

2.5 Future changes in accounting policies

IFRSs and IFRIC interpretations not yet effective

The Group has not applied the following IFRSs and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that have been issued but are not yet effective:

Amendment to IFRS 2 Share-based Payment

The amended refers to vesting conditions and cancellations. An entity shall apply the amendments retrospectively in annual periods beginning on or after 1 January 2009.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRS 3 Business Combinations (revised)

The objective of this IFRS is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statement about a business combination and its effects.
The revised IFRS 3 shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted.

IFRS 8 Operating Segments

IFRS 8 sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.
The standard is effective for annual periods beginning on or after 1 January 2009. This new standard replaces IAS 14 Segment Reporting and adopts a management approach to segment reporting.

IAS 1 Presentation of Financial Statements (revised)

IAS 1 sets overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main objective of the International Accounting Standards Board (IASB) in revising IAS 1 was to aggregate information in the financial statements on the basis of shared characteristics.
An entity shall apply the revised Standard for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

IAS 23 Borrowing Cost (revised)

A revised IAS 23 Borrowing costs was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Bank [Group] will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

Amendment to IAS 27 Consolidated and Separate Financial Statements

In 2008 the Standard was amended as part of the second phase of the business combinations project. The amendments related, primarily, to accounting for non-controlling interests and the loss of control of a subsidiary.
An entity shall apply the amendments to IAS 27 made in 2008 for annual periods beginning on or after 1 July 2009. Earlier application is permitted.

Amendment to IAS 32 and IAS 1 – Puttable Financial Instruments and Obligations Arising on Liquidation

In February 2008 the IASB amended IAS 32 and IAS 1 by requiring some financial instruments that meet the definition of a financial liability to be classified as equity.
Entities should apply the amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

Amendment to IFRS 1 and IAS 27 – Cost of an Investment in a subsidiary, Jointly Controlled Entity or Associate

The amendment was issued in May 2008. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRIC 13 Customer Loyalty Programmes

IFRIC interpretation 13 gives a specific guidance on how entities should account for the awards offered to customers in customer loyalty programmes. The entity's obligation to provide free or discounted goods or services ('awards') must be recognised and measured by allocating some of the consideration received or receivable from the sales transaction to the award credits and deferring the recognition of revenue, and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the 'initial sale').
Effective for annual periods beginning on or after 1 July 2008.

IFRIC 15 Agreements for the Construction of Real Estate

The Interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.
An entity shall apply the Interpretation for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

IFRIC 16 Hedges of a Net Investment in a Foreign Operation

The Interpretation applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with IAS 39.
An entity shall apply the Interpretation for annual periods beginning on or after 1 October 2008. Earlier application is permitted.

The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group's consolidated financial statements in the period of initial application.

2.6 Reclassification

Certain comparative information has been reclassified in these accounts for presentation purposes.

Reclassifications in the consolidated balance sheet

In the consolidated balance sheet reclassifications were made to align with KBC Group reporting standards. The coherency between the previously reported and the new form is illustrated in the following tables (in million HUF).

Form of Balance Sheet as at 31 December 2007 / Form of Balance Sheet as at December 2008	Cash and balances with the National bank of Hungary	Trading securities	Financial assets designated at fair value through profit or loss	Balances due from other banks	Derivative financial instruments	Loans to customers	Investment securities	Securities pledged under repurchase agreements	Other assets	Current tax assets	Deferred tax assets	Investments in associates	Intangible assets	Bank premises and equipments	Total assets
ASSETS															
Cash and cash balances with central banks	176 853														176 853
Financial assets															2 172 570
Held for trading		42 177			27 885										70 062
Designated at fair value through profit or loss			11 065												11 065
Available for sale							335 370	30 994							366 364
Loans and receivables				194 495		1 528 672									1 723 167
Hedging derivatives					1 912										1 912
Tax assets															2 973
Current tax assets										2 658					2 658
Deferred tax assets											315				315
Investments in associated companies												2 065			2 065
Property and equipment														28 649	28 649
Other intangible assets													5 015		5 015
Other assets									33 525						33 525
TOTAL ASSETS	176 853	42 177	11 065	194 495	29 797	1 528 672	335 370	30 994	33 525	2 658	315	2 065	5 015	28 649	2 421 650

Form of Balance Sheet as at 31 December 2007 / Form of Balance Sheet as at December 2008	Trading liabilities	Financial liabilities designated at fair value through profit or loss	Balances due to banks	Derivative financial instruments	Deposits and certificates of deposits	Refinancing credits	Other liabilities	Current tax liability	Deferred tax liability	Provision	Subordinated debt	Share capital	Share premium	Statutory risk reserve	Available for sale reserve	Cash flow reserve	Accumulated profit	Total liabilities and equity
LIABILITIES AND EQUITY																		
Financial liabilities																		2 104 526
Held for trading	5 824			24 123														29 947
Designated at fait value through profit or loss		110 909																110 909
Measured at amortised cost			390 767		1 361 294	191 593					19 855							1 963 509
Hedging derivatives				161														161
Tax liabilities																		2 620
Current tax liabilities								132										132
Deferred tax liabilities									2 488									2 488
Provisions for risks and charges										28 725								28 725
Other liabilities							78 569											78 569
TOTAL LIABILITIES																		2 214 440
Total equity												66 307	48 775	9 358	(942)	1 373	82 339	207 210
TOTAL LIABILITIES AND EQUITY	5 824	110 909	390 767	24 284	1 361 294	191 593	78 569	132	2 488	28 725	19 855	66 307	48 775	9 358	(942)	1 373	82 339	2 421 650

NOTE 2 – ACCOUNTING POLICIES (continued)

Reclassifications in the consolidated balance sheet (continued)

Fixed rate corporate bonds and listed equity instruments reported as available for sale financial assets in previous year were reclassified to held for trading financial assets and financial assets at fair value through profit or loss in order to correspond with the treasury policy of KBC group. The retrospective reclassification of the assets presented below ensures the consistency between the reported periods:

	As previously reported 2007	Reclassification of fixed rate corporate bonds	Reclassification of listed equity instruments	Reclassified 2007
	MHUF	MHUF	MHUF	MHUF
Financial assets				
Held for trading	70 602	-	4 012	74 074
Designated at fair value through profit or loss	11 065	1 044	-	12 109
Available for sale	366 364	(1 044)	(4 012)	361 308

The effect of the above mentioned reclassifications considering the consolidated result of the previous year is immaterial and it doesn't distort the consistency, therefore the consolidated income statement was not modified.

Reclassifications in the consolidated income statement

Certain expenses recorded previously as general administrative expenses were reclassified to fee and commission expenses in 2008. The mentioned expenses amounted to HUF 2 407 million in 2008 (HUF 1 456 million in 2007).

Reclassifications resulting from changes in the definition of cash and cash equivalents

More details related to the change in the definition of cash and cash equivalents can be found under heading 2.3 Changes in accounting policies.

NOTE 3 – NET INTEREST INCOME

	2008 MHUF	2007 MHUF
Loans and receivables	142 766	126 360
Held-to-maturity investments	-	1 234
Available-for-sale assets	36 770	22 500
Subtotal, interest income from financial assets not measured at fair value through profit or loss	179 536	150 094
of which: impaired financial assets	*600*	*515*
Financial assets held for trading	8 766	2 064
Other financial assets at fair value through profit or loss	831	574
Total interest income	189 133	152 732
Financial liabilities measured at amortised cost	(113 396)	(89 323)
Financial liabilities held for trading	(30)	(209)
Other financial liabilities at fair value through profit or loss	(9 288)	(6 296)
Total interest expenses	(122 714)	(95 828)
Net interest income	66 419	56 904

NOTE 4 – NET FEE AND COMMISSION INCOME

	2008 MHUF	Reclassified 2007 MHUF
Brokerage services	670	882
Trust and fiduciary activities	6 876	6 979
Credit and guarantee fee income	4 318	4 136
Structured finance	271	582
Payment services	20 153	19 851
Card services	10 708	9 655
Other	933	1 009
Fee and commission income	43 929	43 094
Brokerage services	(640)	(536)
Credit and guarantee fee expense	(1 628)	(1 417)
Commissions to agents	(234)	(482)
Payment transactions (reclassified)	(5 754)	(4 607)
Card services (reclassified)	(5 987)	(5 135)
Insurance services	(2 022)	(1 616)
Other (reclassified)	(870)	(722)
Fee and commission expense	(17 135)	(14 515)
Net fee and commission income	26 794	28 579

Front-end fees related to loans and receivables are part of the effective interest rate method calculation and they are recorded as interest income or expenses.

NOTE 5 – NET GAINS FROM FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2008 MHUF	2007 MHUF
Trading securities	1 694	415
Interest rate derivatives (including interest and fair value changes in trading derivatives)	6 097	5 503
Other financial instruments initially recognised at fair value through profit or loss	136	77
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	28 880	26 494
Fair value adjustments in hedge accounting*	699	1 175
Net gains from financial instruments at fair value through profit or loss	37 506	33 664

* Realised results of micro cash flow hedge derivatives amounted to HUF 1 578 million gain in 2008 (HUF 1 175 million gain in 2007). In 2008 the remaining HUF 879 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions.

Net gains from financial instruments at fair value through profit or loss include the fair value changes and the net realised gains of

- derivatives
- held for trading government bonds, treasury bills and listed equity instruments
- other financial instruments at fair value through profit or loss (see note 16),

the interest result on derivatives and the (un)realised gains from foreign currency translation.

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 amounts to HUF 1 510 million in 2008 (immaterial in 2007).

NOTE 6 – NET REALISED GAINS FROM AVAILABLE-FOR-SALE

	2008 MHUF	2007 MHUF
Fixed-income securities	(27)	255
Equity instruments	(22)	305
Net realised gains from available for sale	(49)	560

In 2007 net realised gains from fixed-income available-for-sale securities includes HUF 271 million gains resulting from the sale of government bonds classified as held to maturity before.

NOTE 7 – DIVIDEND INCOME

	2008 MHUF	2007 MHUF
Available-for-sale shares*	956	26

*Of which HUF 954 million is dividend paid by VISA Europe Limited.

NOTE 8 – OTHER NET INCOME

	2008	2007
	MHUF	MHUF
Gain on property, plant and equipment	169	158
Sale of goods	1 342	1 096
Gain on disposal of investments	864	8 664
Gain on other services	847	935
Other	1 725	381
Other net income	4 947	11 234

On 8 January 2007 the Bank signed an agreement for the sale of its 75% owned subsidiary GIRO Bankkártya Zrt. After formally approval of the Hungarian Financial Supervisory Authority, the Bank sold its participation and the control over the company was transferred to the new shareholders on 2 July 2007. The carrying value of HUF 556 million and the selling price of HUF 9 223 million are recorded net in gain on disposal of subsidiaries. The sale was financially completed in 2007; disposal consideration affected exclusively the Group's cash and cash equivalents.

In 2008 the Bank realised HUF 907 million gains on sale of its shares in Mastercard International which was recorded as gain on disposal of investments.

Gains resulting from services provided by K&H Csoportszolgáltató Kft. are presented as gain on other services. Other income contains HUF 965 million compensation income for covering the contributory expenses of the fraud occurred at K&H Equities (excluding the payments to clients).

NOTE 9 – PERSONNEL

	2008	2007
White-collar staff	3 868	3 902
Blue-collar staff	6	6
Management	6	6
Total average number of persons employed	3 880	3 914

NOTE 10 – IMPAIRMENT(income statement)

	2008	2007
	MHUF	MHUF
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for on-balance-sheet lending	(12 700)	(9 811)
Specific provisions for off-balance-sheet credit commitments	2 640	(3 511)
Portfolio-based impairments and provisions	2 301	2 484
Total impairments and provisions on loans and receivables and credit commitments	(7 759)	(10 838)

NOTE 10 – IMPAIRMENT (income statement) (continued)

	2008	2007
	MHUF	MHUF
Impairment on other available-for-sale assets	2	(209)

Impairment on other available-for sale assets includes HUF 212 million impairment loss on fixed rate corporate bonds in 2007, which are classified as financial assets at fair value through profit or loss in 2008 (see reclassifications in Note 2).

