



# **Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság**

**CONSOLIDATED ANNUAL REPORT**

**31 December 2010**

K&H BANK ZRT.

CONSOLIDATED ANNUAL REPORT  
31 DECEMBER 2010

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## Statement of the Issuer

K&H Bank Zrt. as the Issuer (represented by: Hendrik Scheerlinck, CEO and Attila Gombás, CFO) hereby declare that the Year 2010 Annual Report and the Year 2010 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 Management 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 28, 2011



**Hendrik Scheerlinck**  
Chief Executive Officer



**Attila Gombás**  
Chief Financial Officer

**Kereskedelmi és Hitelbank Zártkörűen  
Működő Részvénytársaság**

Consolidated annual financial statements prepared in accordance with  
International Financial Reporting Standard as adopted  
by the European Union for the year ended 31 December 2010  
with the Report of Independent Auditors

## Independent auditors' report

To the shareholder of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

We have audited the accompanying consolidated financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság and its subsidiaries, ("the Group") which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### 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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### 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 about 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 as of 31 December 2010, 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.

### Emphasis of matter

We draw attention to note 31 of these consolidated financial statements. In 2003 a significant fraud was discovered at K&H Equities Rt., a member of the Group. As at 31 December 2010 the Group has a provision of HUF 27,484 million for its potential liability to clients as a result of the fraud, and an asset of HUF 19,826 million for expected reimbursements. The ultimate outcome of this matter cannot presently be determined and due to its fundamental uncertainty the actual loss incurred by the Group might be significantly different from the provision and the asset created. Our opinion is not qualified in respect of this matter.

A handwritten signature in black ink, appearing to be 'G. L. G.'.

Ernst & Young Kft.  
Budapest, Hungary  
29 March 2011

## CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**
**CONSOLIDATED INCOME STATEMENT**

	Notes	2010 MHUF	After reclassification 2009 MHUF
Interest income		183 421	233 976
Interest expense		(80 122)	(146 174)
Net interest income	4	103 299	87 802
Fee and commission income		45 746	44 931
Fee and commission expense		(15 440)	(16 759)
Net fee and commission income	5	30 306	28 172
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	6	14 171	19 979
Net realised gains / (losses) from available-for-sale assets	7	1 514	218
Dividend income	8	4	3
Other net income (after reclassification)	9	8 888	(6 138)
Total income		158 182	130 036
Operating expenses		(86 633)	(73 198)
Staff expenses (after reclassification)	12	(32 823)	(31 966)
General administrative expenses (after reclassification)	10	(31 713)	(33 449)
Depreciation and amortisation of fixed assets		(7 071)	(7 783)
Bank tax	11	(15 026)	-
Impairment:	13	(35 796)	(40 315)
Loans and receivables		(35 688)	(40 142)
Other		(108)	(173)
Share in results of associated companies	14	372	454
Profit before tax		36 125	16 977
Income tax expense	15	(8 902)	(6 942)
Profit after tax		27 223	10 035
Earnings per share (HUF)	16	0.37	0.14

For changes in the presentation of the consolidated income statement see note 2.7.

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.



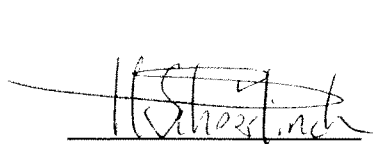
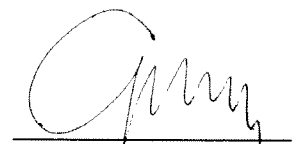
**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Profit after tax	27 223	10 035
Other comprehensive income		
Available-for-sale equity instruments		
Net change in revaluation reserve	4	45
Transfer from available for sale reserve to net profit		
Losses on disposal	-	(16)
Deferred income tax	-	3
Available for sale debt instruments		
Net change in revaluation reserve	(4 986)	6 738
Transfer from available for sale reserve to net profit		
(Losses)/ gains on disposal	(1 514)	(138)
Deferred income tax	185	30
Net change in cash flow hedge reserve	(561)	104
Transfer from cash flow hedge reserve to net profit		
Gross amount	707	598
Deferred income tax	(146)	(128)
Other movements	(278)	(122)
Total other comprehensive income	(6 589)	7 114
Total comprehensive income	<u>20 634</u>	<u>17 149</u>

Other movements include deferred tax expense resulting from change in the future tax rate (for more details see Note 15).

Approved by the Board of Directors on 29 March 2011.

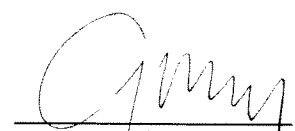
 Hendrik Scheerlinck Chief Executive Officer Member of the Board	 Attila Gombás Chief Financial Officer
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**K&H BANK ZRT.****CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010****CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

	<u>Notes</u>	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
<b>ASSETS</b>			
Cash and cash balances with central banks		115 351	147 343
Financial assets	17	3 033 039	2 839 742
Held for trading	25	177 952	117 658
Designated at fair value through profit or loss	19	6 416	9 145
Available for sale	23	758 909	1 075 978
Loans and receivables	21	1 681 112	1 636 614
Held to maturity		408 601	-
Hedging derivatives	25	49	347
Tax assets		3 244	7 018
Current tax assets		2 312	6 270
Deferred tax assets	27	932	748
Investments in associated companies	28	2 104	2 125
Property and equipment	29	35 333	29 268
Intangible assets	30	8 175	7 796
Other assets	26	31 694	31 205
Total assets		<u>3 228 940</u>	<u>3 064 497</u>
<b>LIABILITIES AND EQUITY</b>			
Financial liabilities	17	2 937 683	2 767 677
Held for trading	25	170 853	60 400
Designated at fair value through profit or loss	19	193 069	155 663
Measured at amortised cost		2 572 896	2 550 137
Hedging derivatives	25	865	1 477
Tax liabilities		285	2 778
Current tax liabilities		160	136
Deferred tax liabilities	27	125	2 642
Provisions for risks and charges	31	34 736	41 811
Other liabilities	32	34 992	41 586
Total liabilities		<u>3 007 696</u>	<u>2 853 852</u>
Total equity	33;42	221 244	210 645
Total liabilities and equity		<u>3 228 940</u>	<u>3 064 497</u>

Approved by the Board of Directors on 29 March 2011.