	2008	2007
	MHUF	MHUF
Impairment on other		
Property and equipment	(51)	(7)
Other	(4)	(553)
Total impairment on other	(55)	(560)

In 2007 most of the other impairments were recorded on other receivables classified as other assets in the consolidated balance sheet.

NOTE 11 – SHARE IN THE RESULTS OF ASSOCIATED COMPANIES

	2008	2007
	MHUF	MHUF
Giro Elszámolásforgalmi ZRt.	552	455
Budatrend III. Ingatlanhasznosító ZRt.	2	145
HAGE Zrt.	33	-
K&H ITS Kft.	-	(3)
Share of the profit of associates	587	597

The impairment made on HAGE ZRt. was a HUF 24 million gain in 2008 (HUF 93 million loss in 2007). The current year’s result and the impairment of the associates are recorded net in share in the result of associated companies.

NOTE 12 – INCOME TAXES

The components of income tax expense for the year ended 31 December 2008 and 2007 are:

	2008	2007
	MHUF	MHUF
Statutory income tax expense	(6 848)	(7 979)
Local tax expense	(4 586)	(3 727)
Deferred taxes on income	(4 253)	(1 603)
Income tax expense	(15 687)	(13 309)

Statutory income tax expense

In 2008, corporate income tax is payable at 16% (16% in 2007) on taxable statutory profits, and an additional 4% solidarity tax is payable on taxable statutory profit.

Local taxes are presented as income tax expense for IFRS purposes, considered their non-turnover character.

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 five years after the period to which they relate. Consequently, the Group 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 2005. Management is not aware of any additional significant unaccrued potential tax liability which might arise relating to years not audited by the tax authorities.

Reconciliation of the total tax charge

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

	2008	2007
	MHUF	MHUF
Profit before tax	41 670	49 856
Income tax rate	21.6%	21.6%
Income tax calculated	(9 001)	(10 769)
Plus/minus tax effects attributable to:		
Tax-free income	2 315	295
Adjustments, opening balance of deferred taxes due to change in tax rate	-	(138)
Unused tax losses and tax credits to reduce deferred tax expense	169	-
Reversal of previously recognised deferred tax on unused tax losses and tax credits	(4)	-
Non-deductible expenses	(9 344)	(2 713)
Other	178	16
Total tax effects	(6 686)	(2 540)
Income tax expense (income tax calculated + total tax effects)	(15 687)	(13 309)

*The 20% of statutory income tax rate was modified, because local taxes are presented as income taxes in the consolidated income statements, which causes and increase of about 1.6% in the statutory income tax rate.

The effective income tax rate for 2008 is 37.65% (2007: 26.69%).

NOTE 13 – EARNINGS PER SHARE

Earnings per share is the profit attributable to shareholders of the Group divided by the weighted average number of shares outstanding during the period, excluding treasury shares. There were no other potentially dilutive securities in existence at 31 December 2008 and 2007. The following amounts were used in the calculation of earnings per share:

	2008	2007
Net profit attributable to shareholders (MHUF)	25 983	36 547
Weighted average shares outstanding (in millions)	66 307	54 624
Earnings per share (HUF)	0.39	0.67

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2008							
Loans and advances to credit institutions and investment firms*	-	-	-	99 817	-	-	99 817
of which reverse repos	-	-	-	*22 307*	-	-	*22 307*
Loans and advances to customers	-	2 430	-	1 754 969	-	-	1 757 399
Discount and acceptance credit	-	-	-	119	-	-	119
Consumer credit	-	-	-	115 237	-	-	115 237
Mortgage loans	-	-	-	673 343	-	-	673 343
Term loans	-	2 430	-	779 220	-	-	781 650
Finance leasing	-	-	-	55 969	-	-	55 969
Current account advances	-	-	-	116 586	-	-	116 586
Other	-	-	-	14 495	-	-	14 495
Equity instruments	7 312	-	1 313	-	-	-	8 625
Debts instruments issued by	134 409	6 981	883 013	-	-	-	1 024 403
Public bodies	134 409	6 903	880 646	-	-	-	1 021 958
Credit institutions and investment firms	-	-	542	-	-	-	542
Corporates	-	78	1 825	-	-	-	1 903
Derivatives	86 546	-	-	-	1 039	-	87 585
Total carrying value	228 267	9 411	884 326	1 854 786	1 039	-	2 977 829

*From the total balance of loans and advances to credit institutions and investment firms HUF 59 776 is repayable on demand or maturing in less than 90 days.

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading (reclassified)	Designated at fair value through profit or loss (reclassified)	Available for sale (reclassified)	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2007							
Loans and advances to credit institutions and investment firms*	-	-	-	194 495	-	-	194 495
of which reverse repos	-	-	-	*40 053*	-	-	*40 053*
Loans and advances to customers	-	2 615	-	1 528 672	-	-	1 531 287
Discount and acceptance credit	-	-	-	114	-	-	114
Consumer credit	-	-	-	104 863	-	-	104 863
Mortgage loans	-	-	-	499 902	-	-	499 902
Term loans	-	2 615	-	732 582	-	-	735 197
Finance leasing	-	-	-	52 395	-	-	52 395
Current account advances	-	-	-	122 531	-	-	122 531
Other	-	-	-	16 285	-	-	16 285
Equity instruments (reclassified)	4 012	-	1 056	-	-	-	5 068
Debts instruments issued by	42 177	9 494	360 252	-	-	-	411 923
Public bodies	42 177	5 172	359 710	-	-	-	407 059
Credit institutions and investment firms	-	-	542	-	-	-	542
Corporates (reclassified)	-	4 322	-	-	-	-	4 322
Derivatives	27 885	-	-	-	1 912	-	29 797
Total carrying value	74 074	12 109	361 308	1 723 167	1 912	-	2 172 570

*From the total balance of loans and advances to credit institutions and investment firms HUF 111 575 is repayable on demand or maturing in less than 90 days.

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2008							
Deposits from credit institutions and investment firms*	-	-	-	-	-	778 508	778 508
of which repos	-	-	-	-	-	*7 946*	*7 946*
Deposits from customers and debt certificates	-	133 563	-	-	-	1 880 399	2 013 962
Deposits from customers	-	132 427	-	-	-	1 859 543	1 991 970
Demand deposits	-	-	-	-	-	386 047	386 047
Time deposits	-	132 427	-	-	-	1 473 496	1 605 923
Debt certificates	-	1 136	-	-	-	20 856	21 992
Certificates of deposits	-	-	-	-	-	292	292
Non-convertible bonds	-	1 136	-	-	-	-	1 136
Non-convertible subordinated liabilities	-	-	-	-	-	20 564	20 564
Derivatives	90 652	-	-	-	3 017	-	93 669
Short positions	2 343	-	-	-	-	-	2 343
In debt instruments	2 343	-	-	-	-	-	2 343
Other	-	-	-	-	-	1 883	1 883
Total carrying value	92 995	133 563	-	-	3 017	2 660 790	2 890 365

*Of which HUF 330 518 million is deposits from banks repayable on demand.

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2007							
Deposits from credit institutions and investment firms*	-	-	-	-	-	531 063	531 063
of which repos	-	-	-	-	-	*30 814*	*30 814*
Deposits from customers and debt certificates	-	110 909	-	-	-	1 432 446	1 543 355
Deposits from customers	-	105 792	-	-	-	1 412 132	1 517 924
Demand deposits	-	-	-	-	-	348 396	348 396
Time deposits	-	105 792	-	-	-	1 063 736	1 169 528
Debt certificates	-	5 117	-	-	-	20 314	25 431
Certificates of deposits	-	-	-	-	-	455	455
Non-convertible bonds	-	5 117	-	-	-	4	5 121
Non-convertible subordinated liabilities	-	-	-	-	-	19 855	19 855
Derivatives	24 123	-	-	-	161	-	24 284
Short positions	5 824	-	-	-	-	-	5 824
In debt instruments	5 824	-	-	-	-	-	5 824
Total carrying value	29 947	110 909	-	-	161	1 963 509	2 104 526

*Of which HUF 52 674 million is deposits from banks repayable on demand.

Details of financial instruments

Repo and reverse repo agreements

Under reverse repo transactions, the Group 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. The fair value of securities accepted as collateral in connection with reverse repo transactions as at 31 December 2008 was HUF 22 792 million, of which HUF 2 343 million (reported as short positions in the consolidated balance sheet) has been sold (31 December 2007 HUF 40 038 million and HUF 5 824 million respectively).

The carrying amount of Hungarian government bonds pledged as collateral for repo liabilities amounted to HUF 8 028 as at 31 December 2008 (HUF 30 994 as at 31 December 2007).

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

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Equity and debt instruments

The breakdown of the held for trading and available-for-sale portfolio is presented in the tables below.

	2008 MHUF	2007 MHUF
Held for trading		
Treasury bills	56 684	881
Government bonds	77 724	41 296
Listed equity instruments	7 312	4 012
Total trading securities	141 720	46 189

	2008 MHUF	2007 MHUF
Available for sale		
Treasury bills	126 879	289
Consolidation bonds issued in HUF	112 605	112 512
Other government bonds issued in HUF	600 585	227 560
Bonds issued by municipality - issued in HUF	28 591	15 800
Bonds issued by municipality - issued in foreign currency	11 947	3 549
Other bonds – listed issued in HUF	2 367	542
Other bonds – unlisted issued in HUF	39	-
Unlisted equity instruments	1 313	1 056
Total available for sale	884 326	361 308

In 2007 the Group reclassified all financial assets included in held to maturity portfolio as available-for-sale.

The difference between the fair value and the amortized cost of the financial assets classified as held to maturity before was a loss of HUF 1 247 million, which was recorded directly in the equity.

Consolidation bonds were acquired as part of the 1992-1994 consolidation programs. These bonds expire in 2013 and 2014, bear a market rate of interest equivalent to the State of Hungary's treasury bill rates and reprice annually or semi-annually. As there is not yet a liquid market for these instruments in Hungary they are carried at amortized historical cost. As they are repriced regularly Management believe that amortized historical cost is the most appropriate estimation of their fair value.

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Available-for-sale equity instruments contain as at 31 December 2008 unlisted equity instruments in a value of HUF 887 million (HUF 649 million at the end of 2007) which fair value can not be measured reliably. These investments are not traded on active markets. Management believes that the carrying value of these investments approximates their fair value.

These available-for-sale investments contain long term investments in companies where the Group does not have significant influence therefore they were not consolidated neither as subsidiary nor through equity consolidation.

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

	2008 MHUF	2007 MHUF
Hitelgarancia ZRt.	640	640
VISA Inc.	238	-
SWIFT S.C.	9	9
	887	649

The table does not contain Mastercard International and Risk Kft., because they are fully impaired as at the end of 2008 and 2007, and does not contain VISA Europe Limited due to immateriality.

Underlying the definition of fair value is the presumption that the Group 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.

Refinancing credits

The Bank has entered into several refinancing credit facilities with financial institutions (such as the EBRD and World Bank, FHB – Mortgage Bank) and central government 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. At 31 December 2008, Management believes that the Bank is in compliance with all significant covenants.

	2008 MHUF	2007 MHUF
Refinancing credits	200 813	191 593

NOTE 14 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Non-convertible subordinated liabilities

	2008 MHUF	2007 MHUF
Subordinated loan from KBC Group	15 834	15 141
Bonds issued to the State	4 714	4 714
	20 548	19 855

In June 2006, the Group borrowed EUR 60 million of subordinated debt from KBC Bank N.V. Dublin branch, a member of the KBC Group. The loan matures on 30 June 2016 and bears a variable interest rate of 3 month-EURIBOR plus 0.55 percent per annum.

The Bank also issued subordinated debt in the form of bonds to the State in December 1994 and bought long-term state bonds from the proceeds. Interest on the bonds issued is the same as on the state bonds acquired. Both securities mature in 2014.