  
Hendrik Scheerlinck  
Chief Executive Officer  
Member of the Board

  
Attila Gombas  
Chief Financial Officer

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

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

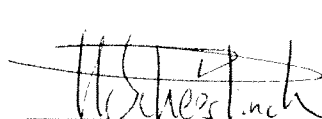
# CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010


## 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	Retained earnings MHUF	Total equity MHUF
2009							
Balance at the beginning of the period	66 307	48 775	10 704	(9 241)	(862)	77 813	193 496
Net profit for the year	-	-	-	-	-	10 035	10 035
Other comprehensive income for the period	-	-	-	6 546	568	-	7 114
Total comprehensive income	-	-	-	6 546	568	10 035	17 149
Dividend	-	-	-	-	-	(7 402)	(7 402)
Capital increase	7 402	-	-	-	-	-	7 402
Transfer from retained earnings to statutory risk reserve	-	-	1 832	-	-	(1 832)	-
Total change	7 402	-	1 832	6 546	568	801	17 149
Balance at the end of the period	73 709	48 775	12 536	(2 695)	(294)	78 614	210 645
of which revaluation reserve for equity instruments	-	-	-	(4)	-	-	(4)
of which revaluation reserve for bonds	-	-	-	(2 691)	-	-	(2 691)
2010							
Balance at the beginning of the period	73 709	48 775	12 536	(2 695)	(294)	78 614	210 645
Net profit for the year	-	-	-	-	-	27 223	27 223
Other comprehensive income for the period	-	-	-	(6 590)	1	-	(6 589)
Total comprehensive income	-	-	-	(6 590)	1	27 223	20 634
Dividend	-	-	-	-	-	(10 035)	(10 035)
Transfer from retained earnings to statutory risk reserve	-	-	2 893	-	-	(2 893)	-
Total change	-	-	2 893	(6 590)	1	14 295	10 599
Balance at the end of the period	73 709	48 775	15 429	(9 285)	(293)	92 909	221 244
of which revaluation reserve for bonds	-	-	-	(9 285)	-	-	(9 285)

The dividend paid on ordinary shares was HUF 10 035 million - 0.136143 HUF/share in 2010 (HUF 7 402 million – 0.111632 HUF/share in 2009). For dividend proposed on ordinary shares see Note 42.

Approved by the Board of Directors on 29 March 2011.

  
Hendrik Scheerlinck  
Chief Executive Officer  
Member of the Board

  
Attila Gombás  
Chief Financial Officer

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**
**CONSOLIDATED STATEMENT OF CASH FLOWS**

	<u>Notes</u>	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
<b>OPERATING ACTIVITIES</b>			
Profit before tax		36 125	16 977
Adjustments for:			
Net transfer from available for sale reserve		(1 514)	(154)
Net transfer from cash flow hedge reserve		707	598
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	29;30	7 179	7 956
(Profit)/Loss on the disposal of property and equipment	9	45	(98)
(Profit)/Loss on the disposal of subsidiaries and associated companies	9	36	7
Change in impairment on loans and advances*	13;24	35 688	40 142
Change in other provisions	31	(7 033)	(6 572)
Unrealised valuation differences		93 647	30 726
Income from associated companies	14	(372)	(454)
Cash flows from operating profit before tax and before changes in operating assets and liabilities		164 508	89 128
Changes in financial assets held for trading		(163 801)	65 138
Changes in financial assets designated at fair value through profit or loss		2 934	(10 728)
Effect of reclassification from available for sale to held to maturity		(258 479)	-
Changes in financial assets available for sale		311 313	(183 114)
Changes in loans and receivables		2 317	134 028
Changes in other assets		8 189	3 684
Changes in operating assets		(97 527)	9 008
Changes in financial liabilities held for trading		119 596	286
Changes in financial liabilities designated at fair value through profit or loss		36 898	15 499
Changes in financial liabilities measured at amortised cost		42 133	(12 322)
Changes in other liabilities		(5 564)	(5 283)
Changes in operating liabilities		193 063	(1 820)
Income taxes paid		(15 374)	(7 108)
Net cash from/(used in) operating activities		<u>244 670</u>	<u>89 208</u>

\* Including impairments on loans and receivables and loan commitments.

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**
**CONSOLIDATED STATEMENT OF CASH FLOWS (continued)**

	<u>Notes</u>	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
<b>INVESTING ACTIVITIES</b>			
Purchase of held-to-maturity securities		(166 022)	-
Proceeds from the repayment of held-to-maturity securities at maturity		15 900	-
Proceeds from the disposal of a subsidiary, net of cash disposed		17	-
Proceeds from the disposal of shares in associated companies		-	98
Dividends received from associated companies	8	415	443
Purchase of intangible fixed assets	30	(2 663)	(4 098)
Purchase of property, plant and equipment	29	(11 503)	(8 332)
Proceeds from the sale of property, plant and equipment		131	327
		<u>          </u>	<u>          </u>
Net cash from/(used in) investing activities		(163 725)	(11 562)
<b>FINANCING ACTIVITIES</b>			
Proceeds from the issuance of share capital		-	7 402
Dividends paid		(10 035)	(7 402)
		<u>          </u>	<u>          </u>
Net cash from/(used in) financing activities		(10 035)	-
<b>CHANGE IN CASH AND CASH EQUIVALENTS</b>			
Net increase/(decrease) in cash and cash equivalents		70 910	77 646
Cash and cash equivalents at beginning of the period		(68 472)	(146 118)
		<u>          </u>	<u>          </u>
Cash and cash equivalents at end of the period		2 438	(68 472)
		<u>          </u>	<u>          </u>

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**
**CONSOLIDATED STATEMENT OF CASH FLOWS (continued)**


	Notes	2010 MHUF	2009 MHUF
<b>ADDITIONAL INFORMATION</b>			
Interest received	4	183 421	233 976
Interest paid	4	(80 122)	(146 174)
Dividend received		419	446
<b>COMPONENTS OF CASH AND CASH EQUIVALENTS</b>			
Cash and cash balances with central banks		115 351	147 343
Loans and advances to banks repayable on demand and term loans to banks < 3 months		99 899	16 372
Deposits from banks repayable on demand and redeemable at notice		(212 812)	(232 187)
Total cash and cash equivalents		<u>2 438</u>	<u>(68 472)</u>

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

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

Approved by the Board of Directors on 29 March 2011.

  
Hendrik Scheerlinck  
Chief Executive Officer  
Member of the Board

  
Attila Gompás  
Chief Financial Officer

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 1 – GENERAL**

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság ("K&H Bank Zrt." or "the Bank") is a limited liability company incorporated in the Republic of Hungary. K&H Bank Zrt. and its subsidiaries ("the Group") provide a full range of banking services through a nation-wide network of 243 branches. K&H Bank Zrt.'s registered office is at Vigadó tér 1, Budapest.

The parent company of K&H Bank Zrt. 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 40.

***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 2010. 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. Subsidiaries under liquidation are consolidated using the equity method (see below).

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 consolidated statement of financial position at an amount that reflects its share of the net assets of the associate.

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**NOTES TO THE FINANCIAL STATEMENTS**

**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 38.

***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:

**Going concern**

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

**Fair value of financial instruments**

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

**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 31 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 or 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.



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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – ACCOUNTING POLICIES (continued)**

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.

**2.3 Changes in accounting policies**

*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 2010.

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

IFRS 1	First-time Adoption of International Financial Reporting Standards - Revised
IFRS 1	First-time Adoption of International Financial Reporting Standards - Additional Exemptions for First-time Adopters
IFRS 2	Share-based Payment - Group Cash Settled Share-based Payment Transactions
IFRS 3	Business Combinations
IAS 27	Consolidated and Separate Financial Statements
IAS 39	Financial Instruments: Recognition and Measurement - Eligible Hedged Items
IFRIC 17	Distribution of Non-cash Assets to Owners

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 1 First-time Adoption of International Financial Reporting Standards (revised) - Additional Exemptions for First-time Adopters (amendment)*

The IASB decided to change the standard to make it easier for the reader to understand and to design it to better accommodate future changes. The revised version of IFRS 1 had been issued in 2008 retains the substance of the previous version, but within a changed structure. It replaces the previous version and is effective for entities applying IFRSs for the first time for annual periods beginning on or after 1 July 2009. Earlier application is permitted.

In July 2009 an amendment had been issued: Additional Exemptions for First-time Adopters. The amendments are required to be applied for annual periods beginning on or after 1 January 2010.

The amendments have no impact on the consolidated financial statement.

*IFRS 2 Share-based Payment - Group Cash Settled Share-based Payment Transactions (amendment)*

The amendment was issued in June 2009. The amendments are required to be applied for annual periods beginning on or after 1 January 2010.

The amendments have no impact on the consolidated financial statement.

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**NOTES TO THE FINANCIAL STATEMENTS**

**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.

The amendments have no impact on the consolidated financial statement.

*Amendment to IAS 27 Consolidated and Separate Financial Statements*

The revised IAS 27 (as issued in 2008) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as 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.

The amendment has no impact on the consolidated financial statement.

*IAS 39 Financial Instruments: Recognition and Measurement - Eligible Hedged Items (amendment)*

The amendment addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations.

This amendment was issued in July 2008 and is effective for financial years beginning on or after 1 July 2009. Earlier application is permitted.

The amendment has no major impact on the consolidated financial statement.

*IFRIC 17 Distribution of Non-cash Assets to Owners (new)*

An entity shall apply this Interpretation prospectively for annual periods beginning on or after 1 July 2009. Earlier application is permitted.

The IFRIC 17 has no impact on the consolidated financial statement.

*Improvements to IFRSs – have no impact on the financial statements of the Group*

IFRS 5	Non- current Assets Held for Sale and Discontinued Operations
IFRS 2	Share-based payment
IAS 1	Presentation of Financial Statements
IAS 17	Leases
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IFRIC 9	Reassessment of Embedded Derivatives

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – ACCOUNTING POLICIES (continued)**

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

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

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**NOTES TO THE FINANCIAL STATEMENTS**

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**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 consolidated statement of financial position.