NOTE 15 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The table below presents information concerning the fair value of financial assets and liabilities for year 2008:

	Quoted market price MHUF	Valuation techniques - market observable inputs MHUF	Valuation techniques - non market observable inputs MHUF	Total carrying amount MHUF	Recognised in profit or loss - non market observable inputs MHUF	Fair value MHUF	Unrecognised gain/(loss) MHUF
Financial assets							
Held for trading	141 720	64 609	21 938	228 267	21 885	228 267	-
Designated at fair value through profit or loss	-	9 333	78	9 411	(4 558)	9 411	-
Available for sale	729 831	113 958	40 538	884 326	-	884 326	-
Loans and receivables	-	-	-	1 854 786	-	1 854 772	(14)
Hedging derivatives	-	1 039	-	1 039	-	1 039	-
Total financial assets	871 551	188 939	62 554	2 977 829	17 327	2 977 815	(14)
Financial liabilities							
Held for trading	2 343	68 647	22 005	92 995	(21 952)	92 995	-
Designated at fair value through profit or loss	-	133 467	96	133 563	3 115	133 563	-
Measured at amortised cost	-	-	-	2 660 790	-	2 660 771	(19)
Hedging derivatives	-	3 017	-	3 017	-	3 017	-
Total financial liabilities	2 343	205 131	22 101	2 890 365	(18 837)	2 890 346	(19)

NOTE 15 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The table below presents information concerning the fair value of financial assets and liabilities for year 2007:

	Quoted market price	Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs	Total carrying amount	Recognised in profit or loss - non market observable inputs	Fair value	Unrecognised gain/(loss)
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
Held for trading (reclassified)	46 189	26 483	1 402	74 074	1 315	74 074	-
Designated at fair value through profit or loss (reclassified)	-	7 787	4 322	12 109	(459)	12 109	-
Available for sale (reclassified)	228 391	113 568	19 349	361 308	-	361 308	-
Loans and receivables	-	-	-	1 723 167	-	1 723 136	(31)
Hedging derivatives	-	1 912	-	1 912	-	1 912	-
Total financial assets	274 580	149 750	25 073	2 172 570	856	2 172 539	(31)
Financial liabilities							
Held for trading	5 824	22 726	1 397	29 947	(1 310)	29 947	-
Designated at fair value through profit or loss	-	107 697	3 212	110 909	509	110 909	-
Measured at amortised cost	-	-	-	1 963 509	-	1 963 280	(229)
Hedging derivatives	-	161	-	161	-	161	-
Total financial liabilities	5 824	130 584	4 609	2 104 526	(801)	2 104 297	(229)

NOTE 15 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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 regulatory published price quotations are marked to market. Treasury bills, government bonds, other listed bonds and listed equity instruments belong to this category.

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. 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 Group 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 is used in case of exotic derivatives, fixed rate corporate bonds and issued bonds linked to these bonds, where the normal valuation technique is adjusted with credit spread. During the fair value calculation of municipality bonds, the Group adjusts the normal valuation technique with liquidity spread.

Consolidation bonds classified as available for sale do not have observable market prices. As the interest rate of these securities follows the market rate for treasury bills and they reprice regularly the carrying value approximates their fair value.

Financial instruments at amortized cost

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

Assets and liabilities for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having 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, variable rate financial instruments.

Loans with a net book value of HUF 42 billion (HUF 52 billion at 31 December 2007), a portion of which is at fixed rate, are refinanced through facilities with the FHB on substantially the same terms and conditions. As such any difference in the fair values from the carrying value will be largely offset by a corresponding variance between the carrying value and the fair value of refinancing credits that were used to finance the loans.

Unrecognised gain / (loss) of loans to customers does not include the fair value adjustments of these refinanced customer loans.

Fixed rate financial instruments

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

The estimated fair value of fixed interest bearing assets with more than one year remaining maturity (carried at amortized 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.

NOTE 16 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2008	Reclassified 2007
	MHUF	MHUF
Financial assets designated at fair value through profit or loss		
Government bonds issued in foreign currencies	6 903	5 172
Corporate bonds – unlisted issued in HUF (reclassified)	-	501
Corporate bonds – unlisted issued in foreign currency (reclassified)	78	3 821
Loans to customers	2 430	2 615
	9 411	12 109

	2008	2007
	MHUF	MHUF
Financial liabilities designated at fair value through profit or loss		
Term deposits:		
- retail	2 657	5 390
- corporate	2 490	9 087
- investment funds	127 280	91 315
Issued bonds designated at fair value due to accounting mismatch	96	3 212
Other issued bonds	1 040	1 905
	133 563	110 909

Included in financial assets designated at fair value through profit or loss are fixed rate government bonds and a corporate loan which are economically hedged by interest derivatives starting from the acquisition.

The changes in the fair value of loans designated at fair value through profit or loss recognised due to credit risk in the consolidated income statement is immaterial in years 2008 and 2007.

The maximum credit risk exposure of the loan designated at fair value through profit or loss is its gross fair value, which was HUF 2 430 million as at 31 December 2008 (HUF 2 615 million as at 31 December 2007).

In 2007 the Bank established a bond issuance program.

The Bank, as issuer sells dematerialised bonds via public placement, denominated in HUF, EUR and USD. The maturities are between 60 days and 20 years.

The Bank issues a wide range of bonds, the interest rate can be fixed or floating, linked to index (equity, currency, commodity), or credit linked.

Upon initial recognition the bonds are designated by the bank as at fair value through profit or loss. The reason behind the way of measurement

- one part of the issued bonds is linked to purchased bonds which are fixed rate corporate bonds issued in foreign currency. The fair value measurement significantly reduces the valuation inconsistency (the ‘accounting mismatch’) between the assets and the liabilities;
- an other part of the issued bonds are economically hedged by interest rate derivatives which do not achieve the criteria for hedge accounting.

NOTE 16 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

The fair value changes of issued bonds recognised in the consolidated income statement due to credit risk was HUF 3 238 million in 2008 (HUF 497 million in 2007).

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

Based on the Group'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, which do not qualify for hedge accounting.

The fair value changes recognised in the consolidated income statement due to credit risk concerning financial liabilities (excluding issued bonds) were immaterial in years 2008 and 2007.

The amount that the Group would contractually be required to pay at maturity is HUF 5 250 million more than the fair value of the deposits and issued bonds (HUF 443 million more in 2007).

NOTE 17 – IMPAIRMENT ON AVAILABLE FOR SALE FINANCIAL ASSETS

	2008	2007
	MHUF	MHUF
Opening balance	515	518
Movements with an impact on results		
Impairment recognised	-	212
Impairment reversed	(2)	(3)
Movements without an impact on results		
Other	-	(212)
Closing balance	513	515

The impairment of available-for-sale instruments includes impairment losses on unlisted shares and on other bonds issued by foreign companies in 2007.

Impairment loss of HUF 212 million recorded in 2007 relates to fixed rate foreign corporate bonds which were reclassified to financial assets designated at fair value through profit or loss in 2008 retrospectively. The change in the balance of impairment resulting from the reclassification is presented as other movement.

NOTE 18 – IMPAIRMENT ON LOANS AND RECEIVABLES (balance sheet)

	2008 MHUF	2007 MHUF
Breakdown by type		
Specific impairment, on-balance sheet lending	41 647	44 747
Specific provision, off-balance sheet credit commitments	2 898	5 147
Portfolio-based impairment and provision	5 983	8 284
Total impairment and provision on loans and receivables and credit commitments	50 528	58 178

	2008 MHUF	2007 MHUF
Breakdown by counterparty		
Impairment for loans and advances to customers (excluding banks)	46 995	51 757
Specific and portfolio based provision, off-balance-sheet credit commitments	3 533	6 421
Total impairment and provision on loans and receivables and credit commitments	50 528	58 178

	Specific impairment on-balance sheet lending MHUF	Specific provision off-balance-sheet credit commitments MHUF	Portfolio-based impairments and provisions MHUF	Total MHUF
Opening balance as at 1 January 2008	44 747	5 147	8 284	58 178
Movements with an impact on results				
Loan loss expenses	17 973	287	-	18 260
Loan loss recoveries	(5 507)	(2 927)	(2 301)	(10 735)
Interest accrued on impaired loans	234	-	-	234
Discount effect	(316)	388	-	72
Movements without an impact on results				
Write-offs	(16 168)	-	-	(16 168)
Other	684	3	-	687
Closing balance as at 31 December 2008	41 647	2 898	5 983	50 528

NOTE 18 – IMPAIRMENT ON LOANS AND RECEIVABLES (balance sheet - continued)

	Specific impairment on-balance sheet lending	Specific provision off-balance-sheet credit commitments	Portfolio-based impairments and provisions	Total
	MHUF	MHUF	MHUF	MHUF
Opening balance as at 1 January 2007	39 272	1 616	10 768	51 656
Movements with an impact on results				
Loan loss expenses	24 628	4 797	-	29 425
Loan loss recoveries	(14 765)	(1 286)	(2 484)	(18 535)
Interest accrued on impaired loans	(52)	-	-	(52)
Discount effect	(320)	-	-	(320)
Movements without an impact on results				
Write-offs	(3 959)	-	-	(3 959)
Other	(57)	20	-	(37)
Closing balance as at 31 December 2007	44 747	5 147	8 284	58 178

NOTE 19 – DERIVATIVE FINANCIAL INSTRUMENTS

	Period ended 31 December 2008				Year ended 31 December 2007			
	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	146 590	147 259	4 757	(1 517)	141 534	143 321	2 516	(3 254)
Currency swaps	725 394	726 433	19 618	(17 556)	1 121 607	1 118 045	12 050	(9 825)
Currency options	1 049 932	1 050 103	27 157	(27 248)	334 654	334 559	2 011	(1 895)
Total foreign exchange derivatives	1 921 916	1 923 795	51 532	(46 321)	1 597 795	1 595 925	16 577	(14 974)
Interest rate derivatives								
Interest rate swaps	1 690 801	1 690 800	21 935	(14 541)	723 335	723 335	8 550	(3 961)
Cross currency interest rate swaps	690 519	704 536	11 139	(27 888)	212 770	213 538	1 736	(3 896)
Interest rate options	75 992	75 992	161	(161)	9 374	9 374	-	-
Forward rate agreements	401 850	546 193	1 689	(1 574)	508 631	562 846	593	(510)
Total interest rate derivatives	2 859 162	3 017 521	34 924	(44 164)	1 454 110	1 509 093	10 879	(8 367)
Equity options	-	3 653	-	(77)	-	2 805	-	(355)
Commodity swaps	514	514	90	(90)	3 258	3 258	429	(427)
Total derivatives held for trading	4 781 592	4 945 483	86 546	(90 652)	3 055 163	3 111 081	27 885	(24 123)
Derivatives designated as cash flow hedges								
Currency options	31 604	33 067	1 039	(3 017)	46 243	40 086	1 912	(161)
Total derivatives held for hedging	31 604	33 067	1 039	(3 017)	46 243	40 086	1 912	(161)
Total derivative financial instruments	4 813 196	4 978 550	87 585	(93 669)	3 101 406	3 151 167	29 797	(24 284)

NOTE 19 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Options

Although they are not accounted for as hedges, the Group 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.

Derivatives designated as cash flow hedges

Currency options

The Group entered into currency options to cover the foreign currency risk deriving from future currency cash flows of leasing companies of the Group.

In 2008 HUF 1 578 million was transferred from cash flow hedge reserve to "Net gains from financial instruments at fair value" in the consolidated income statement (HUF 1 175 million in 2007).

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

	31 December 2008				31 December 2007			
	Expected cash flows		Discounted cash flows		Expected cash flows		Discounted cash flows	
	Inflow MHUF	Outflow MHUF	Inflow MHUF	Outflow MHUF	Inflow MHUF	Outflow MHUF	Inflow MHUF	Outflow MHUF
< 3 months	20	(52)	20	(51)	317	-	315	-
3-6 months	13	(230)	13	(223)	407	-	396	-
6 months - 1 year	184	(727)	171	(678)	929	(3)	884	(3)
1-2 years	817	(1 819)	721	(1 603)	351	(178)	318	(159)
2-5 years	136	(549)	114	(462)	-	-	-	-
Total	1 170	(3 377)	1 039	(3 017)	2 004	(181)	1 913	(162)

Expected cash flows were changed due to the restriction of the Lease Group's activities in 2008. The Group adjusted the structure of hedging transactions without costs to comply with the new cash flow forecast.