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

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 consolidated 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 are 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 the consolidated other comprehensive income 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 the consolidated other comprehensive income 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 the consolidated other comprehensive income remains in the consolidated other comprehensive income until the forecasted transaction occurs, when it is then 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 / (losses) from financial instruments at fair value through profit or loss and foreign exchange.

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**NOTES TO THE FINANCIAL STATEMENTS**

**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 Group 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 Group 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 Group's control, is non-recurring and could not have been reasonably anticipated by the Group.

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**NOTES TO THE FINANCIAL STATEMENTS**

**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 the consolidated other comprehensive income is included in 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 statement of financial position date. For instruments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current fair value of another instrument, which is substantially the same and discounted cash flow analysis.

Available-for-sale investments include 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 Day 1 profit***

For financial instruments at fair value the difference between the transaction price and the fair value is recognised immediately in the consolidated income statement or in the consolidated other comprehensive income at initial recognition. For other financial instruments, for which the transaction price is calculated using a valuation technique, the difference is amortised as profit or loss during the maturity of the instrument.

***2.4.4 Repo and reverse repo agreements***

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

***2.4.5 Securities lending and borrowing***

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

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – ACCOUNTING POLICIES (continued)**

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

***2.4.6 Allowances for impairment of financial assets***

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

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

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

***2.4.6.1 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.

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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 2 – ACCOUNTING POLICIES (continued)**

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.

***2.4.6.2 Available-for-sale financial assets***

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognized in the 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 was 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.

***2.4.6.3 Renegotiated loans***

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms of a restructured loan have been renegotiated, the loan is no longer considered past due. The loans continue to be subject to an individual or collective impairment assessment.

***2.4.7 Offsetting***

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position 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.

***2.4.8 Derecognition of financial assets***

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

- the rights to receive cash flows from the asset have expired; or
- the 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.



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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 2 – ACCOUNTING POLICIES (continued)**

***2.4.9 Derecognition of financial liabilities***

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

***2.4.10 Leases***

***Determination of whether an arrangement contains a lease***

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

***2.4.10.1 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.

***2.4.10.2 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 consolidated statement of financial position and lease payments received are presented as income in the consolidated income statement.

***2.4.11 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.

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

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

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**NOTE 2 – ACCOUNTING POLICIES (continued)**

***2.4.13 Cash and cash equivalents***

For the purposes of reporting cash flows, cash and cash equivalents comprise balances with an original maturity less than 90 days, including cash, balances due from banks and balances with the National Bank of Hungary (including obligatory reserves) decreased with deposits from banks repayable on demand.

***2.4.14 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.

***2.4.15 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
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***2.4.16 Commitments, contingent liabilities***

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

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**NOTE 2 – ACCOUNTING POLICIES (continued)**

Any increase in the liability relating to financial guarantees is taken to the consolidated income statement in 'Impairment on loans and receivables' including provisions for credit commitments. 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.

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

***2.4.17 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. Any compensation that arises in relation to provisions for operational losses from claims and legal disputes regarding commercial activity are presented in other net income when they become virtually certain.

***2.4.18 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 statement of financial position date.

***2.4.19 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.

***2.4.20 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 Group.

***2.4.21 Equity reserves***

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

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

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

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

***2.4.22 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.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – ACCOUNTING POLICIES (continued)**

***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:

*IFRS 9 Financial Instruments (new)*

IFRS 9 is a new standard dealing with the accounting for financial instruments. IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39.

IFRS 9 shall be applied for annual periods beginning on or after 1 January 2013. Early application is permitted. In subsequent phases the Board will address impairment and hedge accounting.

The adoption of the first phase of IFRS 9 will primarily have an effect on the classification and measurement of the Group's financial instruments.

*IAS 24 Related Party Disclosures (revised)*

The standard had been revised by simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition and providing a partial exemption from the disclosure requirements for government-related entities.

The revised standard shall be applied for annual periods beginning on or after 1 January 2011. Early application is permitted.

*IAS 32 Financial Instruments: Presentation - Classification of Rights Issues (amendment)*

Paragraphs 11 and 16 were amended by Classification of Rights Issues issued in October 2009. The definition of a financial liability has been amended in order to classify the rights issued (and certain options and warrants) as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, or to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency.

An entity shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted.

*IFRIC 14 IAS 19 - The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction - Prepayments of Minimum Funding Requirements (amendment)*

The amendments apply in limited circumstances: when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendments permit such an entity to treat the benefit of such an early payment as an asset.

Entities shall apply these amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – ACCOUNTING POLICIES (continued)**

*IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (new)*

The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case this cannot be reliably measured, they are measured at the fair value of the liability extinguished. Any gain or loss is recognised immediately in profit or loss.

An entity shall apply this Interpretation for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

The Group expects that the adoption of the pronouncements listed above will have no significant (except for IFRS 9) impact on the Group's consolidated financial statements in the period of initial application.

*Improvements to IFRSs (issued in May 2010)*

The IASB issued Improvements to IFRSs, an omnibus of amendments to its IFRS standards. The amendments have not been adopted as they become effective for annual periods on or after either 1 July 2010 or 1 January 2011. The amendments are listed below.

- IFRS 1 First-time Adoption of International Financial Reporting Standards
- IFRS 3 Business Combinations
- IFRS 7 Financial instruments: Disclosures
- IAS 1 Presentation of Financial Statements
- IAS 27 Consolidated and Separate Financial Statements
- IAS 34 Interim Financial reporting
- IFRIC 13 Customer Loyalty Programmes

**2.6 Tax payable by financial institutions**

In August 2010 the Hungarian Parliament approved a new Act which provides a framework for the levying of a "bank tax" on financial institutions in the years 2010, 2011 and 2012. This act provided that as regards 2010 each financial institution that already had a closed financial year and related financial statements on 1 July 2010 would be subject to assessment and payment of the bank tax for 2010. Due to the significance of the amount concerned the bank tax is presented as a separate line on the face of the consolidated income statement.