NOTE 20 – OTHER ASSETS

	2008 MHUF	2007 MHUF
Receivables from investment services	1 115	5 782
Prepayments	2 879	338
Trade receivables	843	737
Receivables from employees	34	48
Receivables from bankcard service	3 541	5 235
Items in transit due to payment services	2 931	733
Receivables from compensation (see Note 25)	16 399	8 419
Items in transit due to trading in securities	229	131
Income accruals and cost prepayments	8 615	9 810
Other inventories	1 201	1 396
Other receivables	1 815	896
	39 602	33 525

NOTE 21 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES

The deferred tax included in the balance sheet and changes recorded in the consolidated income statement and equity are as follows:

For the period ended 31 December 2008:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	(113)	(86)	-
Losses carry forward	36	(276)	159	-
Tangibles and intangibles assets	-	(224)	(1)	-
Provisions for risk and charges	(4)	(198)	52	-
Impairment for losses on loans and advances	225	3 437	(1 243)	-
Financial instruments at fair value	-	1 955	(813)	-
Fair value adjustments AFS	-	(2 547)	-	2 286
Cash flow hedge	-	(237)	-	616
Other	(21)	1 962	(2 321)	-
Total	236	3 759	(4 253)	2 902

For the year ended 31 December 2007:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	(199)	(6)	-
Losses carry forward	153	-	(8)	-
Tangibles and intangibles	(172)	(397)	(47)	-
Provisions for risk and charges	-	(142)	330	-
Impairment for losses on loans and advances	286	2 256	(781)	-
Financial instruments at fair value	20	1 162	(954)	-
Fair value adjustments AFS	-	(260)	-	372
Cash flow hedge	-	378	-	(81)
Other	28	(310)	(137)	-
Total	315	2 488	(1 603)	291

Deferred income taxes are calculated on all temporary differences under the asset and liability method using a principal rate of 21.6% (16% corporate income tax, 4% solidarity tax and 1.6% local tax).

According to the Hungarian Tax Law, any operating losses incurred for income tax purposes by the Bank are not eligible for carry forward against future years' income. Deferred income tax for tax loss carry forward is calculated only for non-banking subsidiaries to the extent that realisation of the related tax benefit is assessed as probable. There is no time limitation for the realisation of tax benefit.

It is highly probable that from the total of HUF 2 100 million tax loss carry forward as at 31 December 2008 (HUF 945 million at 31 December 2007), HUF 540 million (HUF 182 million at 31 December 2007) will not be assessed, therefore it is not included in the base of deferred tax calculation. Tax loss carry forward for which tax asset was recognised in the consolidated balance sheet amounted to HUF 1 560 million as at 31 December 2008 (HUF 763 million as at 31 December 2007).

NOTE 22 – INVESTMENTS IN ASSOCIATED COMPANIES

	2008 MHUF	2007 MHUF
GIRO Elszámolásforgalmi Zrt.	1 572	1 383
Budatrend-III Zrt.	98	96
HAGE Zrt.	542	543
K&H ITS Kft. "v.a."	-	43
Total	2 212	2 065

	2008 MHUF	2007 MHUF
Opening balance	2 065	2 068
- Carrying value, transfers, liquidation	(42)	-
- Share in the result for the period	587	597
- Dividends paid	(398)	(600)
- Other movements	-	-
Closing balance	2 212	2 065

NOTE 23 – PROPERTY AND EQUIPMENT

	Land and buildings	IT equipment	Office equipment	Other	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
At 1 January 2007					
Cost	17 978	11 828	10 053	6 069	45 928
Accumulated depreciation	(5 584)	(8 591)	(4 465)	(1 398)	(20 038)
Net book value	12 394	3 237	5 588	4 671	25 890
Movements in 2007					
Additions	2 127	2 583	3 198	1 054	8 962
Disposals - net	(341)	(339)	(47)	(62)	(789)
Impairment charge	(6)	-	-	-	(6)
Depreciation charge	(773)	(2 052)	(2 007)	(457)	(5 289)
Other	(6)	5	11	(129)	(119)
At 31 December 2007					
Cost	19 503	12 655	12 238	6 665	51 061
Accumulated depreciation	(6 108)	(9 221)	(5 495)	(1 588)	(22 412)
Net book value	13 395	3 434	6 743	5 077	28 649
Movements in 2008					
Additions	2 412	540	2 681	2 623	8 256
Disposals - net	(121)	-	(895)	(18)	(1 034)
Impairment charge	-	-	-	(51)	(51)
Depreciation charge	(862)	(1 494)	(2 247)	(851)	(5 454)
Other	-	-	19	-	19
At 31 December 2008					
Cost	21 720	13 694	12 882	9 180	57 476
Accumulated depreciation	(6 896)	(11 214)	(6 581)	(2 400)	(27 091)
Net book value	14 824	2 480	6 301	6 780	30 385

NOTE 24 – OTHER INTANGIBLE ASSETS

	Acquired software MHUF	Other intangible assets MHUF	Total MHUF
At 1 January 2007			
Cost	30 623	481	31 104
Accumulated depreciation	(24 560)	(1)	(24 561)
Net book value	6 063	480	6 543
Movements in 2007			
Additions	1 078	13	1 091
Disposals - net	(4)	-	(4)
Depreciation charge	(2 553)	(28)	(2 581)
Other	(71)	37	(34)
At 31 December 2007			
Cost	31 681	504	32 185
Accumulated depreciation	(27 168)	(2)	(27 170)
Net book value	4 513	502	5 015
Movements in 2008			
Additions	1 975	35	2 010
Depreciation charge	(2 588)	(1)	(2 589)
Other	-	1	1
At 31 December 2008			
Cost	32 843	539	33 382
Accumulated depreciation	(28 943)	(2)	(28 945)
Net book value	3 900	537	4 437

NOTE 25 – 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 2007	270	21 653	216	22 139
Amounts allocated	-	1 290	781	2 071
Amounts used	-	(43)	-	(43)
Unused amounts reversed	(82)	(2 917)	(106)	(3 105)
Discount effect	-	1 242	-	1 242
Other (foreign exchange revaluation)	-	(21)	20	(1)
Balance as at 31 December 2007	188	21 204	911	22 303
Amounts allocated	899	21 589	1 054	23 542
Amounts used	-	(815)	-	(815)
Unused amounts reversed	(84)	(694)	(306)	(1 084)
Discount effect	-	159	-	159
Other (foreign exchange revaluation)	-	627	(621)	6
Balance as at 31 December 2008	1 003	42 070	1 038	44 111

From the total of HUF 42 070 million provision for pending legal disputes the Group has a provision of HUF 23 864 million (HUF 20 879 million in 2007) for its liability to clients as a result of the fraud that occurred at K&H Equities in 2003 and before. In 2003, the two shareholders of the Bank, KBC Bank N.V. and ABN Amro Bank N.V., issued a letter of commitment that they will maintain the legally required level of equity in K&H Bank Rt. The Bank also issued a letter of commitment that it will maintain the legally required level of equity at K&H Equities.

For the majority of claims, criminal investigations were launched which are litigated in Court. Some contested claims have already been determined by the Courts. As a result K&H Equities has incurred and charged against the provision HUF 815 million in 2008 (HUF 43 million in 2007).

The Group revised its previous estimate for the fraud case and increased the provisions by HUF 3 641 million (HUF 1 213 million decrease in 2007).

In 2006 the letter of commitment of ABN Amro Bank N.V. was replaced by an indemnity agreement between KBC Bank N.V., ABN Amro Bank N.V., K&H Bank and K&H Equities. Under this agreement ABN Amro Bank N.V. indemnifies 40% of the payments to clients based on finalised court decisions. According to the insurance agreement which was subscribed in 2008, the insurance company partly recovers the loss of the Group resulting from the compensation payments to clients. In order to recognise the indemnity provided by ABN Amro N.V. and the insurance company the Group created an asset (HUF 11 118 million increase in 2008 and HUF 324 million decrease in 2007).

The change in provision and the asset itself are presented net in the consolidated income statement (HUF 7 477 million gain in 2008 and HUF 889 million gain in 2007). From 2007 on the calculation of provision is based on effective interest rate method which causes HUF 159 million increase recorded as interest expense in the consolidated income statement (HUF 1 242 million increase in 2007).

NOTE 25 – PROVISIONS FOR RISK AND CHARGES (continued)

The further timing and the final decisions of the Courts are uncertain. As a result of this the amount of the provision may be subject to changes in the years ahead. However after careful consideration, based on comprehensive investigation and substantiated legal opinions the Group believes that the amount of provision raised is the best possible estimate and is at this moment adequate to cover actual losses. This provision does not include legal and ancillary costs of settling claims.

The K&H Equities is in a settlement dispute with the insurance company. The insurer rejected the claim of K&H Equities in amount of HUF 1 028 million and related penalty interest due to faulty settlement. The insurer also anounced counter claims toward K&H Equities in amount of HUF 615 million and related penalty interest which were not accepted by K&H Equities. The outcome of the settlement dispute is uncertain. Based on the legal opinions it is possible, but not probable that the claims of insurer will succeed actions therefore the Group has not made any provision on the claim of the insurer.

The K&H Group is also party to litigation and claims arising in the normal course of business. The majority of the provision of HUF 18 206 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2008 (HUF 325 million at 31 December 2007) has been created relating to tax litigation and commercial litigations. The final outcome of these litigations is uncertain however Management believes that the amount of provision raised is the best possible estimate and is at this moment adequate to cover the potential losses from litigations.

NOTE 26 – OTHER LIABILITIES

	2008 MHUF	2007 MHUF
Trade creditors	3 675	5 156
Lease liabilities	5	12
Items in transit due to payment services	19 813	24 076
Vostro accounts	769	23 390
Items in transit due to lending activity	3 176	2 543
Items in transit due to trading in securities	1 003	1 375
Liabilities from bankcard service	1 988	2 711
Liabilities from brokerage services	2 783	7 863
Other	13 827	11 443
Total other liabilities	47 039	78 569

NOTE 27 – SHARE CAPITAL

	2008 MHUF	2007 MHUF
Ordinary shares issued and outstanding	66 307	66 307

During 2007 KBC Bank N.V increased the Bank’s share capital. The capital increase of HUF 13 800 million was effective on 6 November 2007.

NOTE 27 - SHARE CAPITAL (continued)

The nominal value of the ordinary shares issued and outstanding at 31 December 2008 is HUF 1 per share (2007: HUF 1).

Shareholders of the Bank:

	2008 Shares held (millions)	2008 Shareholding %	2007 Shareholding %
KBC Bank N. V.	66 307	100.00%	100.00%
	66 307	100.00%	100.00%

On 28 September 2007 KBC Bank N.V. fully acquired other shareholder's participation in K&H Bank.

NOTE 28 – COMMITMENTS, CONTINGENT ASSETS AND LIABILITIES

In the normal course of business, the Group is a party to credit related financial instruments with off-balance sheet 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 balance sheet.

Credit risk for off-balance sheet 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 Group uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet financial instruments 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 Group 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 facilities to other customers. The Group 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 Group 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 28 – COMMITMENTS, CONTINGENT ASSETS AND LIABILITIES (continued)

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

	2008 MHUF	2007 MHUF
Credit commitments – undrawn amount		
Received	2 241	2 516
Given		
Irrevocable	174 672	194 599
Revocable	149 095	146 426
Total given	323 767	341 025
Financial guarantees		
Given	143 941	151 449
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets	178 319	159 029
Financial assets	180	4 431
For assets that are not impaired or past due		
Non-financial assets	1 417 955	1 664 007
Financial assets	29 819	94 771
Total guarantees received/collateral	1 626 273	1 922 238

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Group has an established protocol of dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Group makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year-end the Group had several unresolved legal claims in amount of HUF 1 969 million (HUF 3 060 million as at 31 December 2007) where the Group has been advised by its legal advisor that it is possible, but not probable that the action will succed and accordingly no provision for these claims has been made in these consolidated financial statements.

NOTE 29 – FINANCE AND OPERATING LEASES

Lessor position

The leasing subsidiaries of the Group operate in the domestic leasing market and provide both finance and operating lease products to customers. Certain lease contracts designated as operating lease under Hungarian Accounting Standards are designated as financial lease according to the IFRS terminology. The following tables indicate the key amounts of this activity:

	2008	**2007**
	MHUF	**MHUF**
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	25 832	21 864
one to five years	37 705	33 128
more than five years	8 739	7 285
	72 276	62 277
The present value of minimum lease payments receivables*:		
less than one year	16 298	15 832
one to five years	32 206	28 832
more than five years	7 465	7 731
	55 969	52 395
Unearned finance income	13 009	6 149
Contingent rents recognized as income - gross	4 312	4 188
Non-guaranteed residual values	1 032	1 483

*Net of impairment.

The total impairment recorded on financial lease receivables amounted to HUF 3 577 million as at 31 December 2008 (HUF 3 970 million as at 31 December 2007).

The term of the new contracts is between 12 and 120 months. Interest rates are in BUBOR, EURO LIBOR or CHF LIBOR plus an average margin of 2.70% (3.20% in 2007).

Lessee position

The Group has entered into property lease agreements which are accounted for as operating leases. The Group has the following commitments for the remaining term of the contracts:

	2008	**2007**
	MHUF	**MHUF**
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	1 535	1 505
one to five years	6 122	6 068
more than five years	2 582	902
	10 239	8 475

NOTE 29 – FINANCE AND OPERATING LEASES (continued)

	2008 MHUF	2007 MHUF
Future minimum sublease payments expected to be received	42	92
Minimum lease payments recognized as expense	4 464	3 689

NOTE 30 – 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 (2007: 100.00%). The ultimate parent of the Group is KBC Group N.V.

Subsidiaries:

See list of subsidiaries in Note 32.

Associates:

See list of associates in Note 32.

Other related parties, members of KBC Group:

Baker Street Finance Ltd
CBC Banque SA
Československa Obchodni Banka a.s.
Dorset Street Finance Ltd
Fin-Force N.V.
Hanover Street Ltd
Irish Intercontinental Bank
KBC Asset Management Ltd
KBC Asset Management N.V.
KBC Bank Deutschland AG.
KBC Bank Nederland N.V.
KBC Exploitatie N.V.
KBC Internationale Financieringsmij N.V.
KBC Lease Holding N.V.
KBC Securities N.V.
K&H Biztosító Zrt.
Kredyt Bank SA
Kredietbank SA Luxembourgeoise
Pembridge Square Ltd
Regent Street Ltd
Sydney Finance Street Ltd

NOTE 30 - RELATED PARTY TRANSACTIONS (continued)

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.

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

	Parent	Subsidiaries	Associates	Other related parties	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2008					
Assets					
Loans and advances	5 620	-	397	4 218	10 235
Current accounts	4 604	-	-	1 106	5 710
Term loans	1 016	-	397	3 065	4 478
Finance leases	-	-	-	47	47
Other receivables	2	-	-	455	457
Total assets	5 622	-	397	4 673	10 692
Liabilities					
Deposits	520 532	-	370	9 270	530 172
Current accounts	315 792	-	370	4 980	321 142
Term deposits (with agreed maturity)	204 740	-	-	4 290	209 030
Subordinated liabilities	15 834	-	-	-	15 834
Other liabilities	406	-	32	2 970	3 408
Total liabilities	536 772	-	402	12 240	549 414
Income statement					
Net interest income	(9 881)	-	34	371	(9 476)
Interest income	1 601	-	22	1 089	2 712
Interest expense	(11 482)	-	12	(718)	(12 188)
Net fee and commission income	(447)	-	(365)	521	(291)
Fee and commission income	380	-	2	1 516	1 898
Fee and commission expense	(827)	-	(367)	(995)	(2 189)
Other net income	(87)	-	(2)	(3 085)	(3 174)
Other income	49	-	-	787	836
Other expense	(136)	-	(2)	(3 872)	(4 010)
Total income statement	(10 415)	-	(333)	(2 193)	(12 940)
Off-balance sheet items					
Commitments and contingent liabilities	13 434	-	-	32 072	45 506
Guarantees received	1 524	-	-	-	1 524
Notional amount of derivatives	1 739 436	-	-	17 506	1 756 942

NOTE 30 - RELATED PARTY TRANSACTIONS (continued)

	Parent	Subsidiaries	Associates	Other related parties	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2007					
Assets					
Loans and advances	41 681	-	367	11 232	53 280
Current accounts	10 061	-	-	711	10 772
Term loans	31 620	-	367	10 521	42 508
Debt instruments designated at fair value through profit or loss (reclassified)	-	-	-	4 214	4 214
Other receivables	2	-	-	413	415
Total assets	41 683	-	367	15 859	57 909
Liabilities					
Deposits	272 773	40	64	14 781	287 658
Current accounts	406	40	64	1 115	1 625
Term deposits (with agreed maturity)	272 367	-	-	13 666	286 033
Subordinated liabilities	15 141	-	-	-	15 141
Other liabilities	444	-	-	604	1 048
Total liabilities	288 358	40	64	15 385	303 847
Income statement					
Net interest income	(4 730)	(5)	(11)	253	(4 493)
Interest income	1 584	-	33	811	2 428
Interest expense	(6 314)	(5)	(44)	(558)	(6 921)
Net fee and commission income	(371)	-	(297)	1 248	580
Fee and commission income	28	-	-	1 686	1 714
Fee and commission expense	(399)	-	(297)	(438)	(1 134)
Net gains from financial instruments at fair value	-	-	-	(212)	(212)
Other net income	(340)	(408)	(3)	(390)	(1 141)
Other income	40	-	-	133	173
Other expense	(380)	(408)	(3)	(523)	(1 314)
Total income statement	(5 441)	(413)	(311)	899	(5 266)
Off-balance sheet items					
Commitments and contingent liabilities	14 254	-	-	17 729	31 983
Guarantees received	14 502	-	-	-	14 502
Notional amount of derivatives	689 346	-	-	9 751	699 097

NOTE 30 - RELATED PARTY TRANSACTIONS (continued)

Transactions with key management

Loans

In accordance with the Group's internal policy, senior 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 (for housing, if the claimant and the property fit pre-defined requirements). Favourable conditions are a waiver of handling fees and lower than market interest rates.

At 31 December 2008 loans with the above conditions were housing loans with long-term maturity obligations (15-20 years).

The outstanding amount of loans at 31 December 2008 was HUF 26 million (HUF 25 million at 31 December 2007).

Deposits

In accordance with the Group's internal policy, all the employees of the Group, 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 maximum interest rate for the K&H Savings Deposit Account + 1.50%, but maximum the basic interest rate of the Hungarian National Bank less 0.5%.

At 31 December 2008 the outstanding amount of deposits was HUF 58 million (HUF 59 million at 31 December 2007). In 2008 the Bank paid HUF 4 million interest on these deposits (HUF 4 million in 2007).

The following amounts have been granted to key management personnel:

Type of benefit	**2008**	**2007**
	MHUF	**MHUF**
Short-term employee benefits	396	290
Post-employment benefits	-	2
Total benefits	396	292

NOTE 31 – AUDITOR'S REMUNERATION

The remuneration recognised due to the audit of statutory annual accounts performed by Ernst & Young Hungary amounted to HUF 152 million in 2008 (HUF 145 million in 2007). In 2008 an additional fee of HUF 146 million was accrued or paid to the auditor for other services, such as audit of investment funds or data custody and delivery in relation to the Equities fraud (HUF 204 million in 2007).

NOTE 32 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2008	Effective Shareholding 2007
Fully consolidated subsidiaries		%	%
K&H Pannonlízing Zrt.	Finance lease	100	100
K&H Autópark Kft.	Operative lease	100	100
K&H Autófinanszírozó Zrt.	Finance lease	100	100
K&H Eszközfinanszírozó Zrt.	Finance lease	100	100
K&H Eszközlízing Kft.	Operative lease	100	100
K&H Alkusz Kft.	Insurance broker	100	100
K&H Lízingház Zrt.	Operative lease	100	100
K&H Lízing Zrt.	Finance lease	100	100
K&H Lízingadminisztrációs Zrt.	Dormant	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
Kvantum KK Rt. "v.a."	Under liquidation	100	100
Associates consolidated using the equity method			
Giro Elszámolásforgalmi Zrt.	Clearing house	21	21
HAGE Zrt.	Meat processing	25	25
Budatrend-III. Zrt.	Real estate management	34	34
K&H ITS Kft. “v.a.”	Under liquidation	-	100
Immaterial, non consolidated investment			
Risk Kft. „f.a.”	Under liquidation	100	100

During 2008, K&H ITS Kft. was liquidated. The carrying amount of the Bank’s participation was HUF 43 million, the Group realised HUF 1 million losses on the liquidation.

NOTE 33 – SUBSEQUENT EVENTS

There were no material subsequent events.

NOTE 34 – RECONCILIATION OF STATUTORY ACCOUNTS TO IFRS ACCOUNTS

	Profit for the year MHUF	Shareholders' equity [1] MHUF	Assets MHUF	Subordinated debt and liabilities MHUF
Bank accounts prepared under Hungarian Accounting Rules	13 458	159 838	3 178 370	3 005 074
Adjustments for IFRS accounts				
Capitalization of VAT, financial leases and revaluation of real estates	36	659	1 042	347
Portfolio-based allowance for loan losses	4 964	11 886	(4 116)	(20 966)
Specific allowance for loan losses	253	(62)	(6)	(197)
Adjustment on delivery repos	11 723	1 827	13 550	-
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	(294)	5 299	(1 402)	(6 407)
Fair valuation of AFS portfolio	-	(11 783)	(11 783)	-
Cash flow hedge on FX options	(879)	(1 099)	1 039	3 017
Holiday accruals	400	(923)	-	523
Amortisation of loan origination fees	2 650	(2 927)	(330)	(53)
Deferred tax	(4 162)	440	-	3 722
Bank standalone IFRS	28 149	163 155	3 176 364	2 985 060
Subsidiaries accounts prepared under Hungarian Accounting Standards	7 643	9 727	217 138	199 768
Adjustments for IFRS accounts				
Portfolio-based allowance for loan losses	198	(1 430)	(1 232)	-
Financial leases	38	633	654	(17)
Specific allowance for loan losses	983	(721)	16 538	16 276
Deferred tax	(91)	289	236	38
Subsidiaries standalone IFRS	8 771	8 498	233 334	216 065
Adjustments for consolidation	(10 937)	(4 140)	(227 207)	(212 130)
Balance per IFRS report	25 983	167 513	3 182 491	2 988 995

[1] Excluding the current year profit

NOTE 35 – RISK MANAGEMENT

35.1 General

The Group is not only a universal commercial bank and a major player in the Hungarian market but also part of the KBC International Bank - and Insurance Group. As such the activities of the Group cover a wide range, including the retail, corporate and the professional money market segments. In its role as a financial intermediary, the Group faces different uncertainties, presenting both risk and opportunity at the same time, and 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 capacity to build value. Therefore at both KBC Group and K&H, value and risk management is based on the following fundamental principles:

- Value, risk and capital management are inextricably linked to one another.
- Risk management should be approached from a comprehensive, enterprise- wide angle, taking into account all the risks a company is exposed to and all the activities it engages in.
- Primary responsibility for value and risk management lies with line management, while a separate Risk Management Directorate – operating independently of line management – performs an advisory, supporting and supervisory role.
- Every material subsidiary is required to adhere to the same risk governance model as the parent company.