The basis and the rate of the bank tax that is payable differs depending on the type of financial institutions. For 2010 the rates are uniformly based on statutory reported financial data of the reporting entity for the period ended 31 December 2009.

The bank tax is recorded as an expense in the financial period in which it is legally payable.

As the bank tax is payable based on prior year non net income measures it does not meet the definition of income tax under IFRS and is therefore presented as an operating expense in the consolidated income statement.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – ACCOUNTING POLICIES (continued)****2.7 Reclassification**

The following comparative information has been reclassified in the consolidated income statement for presentation purposes.

	<b>As previously reported 2009</b>	<b>Reclassification</b>	<b>After reclassification 2009</b>
	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>
Other net income	1 589	(7 727)	(6 138)
Staff expenses	(32 027)	61	(31 966)
General administrative expenses	(47 687)	14 238	(33 449)
Provisions for risks and charges	6 572	(6 572)	-

All reclassifications result from the implementation of updated reporting definitions as introduced within the KBC Group as from the beginning of 2010.

Due to the new reporting definitions provisions and related expenses are presented under the same line of result in the Consolidated Income Statement.

Management believes the above reclassifications relating to 2009 are immaterial to the consolidated financial statements taken as a whole.

**2.8 Change in estimate**

In 2010 the Group switched to a new valuation methodology on financial derivatives based on standardised KBC market yield curves instead of the previously used money market yield curves of the local analytical position management system. In the new valuation methodology EUR is considered to be the base currency for cross currency spread estimations and the new yield curves already include the market observable cost of maturity transformation (via inclusion of basis swap points). The method change resulted in a HUF 1 674 million positive revaluation impact in 2010 reported under the heading 'net gains from financial instruments at fair value through profit or loss'. This change in the estimate has no impact on the result of future periods.

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 3 – SEGMENT INFORMATION**

Management monitors the operating result of its business units separately for the purpose of making decisions about resource allocation and performance assessment.

Since the internal business segmentation criteria for Retail and Corporate Business Lines have undergone significant changes in 2010, segment information for 2009 was restated to align with the new segmentation rules.

Definitions of customer segments:

Retail: private individuals, entrepreneurs and companies with a turnover of less than HUF 2 000 million. Services provided: loans and financing products, deposits and other savings products, transactional services, etc.

Corporate: companies with a turnover of higher than HUF 2 000 million, municipalities, project financing, and non-banking institutions in the financial sector. Services: loans and other credit facilities, deposits and transactional services, etc.

Treasury: proprietary trading activity.

Leasing: loans, financial and operational lease products provided by K&H Leasing Group.

General Management: consists of items which are not directly attributable to the business activity of the above defined segments. These include the result of tax and commercial litigations (see Note 31), bank tax, yield on real equity (result on the reinvestment on free equity) and fair value changes recognised under IFRS on derivatives used for hedging purposes that do not qualify for fair value hedge accounting for a portfolio hedge of interest rate risk.

Intersegment transactions are transactions concluded between the different segments on an arm's length basis comprising the costs of services and transactions related to corporate clients managed and incurred by retail branches (charged to the corporate segment on the basis of internally agreed settlement price).

The Group only operates in the Republic of Hungary.

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 3 – SEGMENT INFORMATION (continued)**

All investments in associates and additions to property, plant and equipment and intangible assets (including capital expenditures) are shown in "General management" segment.

Segment reporting information by customer segments for 2010:

	<b>Retail MHUF</b>	<b>Corporate MHUF</b>	<b>Treasury MHUF</b>	<b>Leasing MHUF</b>	<b>General management MHUF</b>	<b>Total MHUF</b>
Net interest income / (expense)	58 627	20 140	1 339	4 800	18 393	103 299
Net fee and commission income / (expense)	26 439	4 796	-	253	(1 182)	30 306
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	6 812	5 814	3 144	(100)	(1 499)	14 171
Net realised gains / (losses) from available-for-sale assets	581	322	-	-	611	1 514
Dividend income	-	-	-	-	4	4
Other net income / (expense)	5	44	-	698	8 141	8 888
Total income / (expense)	92 464	31 116	4 483	5 651	24 468	158 182
of which:						
external income / (expense)	92 061	31 518	4 482	5 652	24 649	158 182
internal income / (expense)	402	(402)	-	-	-	-
Operating expenses	(50 902)	(12 421)	(2 616)	(4 069)	(16 625)	(86 633)
Impairment	(20 852)	(8 835)	-	(6 109)	-	(35 796)
Share in results of associated companies	-	-	-	-	372	372
Profit / (loss) before tax	20 710	9 860	1 867	(4 527)	8 215	36 125
Income tax benefit / (expense)	(5 284)	(2 046)	(358)	(371)	(843)	(8 902)
Segment profit / (loss)	15 426	7 814	1 509	(4 898)	7 372	27 223
Total assets	912 499	702 354	161 415	108 723	1 343 949	3 228 940
Total liabilities and equity	1 383 391	589 764	11 488	1 159	1 243 138	3 228 940



**K&H BANK ZRT.**
**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 3 – SEGMENT INFORMATION (continued)**

Segment reporting information by customer segments for 2009 after reclassification:

	<u>Retail MHUF</u>	<u>Corporate MHUF</u>	<u>Treasury MHUF</u>	<u>Leasing MHUF</u>	<u>General management MHUF</u>	<u>Total MHUF</u>
Net interest income / (expense)	55 014	14 322	1 832	6 495	10 139	87 802
Net fee and commission income / (expense)	24 575	5 042	-	408	(1 853)	28 172
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	6 523	6 209	8 812	642	(2 207)	19 979
Net realised gains / (losses) from available-for-sale assets	-	-	-	-	218	218
Dividend income	-	-	-	-	3	3
Other net income / (expense)	92	38	-	1	(6 269)	(6 138)
Total income / (expense)	86 204	25 611	10 644	7 546	31	130 036
of which:						
external income / (expense)	85 719	26 095	10 644	7 547	31	130 036
internal income / (expense)	483	(483)	-	-	-	-
Operating expenses	(52 221)	(12 507)	(2 702)	(4 127)	(1 641)	(73 198)
Impairment	(21 811)	(14 035)	-	(4 469)	-	(40 315)
Share in results of associated companies	-	-	-	-	454	454
Profit / (loss) before tax	12 172	(931)	7 942	(1 050)	(1 156)	16 977
Income tax benefit / (expense)	(4 350)	(685)	(1 165)	(33)	(709)	(6 942)
Segment profit / (loss)	<u>7 822</u>	<u>(1 616)</u>	<u>6 777</u>	<u>(1 083)</u>	<u>(1 865)</u>	<u>10 035</u>
Total assets	861 026	747 293	76 045	147 695	1 232 438	3 064 497
Total liabilities and equity	1 366 026	667 748	8 325	4 649	1 017 749	3 064 497

**K&H BANK ZRT.**
**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 4 – NET INTEREST INCOME**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Loans and receivables	108 391	134 436
Held to maturity	12 092	-
Available-for-sale assets	53 409	92 075
Subtotal, interest income from financial assets not measured at fair value through profit or loss	173 892	226 511
<i>of which: impaired financial assets</i>	2 422	1 707
Financial assets held for trading	8 315	6 468
Other financial assets at fair value through profit or loss	1 214	997
Total interest income	183 421	233 976
Financial liabilities measured at amortised cost	(66 253)	(135 374)
Financial liabilities held for trading	(751)	(171)
Other financial liabilities at fair value through profit or loss	(13 118)	(10 629)
Total interest expenses	(80 122)	(146 174)
Net interest income	103 299	87 802

**NOTE 5 – NET FEE AND COMMISSION INCOME**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Brokerage services	6 556	5 266
Trust and fiduciary activities	4 706	4 211
Credit and guarantee fee income	3 954	3 607
Structured finance	379	272
Payment services	19 509	20 687
Card services	9 713	10 055
Other	929	833
Fee and commission income	45 746	44 931
Brokerage services	(972)	(820)
Credit and guarantee fee expense	(2 048)	(1 973)
Commissions to agents	-	(60)
Payment transactions	(4 743)	(5 507)
Card services	(4 634)	(5 046)
Insurance services	(2 121)	(2 359)
Other	(922)	(994)
Fee and commission expense	(15 440)	(16 759)
Net fee and commission income	30 306	28 172

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

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**NOTES TO THE FINANCIAL STATEMENTS**

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

	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
Trading securities	390	1 533
Interest rate derivatives (including interest and fair value changes in trading derivatives)	2 118	8 508
Other financial instruments initially recognised at fair value through profit or loss	(410)	(4 381)
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	12 467	14 798
Fair value adjustments in hedge accounting*	<u>(394)</u>	<u>(479)</u>
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	<u>14 171</u>	<u>19 979</u>

\* Realised results of micro cash flow hedge derivatives amounted to HUF 707 million loss in 2010 (HUF 598 million loss in 2009), and HUF 313 million gain was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 119 million gain in 2009).

Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange include the interest result on derivatives, the (un)realised gains from foreign currency translation and the fair value changes and the net realised gains of

- derivatives
- held-for-trading government bonds, treasury bills and equity instruments
- other financial instruments at fair value through profit or loss (see note 19),

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 has no impact on the consolidated income statement in 2010 (HUF 2 228 million loss in 2009).

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

	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
Fixed-income securities	1 514	137
Equity instruments	<u>-</u>	<u>81</u>
Net realised gains from available for sale	<u>1 514</u>	<u>218</u>

**K&H BANK ZRT.****CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010****NOTES TO THE FINANCIAL STATEMENTS****NOTE 8 – DIVIDEND INCOME**

	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
Available-for-sale shares	4	3

Dividends in 2010 and 2009 are paid by VISA Inc..

**NOTE 9 – OTHER NET INCOME**

	<u>2010</u> <u>MHUF</u>	<u>After reclassification 2009</u> <u>MHUF</u>
Gain on property, plant and equipment	(11)	120
Sale of goods (after reclassification)	687	692
Gain / (loss) on disposal of investments	(36)	(8)
Gain on other services	686	940
Gain / (loss) due to operational risks (after reclassification)	7 329	(8 259)
Other (after reclassification)	233	377
Other net income	8 888	(6 138)

Gains resulting from services provided by K&H Csoportszolgáltató Kft. are presented as gain on other services. In 2010 gain / (loss) due to operational risks contains HUF 6 818 million compensation income for covering the losses resulting from operational risks.