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 Group's risk governance model is organised in three tiers:

- Overarching company and risk committees are the Board of Directors, Audit Committee, Executive Committee, Country Team and ALCO. These committees concentrate on global risk management and on monitoring value creation.
- Specialised risk committees (Credit Risk Committee (CRC), Operational Risk Committee (ORC), Insurance Risk Committee (IRC)) concentrate on developing a group-wide framework for one particular type of risk and monitoring the associated risk management process. Chaired by the Chief Financial and Risk Officer, the risk committees are composed of representatives from line management and Risk Management Directorate.
- Line management and activity-specific committees have primary responsibility for value and risk management. Risk Management Directorate 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.

The Board of Directors and the Audit Committee have an important role to play in value creation and risk governance. Regular reporting to the Audit 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 Group and on the adequacy of the risk management structure.

NOTE 35 – RISK MANAGEMENT (continued)

Risk measurement and – monitoring

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

- Identification of risks; is a process of discovering and defining material risks, namely those risks that could have a positive or negative impact on the Group.
- Measurement of risks; qualitative and quantitative assessment of exposure to risk. The Group uses the following risk measures for the following significant risk types:
  - Credit risk: nominal positions (outstanding/exposure), LGD/EL (loss given default/expected loss), stress test results. In the future the Group will more intensively use economic capital approach to credit risk measurement.
  - Trading risk: BPV (basis point variance), historic VaR (value at risk), and stress test results.
  - ALM (asset-liability management) risk: BPV, results of stress test on interest income, net present value.
  - Operational risk: KRI (key risk indicator), results of self assessment, level of compliance with Group Standards.
  - Liquidity risk: Operational unsecured liquidity gap, loan-to –deposit ratio, long term liquidity gap limits, liquidity stress test results.

- Setting limits; is a way of authorizing specific forms of risk taking. A limit indicates how much risk the Group considers to be ‘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 (mainly local risk committees) in a structured format. Main types of reports used in the Group:
  - exposures to key risk types
  - limit breaches
  - losses and near misses
  - 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 Directorate 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 constraint 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 Group’s risk limits.

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

35.2 Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances.

NOTE 35 – RISK MANAGEMENT (continued)

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

- Building up and maintenance of a sound and diversified liability structure;
- Attracting significant client funds (both corporate and retail);
- 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 reliance on volatile deposits that can be attracted by aggressive pricing;
- Offering full service to clients with the widest possible array of financial products.

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

The medium and long term liquidity planning is part of the business and strategic planning process. The business and strategic plans show the expected funding structure and profitability in each segment.

The Group's overall liquidity is managed by the Treasury, the relevant procedures, methods and limits are approved by ALCO (Asset and Liability Committee), Risk Management measures liquidity exposure and monitors liquidity limits.

To limit liquidity risk the Group has worked out a comprehensive liquidity risk policy. The objective of the policy is to limit liquidity risks by taking into account adequate level of funding, potential growth of the Bank, and considering liquidity shocks to guarantee the availability of sufficient cash flow to meet all of the Group's financial commitments:

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

The Group uses different ratios to measure and limit liquidity risk that arises from financial intermediation. The operational liquidity is monitored via the unsecured liquidity gap limit. From structural liquidity point of view a group wide loan–to–deposit ratio is used. The Group is also analysing liquidity stress test results and has limited long term gaps.

Operational liquidity measures were changed during 2008. The formerly used stock liquidity ratio was replaced by unsecured liquidity gap limit. The operational liquidity gap is the difference between the cash in and outflows in different time horizons (5 day, 30-day and 90-days) and internal limit was set for the gap to be covered by National Bank of Hungary eligible collaterals.

30 day Operational Liquidity Gap on 31 December 2008 in HUF billion

	CHF	**EUR**	**HUF**	**USD**	**Total**
30-day Liquidity GAP	(113 591)	(53 750)	435 828	7 943	276 166
NBH eligible collateral	-	-	543 064	-	543 064
Total	(113 591)	(53 750)	978 627	7 943	819 229

The Group had no uncovered operational liquidity gap in 2008, its operational liquidity situation was sound and stable despite of the international financial crisis during year 2008.

Structural liquidity is managed via the loan-to-deposit (LTD) ratio, an overall liquidity benchmark. LTD is calculated as the amount of a bank's loans to customers divided by the amount of its customer deposits at any given time. The higher the ratio, the more the bank is relying on borrowed wholesale funds. The consolidated ratio of loans and advances to customers compared to deposits from customers was 100.9% in 2007 and 88.2% in 2008.

NOTE 35 – RISK MANAGEMENT (continued)

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

The following table shows a breakdown of the financial assets and financial liabilities by contractual remaining maturity at 31 December 2008:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
Not more than one year	85 390	-	573 075	644 660	204	-	1 303 329
More than one but not more than five years	44 763	6 221	190 426	534 455	835	-	776 700
More than five years	4 322	3 190	119 514	675 671	-	-	802 697
Without maturity	93 792	-	1 311	-	-	-	95 103
Total	228 267	9 411	884 326	1 854 786	1 039	-	2 977 829
Financial liabilities							
Not more than one year	-	76 824	-	-	952	2 124 799	2 202 575
More than one but not more than five years	2 343	56 739	-	-	2 065	434 747	495 894
More than five years	-	-	-	-	-	101 244	101 244
Without maturity	90 652	-	-	-	-	-	90 652
Total	92 995	133 563	-	-	3 017	2 660 790	2 890 365

NOTE 35 – RISK MANAGEMENT (continued)

The following table shows a breakdown of the financial assets and financial liabilities by contractual remaining maturity at 31 December 2007:

	Held for trading (reclassified)	Designated at fair value through profit or loss (reclassified)	Available for sale (reclassified)	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
Not more than one year	23 416	-	86 844	683 981	1 594	-	795 836
More than one but not more than five years	37 312	5 506	81 165	521 559	318	-	645 861
More than five years	13 345	6 603	188 231	517 637	-	-	725 816
Without maturity	-	-	5 068	-	-	-	5 068
Total	74 074	12 109	361 308	1 723 177	1 912	-	2 172 580
Financial liabilities							
Not more than one year	542	15 564	-	-	3	1 539 393	1 555 502
More than one but not more than five years	4 868	92 133	-	-	159	303 296	400 456
More than five years	415	3 212	-	-	-	120 820	124 446
Without maturity	24 122	-	-	-	-	-	24 122
Total	29 947	110 909	-	-	161	1 963 509	2 104 526

Non-financial assets and liabilities can be classified as assets and liabilities without maturity or assets and liabilities with a remaining maturity not more than one year, as appropriate.

NOTE 35 – RISK MANAGEMENT (continued)

35.3 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 objective of market risk management is to measure, report and analyze the market risk of the aggregate trading position at Group level taking into account the main risk factors and specific risk.
The Group classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a historical VaR (hVaR) methodology. Market risks of non-trading positions (banking book) are managed and monitored using other risk measures.

Market risk – trading

The Group is exposed to market risk via the trading books of the Bank dealing room and via the FX exposure of the subsidiaries. The Group has set limits on the level of market risk that may be accepted. The bank applies VaR methodology to asses 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 ensure that the bank would withstand market shocks.

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

Managing market risk

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. 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.

One of the building blocks of a sound risk management is also prudent valuation. A daily independent valuation of front-office positions is performed by the Bank's middle office.

Risk Analyses and quantification

The hVaR that the Group applies is an estimate- using a confidence level of 99%, ten-day holding period, historical data going back to 500 scenario dates, - of the potential loss that is not expected to be exceeded if the current market risk positions were to be held unchanged. 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 will exceed a certain amount.

NOTE 35 – RISK MANAGEMENT (continued)

VaR results can be presented as follows:

	Foreign exchange	Interest rate	Global VAR
	MHUF	MHUF	MHUF
2008 – 31 December	202	1 315	1 147
2008 – Average daily	186	851	816
2008 – Highest	1 041	2 718	2 785
2008 – Lowest	13	288	321
2007 – 31 December	121	307	359
2007 – Average daily	99	289	320
2007 – Highest	355	567	665
2007 – Lowest	11	97	123

The Group's hVaR exposure increased significantly in 2008 compared to the previous years' results due to the market turmoil in Hungary and in the entire global financial system. The main contributor to the Group hVaR exposure was the interest rate position. There were more periods in 2008 when the HUF yield curves demonstrated huge volatility and in some cases the different yield curves moved in opposite directions, increasing the spread risk. Spread risk appears when the position is hedged with the instrument of the same currency and maturity, but this hedge is sensitive to movements in different yield curves. In a normal market environment there is a positive correlation between the different yield curves thus hedges are effective. However, in cases when yield curves move in the opposite direction, then it can happen that the "hedged" portfolio VaR is higher than the VaR of the outright position in the underlying instrument. The highest hVaR figures in 2008 were observed when the bank was exposed to significant spread risk. Consequently during such days risk management took into consideration also the results of the other risk measures e.g. BPV exposures and stress test results. The average limit utilization was below the hVaR limit of K&H.

Market risk – Non-trading

At the Bank the ALCO is controlling the value creation and the risks of the banking book. The Bank's ALM (Asset and Liability Management) is in accordance with international and KBC Group standards. The Group applies the KBC ALM risk management methodology. Risk tolerance levels are decided and allocated by the KBC Group ALCO. Since in the Group the majority of the ALM is covered by interest rate risks the tolerance level is limited in BPV terms. The interest rate risk is also measured with scenario analyses on the net interest income. Next to the trading book the Group applies VaR methodology also in case of the banking book. However, this time the VaR calculations are done using parametric VaR approach and limited to the interest rate risk of the banking book since the Group does not assume any equity or real-estate risk in the banking book.

Banking Book Economic Value Stress testing

The BPV tables below presents the results of stress testing of the economic value of the Banking Book on 31 December 2008. Stressing was done based on the scenarios of 10, 100, 200 BP parallel shifts in yield curves. Banking book is limited in BPV by an internally set limit; K&H performed within the limit in 2008.

NOTE 35 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2008	denomination	BPV MHUF
10 bp parallel up	CHF	(11)
	EUR	(10)
	HUF	(532)
	USD	(1)
10 bp parallel up total	EUR	(554)
100 bp parallel up	CHF	(112)
	EUR	(74)
	HUF	(5 148)
	USD	(8)
100 bp parallel up total	EUR	(5 342)
200 bp parallel up	CHF	(220)
	EUR	(96)
	HUF	(9 940)
	USD	(12)
200 bp parallel up total	EUR	(10 268)

DOWN Scenarios, 31 December 2008	denomination	BPV MHUF
10 bp parallel down	CHF	11
	EUR	11
	HUF	536
	USD	1
10 bp parallel down Total	EUR	559
100 bp parallel down	CHF	203
	EUR	134
	HUF	5 537
	USD	9
100 bp parallel down total	EUR	5 883
200 bp parallel down	CHF	206
	EUR	455
	HUF	11 500
	USD	4
200 bp parallel down total	EUR	12 165

NOTE 35 – RISK MANAGEMENT (continued)

Currency risk

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

35.4 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 balance sheet. The Group makes available to its customers guarantees which may require that the Group makes payment on their behalf. Such payments are collected from customers based on the terms of the credit contracts. They expose the Group 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 consolidated loan portfolio, monitoring limit discipline and the specific portfolio management function.

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 and the type of counterparty (private individuals, companies, etc.) 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 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, 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 lending policy.

Defaulting obligors are put into PD classes 10, 11 or 12. PD class 10 is for 'still performing' borrowers, i.e. borrowers with loans for which interest payments and principal repayments are not more than 90 days in arrears or overdrawn. Classes 11 and 12 are for 'non-performing' borrowers. Class 11 groups borrowers that are more than 90 days in arrears or overdrawn, while class 12 comprises borrowers whose credit has been cancelled or which are in danger of going bankrupt.

NOTE 35 – RISK MANAGEMENT (continued)

Impairment.
For credit granted to borrowers in PD classes 10, 11 and 12 (impaired loans), the Group records impairment losses based on an estimate of the net present value of the recoverable amount. In addition, for credit in PD classes 1 to 9, impairment losses are recorded on a 'portfolio basis', using a formula based on the IRB Foundation models intended to be used for calculating capital requirements. This formula was introduced in the fourth quarter of 2007 in order to better comply with IFRS requirements for Incurred But Not Reported provisions.

Credit risk management at portfolio level

Monitoring is also conducted on a portfolio basis, inter alia by means of regular reports on the consolidated credit portfolio. The largest risk concentrations are, in addition, monitored via periodic and ad hoc reports. Limits are in place at borrower or counterparty level and for specific activities (such as real estate financing). Whereas some limits are still in notional terms, more advanced concepts (such as '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 sublimits 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 interprofessional transactions (such as exchange transactions and swaps);
- short-term commercial transactions (such as documentary credit and pre-export finance).

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

- fully fledged guarantees transfer the country risk to the guarantor's country;
- 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.

NOTE 35 – RISK MANAGEMENT (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 consolidated balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	2008	2007
	MHUF	MHUF
Equity instruments*	8 625	5 068
Debt instruments*	1 024 403	411 923
Loans and advances	1 961 060	1 796 497
of which designated at fair value through profit or loss*	2 430	2 615
Derivatives*	87 585	29 797
Other assets	39 602	33 525
Total assets	3 123 705	2 279 425
Commitments to extend credit	323 719	341 025
Guarantees	134 740	141 424
Letters of credit	5 717	3 604
Total commitments and contingent liabilities	464 176	486 053
Total credit exposure	3 587 881	2 765 478

*For more information see Note 14.

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 below.

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 2008 was HUF 34 634 million (HUF 36 925 million as of 31 December 2007) before taking account of collateral or other credit enhancements and HUF 8 284 million (HUF 17 607 million as at 31 December 2007) after such protection.

NOTE 35 – RISK MANAGEMENT (continued)

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

	2008 MHUF	2007 MHUF
Industry sector		
Service industry	283 815	263 040
Agriculture	89 717	92 702
Manufacturing and building	71 794	171 182
Food processing	288 905	53 523
Wholesale and retail	171 361	141 351
Power industry	37 874	110 797
Other	47 961	87 897
Individuals	810 537	659 937
Gross loans	1 801 964	1 580 429
Portfolio-based allowance for loan losses	(5 348)	(7 010)
Specific allowance for loan losses	(41 647)	(44 747)
Impairment on loans and receivables (see Note 18)	(46 995)	(51 757)
Loans to customers	1 754 969	1 528 672

NOTE 35 – RISK MANAGEMENT (continued)

The Group's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2008 can be analysed by the following geographical regions.

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
Hungary	188 716	9 411	884 317	1 782 713	-	-	2 865 157
EMU countries	22 695	-	9	39 171	698	-	62 573
East-European countries	4 170	-	-	13 620	-	-	17 790
Russia	-	-	-	3 140	-	-	3 140
Other European countries	11 502	-	-	9 219	341	-	21 062
Non-European countries	1 184	-	-	6 923	-	-	8 107
Total	228 267	9 411	884 326	1 854 786	1 039	-	2 977 829
Financial liabilities							
Hungary	25 118	133 563	-	-	-	1 524 208	1 682 889
EMU countries	45 377	-	-	-	1 132	1 097 338	1 143 847
East-European countries	2 087	-	-	-	-	6 193	8 280
Russia	-	-	-	-	-	4 967	4 967
Other European countries	18 672	-	-	-	1 885	17 363	37 920
Non-European countries	1 741	-	-	-	-	10 721	12 462
Total	92 995	133 563	-	-	3 017	2 660 790	2 890 365

NOTE 35 – RISK MANAGEMENT (continued)

The geographical breakdown of financial assets and financial liabilities as at 31 December 2007 is presented below:

	Held for trading (reclassified)	Designated at fair value through profit or loss (reclassified)	Available for sale (reclassified)	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
Hungary	57 445	12 109	361 299	1 645 662	-	-	2 076 515
EMU countries	10 097	-	9	54 837	705	-	65 648
East-European countries	669	-	-	9 811	-	-	10 480
Russia	-	-	-	666	-	-	666
Other European countries	5 689	-	-	5 440	1 207	-	12 336
Non-European countries	174	-	-	6 751	-	-	6 925
Total	74 074	12 109	361 308	1 723 167	1 912	-	2 172 570
Financial liabilities							
Hungary	11 654	110 587	-	-	-	1 450 729	1 572 970
EMU countries	9 735	-	-	-	68	481 544	491 347
East-European countries	222	100	-	-	-	5 294	5 616
Russia	-	127	-	-	-	3 485	3 612
Other European countries	7 289	-	-	-	93	7 868	15 250
Non-European countries	1 047	95	-	-	-	14 589	15 731
Total	29 947	110 909	-	-	161	1 963 509	2 104 526

Collateral and other credit enhancements

In compliance with its business policy the Group normally does not grant collateral-based financing (i.e. financing that is not based on the loan repayment capacity of the client), however, there may be exceptions to this rule (especially in consumer segment in case of no income-verification products). The Group grants credits to advance resources that may be repaid from the borrower's cash flow, and assumes active lending commitments only if they may be returned from cash flow. The borrower's cash flow represents the primary – direct – source of loan repayment to the Group.

NOTE 35 – RISK MANAGEMENT (continued)

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), pledge on inventory and trade receivables
- for securities lending cash or securities

The Group also obtains guarantees from parent companies for loans to their subsidiaries, but the benefits are not included in the above table. Value of collaterals must be re-assessed regularly and is subject to the yearly review process as well. In case of insufficient collateral coverage (e.g. due to changes in market value) additional collateral is requested.

Management monitors the market value of collaterals, regularly requests 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.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal credit grades (both on client and facility level). It is the Group'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 Group's rating policy. Risk ratings are assessed and updated regularly. Bank's assets have been distributed among classes based on the Basel II PD rating for Corporate and SME counterparties, and based on the facility rating for Leasing and Consumer 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="7">Problem-free</td></tr>
<tr><td>2</td></tr>
<tr><td>3</td><td rowspan="2">Standard grade</td></tr>
<tr><td>4</td></tr>
<tr><td>5</td><td rowspan="5">Sub-standard grade</td></tr>
<tr><td>6</td></tr>
<tr><td>7</td></tr>
<tr><td>8</td><td rowspan="2">Watch</td></tr>
<tr><td>9</td></tr>
<tr><td>10</td><td rowspan="3">Impaired</td><td>Substandard</td></tr>
<tr><td>11</td><td>Doubtful</td></tr>
<tr><td>12</td><td>Bad</td></tr>
</table>

NOTE 35 – RISK MANAGEMENT (continued)

Credit quality per class of financial assets

The table below presents the credit quality by asset classes as at 31 December 2008:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Unimpaired assets	228 267	9 411	884 326	1 784 076	1 039	2 907 119
Impaired assets	-	-	513	117 706	-	118 218
Impairment	-	-	(513)	(46 995)	-	(47 508)
Total carrying value	228 267	9 411	884 326	1 854 786	1 039	2 977 829

The credit quality of assets as at 31 December 2007 can be presented as follows:

	Held for trading (reclassified)	Designated at fair value through profit or loss (reclassified)	Available for sale (reclassified)	Loans and receivables	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Unimpaired assets (reclassified)	74 074	12 109	361 308	1 633 788	1 912	2 083 191
Impaired assets (reclassified)	-	-	515	141 136	-	141 651
Impairment (reclassified)	-	-	(515)	(51 757)	-	(52 272)
Total carrying value	74 074	12 109	361308	1 723 167	1 912	2 172 570

For breakdown per credit grade categories concerning unimpaired loans and receivables see Credit risk exposure for each internal risk rating under this heading. Unimpaired assets included in the portfolios outside Loans and receivables are classified as high grade or standard grade.

NOTE 35 – RISK MANAGEMENT (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 2008 is as follows:

	Less than 30 days MHUF	30 days or more, but less than 90 days MHUF	Total MHUF
Loans to customers			
- Corporate	13 943	2 723	16 666
- Retail	62 964	3 813	66 777
Total	76 907	6 536	83 443

Aging analysis of past due but not impaired financial assets as at 31 December 2007 is as follows:

	Less than 30 days MHUF	30 days or more, but less than 90 days MHUF	Total MHUF
Loans to customers			
- Corporate	7 660	735	8 395
- Retail	46 575	3 861	50 436
Total	54 235	4 596	58 831

Past due assets include those that are past due even by one day. The majority of past due loans are not considered to be impaired.

NOTE 35 – 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	Average unsecured share of exposure 2008	Total 2008	Average unsecured share of exposure 2007	Total 2007
	%	%	MHUF	%	MHUF
High grade	0.05	81.49	237 450	89.08	224 784
Standard grade	12.69	33.85	1 184 757	87.45	981 172
Sub-standard grade	12.35	46.52	719 692	49.54	739 183
Impaired	100.00	49.88	151 368	84.03	165 108
Total			2 293 267		2 110 247

Carrying amount per class of financial assets whose terms have been renegotiated

The table below presents the carrying amount of renegotiated financial assets, by segment.

	2008	2007
	MHUF	MHUF
Loans to customers		
- Corporate lending	3 636	4 732
- Small business lending	6 314	3 480
- Consumer lending	4 047	4 295
Total	13 997	12 507

NOTE 35 – RISK MANAGEMENT (continued)

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 Group addresses impairment assessment in two areas:

- individually assessed impairments
- collectively assessed impairments

Collectively assessed impairments

Portfolio-based impairment

Allowances are assessed collectively and on 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.

Statistical impairment

Allowances are assessed on portfolio basis with statistical method for losses on loans and advances if there is an objective evidence that an impairment loss has incurred, but the loans and advances are not significant individually (including credit cards, residential mortgages and unsecured consumer lending).

Individually assessed impairments

Allowances are assessed individually on loans and advances and on loan commitments that are individually significant, if there is objective evidence that an impairment loss has incurred.

Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, 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.

Provisions for commitments and contingent liabilities shall be created, and impairment of balance-sheet 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.

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

NOTE 35 – RISK MANAGEMENT (continued)

Internal credit risk models and Basel II

In order to quantify credit risks, the Group 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 group (for instance, the models for governments, banks, large companies and project finance), while others have been designed for specific geographic markets (SMEs, private individuals, etc.). The same internal rating scale is used throughout the Group.

Starting from 2010, these models are also planned to form the building blocks for calculating the regulatory capital requirements for credit risk. The Bank is in other words opting to use the Internal Rating Based (IRB) Approach. Initially, the Bank will use the IRB 'Foundation' Approach, but a switch to the 'Advanced' approach is envisaged in 2013.

The switch to the Basel II IRB Foundation approach is taking place in stages, with the Bank planning to switch over in 2010, while main subsidiary (K&H Leasing Group) is planning to adopt the IRB Advanced approach in 2013 directly from being under Standardised approach since 2008 (subject to regulatory approval).

The far-reaching introduction of rating models in the 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 Model Committee at group level and the Credit Risk Committee on local level is responsible for the final validation and approval of all models.

35.5 Operational risk

In line with KBC Group, the Group applies the official Basel II 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 Group 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 Group 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 Standards* 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 the Group Standards. The compliance with the Group Standards is monitored via a benchmarking exercise, Group Standard Assessments. Local line management is responsible for translating the Group Standards into local procedures.

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 Group collects the *operational loss events* in a unified and integrated database which is also used for reporting purposes.

NOTE 35 – RISK MANAGEMENT (continued)

The establishment of the system of *Key Risk Indicators* covering the Group is planned for the year of 2009. These are measurable metrics or indicators which would 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.

NOTE 36 – SOLVENCY AND CAPITAL

In accordance with Act CXII of 1996 on Credit Institutions and Financial Enterprises, the Bank must have a minimum tier capital amount higher than 8% of risk weighted assets. According to the law, the capital adequacy ratio calculation is prepared based on Hungarian accounting standards. The main differences between statutory and IFRS accounts are presented in Note 34. The Bank takes this regulation into account when preparing its detailed budget and creates further reserves in order to have sufficient guarantee capital in case of the depreciation of the HUF or other unexpected events. The Bank reports its capital adequacy situation to the Hungarian Financial Supervisory Authority (HFSA) each month and also prepares monthly forecasts to the Asset-Liability Committee (ALCO) of the Bank. When needed, the Bank's Executive Committee decides and proposes to KBC over the necessary steps to be taken (capital increase, dividend payment etc).