**NOTE 10 – GENERAL ADMINISTRATIVE EXPENSES**

	<u>2010</u> <u>MHUF</u>	<u>After reclassification 2009</u> <u>MHUF</u>
IT expenses	(10 608)	(11 043)
Rental expenses	(4 295)	(4 610)
Repair and maintenance	(1 508)	(1 365)
Marketing expenses	(2 083)	(2 315)
Professional fees (after reclassification)	(2 322)	(2 388)
Other facilities expenses	(5 793)	(6 481)
Communication expenses	(292)	(255)
Travel expenses	(82)	(65)
Training expenses	(586)	(194)
Personnel related expenses	(356)	(814)
Other administrative expenses (after reclassification)	(3 636)	(4 886)
Provision for restructuring charges (after reclassification)	-	857
Other provision (after reclassification)	(152)	110
Total general administrative expenses	(31 713)	(33 449)

## K&H BANK ZRT.

### CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

#### NOTES TO THE FINANCIAL STATEMENTS

##### NOTE 11 – BANK TAX

The Group paid a bank tax of HUF 15 026 million in 2010 (no bank tax was recorded in 2009). The basis and the tax rate of the tax payable by financial institutions can differ per group members, dependent on their activities.

The table below presents the details of the bank tax paid by the group members in 2010.

Group members	Activity	Tax base	Tax rate	Tax
		MHUF	%	MHUF
K&H Bank Zrt.	Credit institution	2 879 214	0.494	14 221
K&H Pannonlizing Zrt.	Finance leasing	7 462	6.500	485
K&H Autófinanszírozó Zrt.	Finance leasing	1 846	6.500	120
K&H Eszközfinanszírozó Zrt.	Finance leasing	109	6.500	7
K&H Lizing Zrt.	Finance leasing	11	6.500	1
K&H Befektetési Alapkezelő Zrt.	Asset management	685 070	0.028	192
Total		3 573 712	0.420	15 026

The bank tax payable by the Group members for the year 2010 is calculated as follows.

For credit institutions the tax base includes the total asset value as at 31 December 2009, less:

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

The bank tax for credit institutions is payable at 0.15% on tax base below HUF 50 000 million and 0.5% on tax base above HUF 50 000 million.

Tax base used by finance lease companies includes interest income and fee and commission income as recorded in the entity's income statement in 2009.

The tax rate applicable for finance lease companies is 6.5%.

The tax base of asset management companies is calculated based on the net asset value of all portfolios managed less all liabilities relating to these portfolios, as at 31 December 2009.

The tax rate used by asset management companies is 0.028%.

The Bank tax for the Group is expected to be HUF 15 878 million in 2011. The liability will be payable quarterly during 2011. The amount of the bank tax and the calculation method for 2012 is not yet determined.

##### NOTE 12 – AVERAGE NUMBER OF PERSONNEL

	2010	After reclassification 2009
White-collar staff (after reclassification)	3 486	3 480
Blue-collar staff (after reclassification)	33	6
Management (after reclassification)	186	189
Total average number of persons employed	3 706	3 675

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 13 – IMPAIRMENT (income statement)**

	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for loans and receivables	(35 502)	(37 025)
Specific provisions on credit commitments	791	535
Portfolio-based impairments and provisions	<u>(977)</u>	<u>(3 652)</u>
Total impairments and provisions on loans and receivables and credit commitments	<u><u>(35 688)</u></u>	<u><u>(40 142)</u></u>
	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
Impairment on other		
Intangible assets	(2)	(4)
Property and equipment	(133)	(173)
Other	<u>27</u>	<u>4</u>
Total impairment on other	<u><u>(108)</u></u>	<u><u>(173)</u></u>

**NOTE 14 – SHARE IN THE RESULTS OF ASSOCIATED COMPANIES**

	<u>2010</u> <u>MHUF</u>	<u>2009</u> <u>MHUF</u>
Giro Elszámolásforgalmi Zrt.	345	454
HAGE Zrt.	34	-
K&H Lízingház Zrt. "v.a"	<u>(7)</u>	<u>-</u>
Share of the results of associates	<u><u>372</u></u>	<u><u>454</u></u>

The impairment reversed on HAGE Zrt. was a HUF 173 million gain in 2010 (HUF 83 million loss in 2009). The current year's result and the impairment of the associates are recorded net within the consolidated income statement as "Share in the results of associated companies".

As K&H Lízingház Zrt. was under liquidation as at 31 December 2010, it was consolidated using the equity method according to the Group's accounting policy, notwithstanding that the Group's share in the company exceeds 50% and which normally would indicate full consolidation.

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 15 – INCOME TAXES**

The components of income tax expense for the year ended 31 December 2010 and 2009 are:

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Statutory income tax expense	(6 653)	(5 871)
Local business tax expense	(4 293)	(4 707)
Deferred taxes on income	2 044	3 636
Income tax expense	<u>(8 902)</u>	<u>(6 942)</u>

Statutory income tax expense

In 2009, corporate income tax was payable at 16% on taxable statutory profits. The additional 4% solidarity tax payable on taxable statutory profit was revoked from 2010. In 2010, corporate income tax payable on the profits of the first half-year is 19%. For the second half of the year the corporate income tax is payable at 10% on yearly profits below a limit of HUF 500 million and 19% on profits above the limit. (The Group considers the limit on a proportional basis during the income tax calculation.)

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

There is no procedure for final agreement of tax assessments in Hungary. The tax authorities may examine the accounting records and revise assessments for up to 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.