As of January 2008, the Bank switched to Basel II Standardized approach in its capital adequacy calculations, introducing Operational Risk related capital charge (on top of Credit and Market Risk).

According to Hungarian capital adequacy regulations, the Bank's capital adequacy ratio at 31 December 2008 was 9.87% (which is not comparable to the 12.18% at 31 December 2007, which was still calculated according to Basel I). The Bank fulfilled the capital requirements set by HFSA continuously during years 2008 and 2007 and at 31 December 2008 (and at 31 December 2007).

The Bank is required to set aside 10% of its profit calculated in accordance with Hungarian Accounting standards as statutory reserve for use against future losses. The balance of this reserve as at 31 December 2008 was HUF 10 704 million (HUF 9 358 million as at 31 December 2007).

According to Hungarian corporate and banking law, only profit for the current period and the retained earnings included in the statutory standalone financial statements may be distributed to shareholders. Additionally, this can occur only after the Group establishes the required minimum level of statutory risk reserve.

Accordingly, the Bank had distributable reserves of HUF 68 215 million as at 31 December 2008 (HUF 85 267 million as at 31 December 2007).

The dividend proposed on ordinary shares for approval to shareholder (not recognized as a liability as at 31 December 2008) is HUF 7 402 million – 0.111632 HUF/share.

Kereskedelmi és Hitelbank Zrt.

Consolidated Business Report

December 31, 2008

The consolidated total assets of the Bank Group amounted to HUF 3,182 billion on December 31, 2008. As a financial institution offering both banking and insurance products in its 231 branches located country-wide, it provides universal financial services to its customers.

PRESENTATION OF THE STRATEGIC SUBSIDIARIES

Leasing Group

The Leasing Group is currently comprised of 10 legal entities. In line with the goals of creating an integrated group where each member has an optimal scope of activity, since April 2002 the following companies have played an active part in increasing the portfolio of the Leasing Group[1]:

Company name	Main profile	Division
K&H Pannonlízing Zrt	Lending	Passenger and commercial vehicles
K&H Autófinanszírozó Zrt.	Financial leasing	Passenger and commercial vehicles
K&H Autópark Kft.	Operative leasing, fleet management (leasing)	Passenger and commercial vehicles
K&H Eszközfinanszírozó Zrt.	Financial leasing	Other assets
K&H Eszközlízing Kft.	Operative leasing (leasing)	Other assets
K&H Ingatlanlízing Zrt.	Financial leasing	Real estates

Insurance mediation is performed by K&H Alkusz Kft. The largest Group member, having a 66% share in the portfolio is K&H Pannonlízing Zrt.

At the end of 2008 the value of the portfolio of **K&H Leasing Group** reached HUF 171 billion representing an 8% growth compared to the end of the previous year. As a considerable portion of the portfolio elements is denominated in foreign currencies, the depreciation of the Forint also had a bearing on the volume of the portfolio (the growth was largely attributable to the exchange rate changes). Owing to new placements totalling at HUF 48 billion, the Leasing Group has obtained a 4.0% share on the leasing market.

Having analysed the eventual ramifications of the economic crisis evolved by late 2008, the shareholders of the Company decided to discontinue the retail vehicle financing line with the effect of 2009. Thus, in the future the Company will focus on corporate clients and offer corporate financing products.

K&H Befektetési Alapkezelő Zrt. (K&H Investment Fund Management Zrt.)

Despite the difficult market conditions, the Company may boast of a successful year. Even though both the situation on the money and capital markets and the population’s propensity to save have deteriorated the volume of the managed portfolio has remained basically at the same level, and the operating profit was also in line with the plans. The Company has continued to pursue its innovation strategy implemented earlier and as a result, now several new product types are offered not only on

[1] The following companies play a passive part in the operation of the Leasing Group: K&H Lízing Zrt., K&H Lízingház Zrt., K&H Lízingadminisztrációs Zrt. They do not enter into new contracts and the existing ones will either expire over the next years, or these companies will be merged into an active company, or alternatively, cease operation when they have no live portfolio any longer.

the markets of closed-ended but also of the open-ended funds. The Company's products have also contributed to the award of K&H Bank for being the "Most innovative bank" in 2008.

In the course of the year 20 new closed-ended, two open-ended and 7 private, closed-ended funds have been issued by the Fund Manager. Partially due to the sales campaigns related to the expiring funds, the majority of the savings thus released has been reinvested in the new investment funds.

As regards discretionary portfolio management, we have further enhanced cooperation with existing partners, although the impairment of the share markets had a substantial impact on the managed portfolios as well. In December 2008 the Company managed assets worth HUF 623 billion (as compared to the HUF 703 billion one year before), of this, investment funds represented HUF 509 billion (as compared to the previous year's figure of HUF 530 billion). Taken this performance and its market share exceeding 21%, the Company has remained the second largest actor on the market of investment funds. At the same time, the Company has maintained its position as a market leader in the segment of guaranteed investment funds.

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

In 2005 the K&H Group – headed by K&H Bank, which wholly owns K&H Csoportszolgáltató Kft. – decided to establish a shared service centre, to be responsible for the centralisation and efficient organisation of services closely associated with the main profiles of the various Group members as well as of auxiliary services.

The Company concludes service level agreements and contracts with the Group members concerning each service. Since 2007, the services provided by KHCSK have also been used by K&H Biztosító and the K&H Leasing Group. Currently, the Company operates as the service centre of 10 companies, including the Bank itself. With the effect of May 1, 2008, using the KBC SAP system, KHCSK also performs the financial and accounting tasks for the Hungarian representative office of KBC Global Services N.V. (KBC GSC).

In addition to rendering services to the Group, the Company also discharges business administration duties (it operates and performs the administrative tasks not only for the Supershop program, but also for K&H Medicina Health Fund and K&H Voluntary Pension Fund).

KEY CONSOLIDATED FIGURES OF THE BANK GROUP

In 2008 the total assets of the Bank increased by 31% (closing value: HUF 3.182 billion). The value of the consolidated assets of the subsidiaries rose by 12% compared to the previous year. The two subsidiaries boasting of the highest volume of total assets are Pannonlízing Zrt. (HUF 124 billion) and K&H Autófinanszírozó Zrt. (HUF 43 billion).

billion HUF	2007	2008	change
Balance sheet total	2,421.7	3,182.5	**31.4%**
Loan portfolio	1,531.3	1,757.4	**14.8%**
Of this: retail lending	530.9	705.6	**32.9%**
Client deposits and deposit certificates	1,543.4	2,014.0	**30.5%**
Of this: retail deposits	526.5	543.8	**3.3%**
Shareholders' equity	207.2	193.5	**-6.6%**

The operations, risk management practice, balance sheet and profit and loss accounts of Kereskedelmi és Hitelbank Zrt. are presented in detail in the Business Report for 2008.

Key items in the consolidated balance sheet:

- The 14.8% growth in *the credit portfolio* was primarily attributable to the expansion in retail lending (+32.9%, of this, 15% growth was due to the changes in foreign currency exchange rates), owing to the FX-based mortgage loans. The rise in the volume of the corporate credit portfolio was mainly due to the segment of medium-sized enterprises. By the end of the period, the ratio of retail loans grew to 40% within the total loan portfolio (2007: 35%).

- In the course of 2008, on Group-level the *deposit portfolio* grew by 30.5%. While the Bank Group closed a successful year considering retail deposit collection (it firmly maintains its 2nd place in terms of savings deposits) , the growth of the deposit portfolio was mainly attributable to the term deposits of the funds managed by KBC Asset Management, being an interest of the shareholder KBC Bank.
- The surplus liquidity, caused by the difference growth rates of the loan and deposit portfolios was used buy the Bank for the purchase of *trading and available-for-sale securities* (the aggregate securities portfolio grew from HUF 407 billion in 2007 to HUF 1.026 billion).
- The *decrease in equity* (2007: HUF 207 billion, 2008: HUF 193 billion) was occurred as combined effect of the following factors: posting the dividend paid to the shareholders on the performance in 2007 (-29.2 billion), current year's profit (+26.0 billion), decrease in cash flow hedge and available for sale reserves (- HUF 10.5 billion).

In 2008 the Bank Group generated HUF 48.9 billion in operating profit. The decrease compared to the previous year (HUF 60.9 billion) was primarily attributable to the sale of the share in Giro Bankkártya Zrt. posted back in 2007 (+ HUF 8.7 billion).

- The *net income from interest and interest-type income* rose by 16.7% in 2008. This growth was due to income earned from the still dynamically expanding retail lending activities on the one hand, and to the interest income realised on trading financial instruments on the other, and also augmented by the improved performance of the subsidiaries during the year.
- Compared to the previous year, *income from fees and commissions* decreased by 6% (2008: HUF 26.8 billion and 2007: HUF 28.6 billion). Apart from bankcard-related incomes, all of the main components of this income type (transaction fees, investment services, credit and guarantee fees) are down compared to the previous year (as a result of the adverse business environment and the fee and commission expenses related to the credit campaigns).
- The increase in the *net profit from financial instruments valued at fair value* (2008: HUF 37.5 billion, 2007: HUF 33.7 billion) is attributable – besides the income generated from Treasury activities – to the growth in conversion incomes received from clients (mainly in connection with retail loans).
- The drop in *other incomes* (2008: HUF 4.9 billion, 2007: HUF 11.2 billion) is primarily due to the sale of the share in Giro Bankkártya Zrt. in 2007 (+HUF 8.7 billion). (In 2008 this line shows the HUF 907 million proceeds from the sale of Mastercard shares).

In 2008 the *operating expenses* of the Bank Group were HUF 17.6 billion higher than in the previous year (2008: HUF 87.7 billion, 2007: HUF 70.1 billion). Within this:

- *Personnel costs* increased by HUF 0.4 billion (+1.4%),
- *Depreciation* basically remained at previous year's level (+ HUF 0.2 billion),
- *Other costs* rose by HUF 5.7 billion, primarily due to the increased costs of office allocation, real estate rents (expanding branch network) and the IT system.
- The *provisions for risks and charges* changed mainly as a result of tax and commercial-type litigations.

The transfer of the IT organisation to a new company (KBC Global Services Hungary) with the effect of May 1, 2008 also induced a change in the cost structure (staff costs were reclassified to IT costs due to the fee charged by the new company for IT services).

The business performance of the Bank Group is also demonstrated by the following indicators:

Ratio	2007	2008	Change
Costs to incomes *	57.9%	56.5%	-1.4%
Non-interest-type income to total income *	53.5%	51.4%	-2.1%
Income from fees and commission to total income *	23.4%	19.6%	-3.8%
Operating income * to average staff	31.2	35.2	+12.6%
Operating costs * to average staff	18.1	19.9	+9.9%
Operating profit * to average staff	13.2	15.3	+16.4%
Loan portfolio to deposit portfolio *	100.9%	88.2%	-12.7%
Equity **/ total liabilities	9.4%	6.7%	-2.7%
Solvency ratio (Basel II) ***	n.a.	9.87%	n.a.
ROE (based on opening value of equity)	21.6%	12.5%	-9.1%
ROA (based on average balance sheet total)	1.6%	0.9%	-0.7%

* costs: without legal and other provisions, incomes: without the sale of Giro Bankkártya Zrt.
** besides equity, it also includes subordinated debt capital
*** according to the rules of the Hungarian supervisory authority

Basically the performance of K&H Bank was in line with the expectations in 2008: disregarding the impact of certain special items (like sale of GBC in 2007) the comparable financial / profitability indicators show further improvements compared to previous year (in opposite to the majority of the competitors), while considering liquidity and capital adequacy positions as well the Bank is among the banks with the most favourable ratios in the Banking Sector.

Date: Budapest, March 24, 2009

Marko Voljč	Attila Gombás
Chief Executive Officer	Chief Financial Officer