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Profit before tax	36 125	16 977
Income tax rate*	20.62%	20.62%
Income tax calculated	(7 449)	(3 501)
Plus/minus tax effects attributable to:		
Tax base decreasing items	925	4 467
Adjustments related to prior years	720	-
Adjustments, opening balance of deferred taxes due to change in tax rate	1 080	301
Unused tax losses to reduce current tax expense	-	19
Unused tax losses to reduce deferred tax expense	167	494
Reversal of previously recognised deferred tax on unused tax losses and tax credits	(46)	(9)
Tax base increasing items	(4 298)	(8 739)
Other	(1)	26
Total tax effects	<u>(1 453)</u>	<u>(3 441)</u>
Income tax expense (income tax calculated + total tax effects)	<u>(8 902)</u>	<u>(6 942)</u>

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010****NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 15 – INCOME TAXES (continued)**

\*The 19% of statutory income tax rate was modified, because local business taxes are presented as income taxes in the consolidated income statement. This creates an increase of about 1.62% in the statutory income tax rate in 2009 and 2010. The effective income tax rate for 2010 is 24.64% (2009: 40.89%).

**NOTE 16 – 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 2010 and 2009. The following amounts were used in the calculation of earnings per share:

	<u>2010</u>	<u>2009</u>
Net profit attributable to shareholders (MHUF)	27 223	10 035
Weighted average shares outstanding (in millions)	73 709	71 289
Earnings per share (HUF)	0.37	0.14



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**NOTE 17 – 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	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2010							
Loans and advances to credit institutions and investment firms*	-	-	-	117 913	-	-	117 913
Loans and advances to customers	-	1 322	-	1 537 350	-	-	1 538 672
Consumer credit	-	-	-	80 134	-	-	80 134
Mortgage loans	-	-	-	715 522	-	-	715 522
Term loans	-	1 322	-	605 758	-	-	607 080
Finance leasing	-	-	-	36 767	-	-	36 767
Current account advances	-	-	-	89 528	-	-	89 528
Other	-	-	-	9 641	-	-	9 641
Equity instruments	9 639	-	910	-	-	-	10 549
Debts instruments issued by public bodies	138 678	5 094	757 999	25 849	408 601	-	1 336 221
Derivatives	29 635	-	-	-	-	49	29 684
Total carrying value	177 952	6 416	758 909	1 681 112	408 601	49	3 033 039

\*From the total balance of loans and advances to credit institutions and investment firms HUF 99 899 million is either repayable on demand or is maturing in less than 90 days. Loans and advances to credit institutions, investment firms and customers include reverse repo transactions of HUF 48 711 million.

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**NOTE 17 – 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	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2009						
Loans and advances to credit institutions and investment firms*	-	-	-	46 692	-	46 692
Loans and advances to customers	-	2 329	-	1 589 922	-	1 592 251
Consumer credit	-	-	-	95 214	-	95 214
Mortgage loans	-	-	-	665 480	-	665 480
Term loans	-	2 329	-	685 137	-	687 466
Finance leasing	-	-	-	44 698	-	44 698
Current account advances	-	-	-	89 578	-	89 578
Other	-	-	-	9 815	-	9 815
Equity instruments	7 402	-	884	-	-	8 286
Debt instruments issued by Public bodies	69 067	6 816	1 075 094	-	-	1 150 977
Credit institutions and investment firms	69 067	6 523	1 071 901	-	-	1 147 491
Corporates	-	293	541	-	-	541
Derivatives	41 189	-	2 652	-	-	2 945
					347	41 536
Total carrying value	117 658	9 145	1 075 978	1 636 614	347	2 839 742

\*From the total balance of loans and advances to credit institutions and investment firms HUF 16 372 million is either repayable on demand or is maturing in less than 90 days. Loans and advances to credit institutions and investment firms includes reverse repo transactions of HUF 2 716 million.

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 17 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT  
(continued)**

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2010					
Deposits from credit institutions and investment firms*	-	-	-	1 105 453	1 105 453
Deposits from customers and debt certificates	-	193 069	-	1 465 988	1 659 057
Deposits from customers	-	191 795	-	1 431 401	1 623 196
Demand deposits	-	-	-	432 379	432 379
Time deposits	-	191 795	-	821 819	1 013 614
Savings deposits	-	-	-	177 203	177 203
Debt certificates	-	1 274	-	34 587	35 861
Certificates of deposits	-	-	-	264	264
Non-convertible bonds	-	1 274	-	12 915	14 189
Non-convertible subordinated liabilities	-	-	-	21 408	21 408
Derivatives	135 587	-	865	-	136 452
Short positions	35 266	-	-	-	35 266
In debt instruments	35 266	-	-	-	35 266
Other	-	-	-	1 455	1 455
Total carrying value	170 853	193 069	865	2 572 896	2 937 683

\*Of which HUF 212 812 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 69 030 million.

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**NOTE 17 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT  
(continued)**

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2009					
Deposits from credit institutions and investment firms*	-	-	-	892 725	892 725
Deposits from customers and debt certificates	-	155 663	-	1 654 764	1 810 427
Deposits from customers	-	148 880	-	1 627 826	1 776 706
Demand deposits	-	-	-	415 631	415 631
Time deposits	-	148 880	-	1 118 447	1 267 327
Savings deposits	-	-	-	93 748	93 748
Debt certificates	-	6 783	-	26 938	33 721
Certificates of deposits	-	-	-	273	273
Non-convertible bonds	-	6 783	-	5 735	12 518
Non-convertible subordinated liabilities	-	-	-	20 930	20 930
Derivatives	57 771	-	1 477	-	59 248
Short positions	2 629	-	-	-	2 629
In debt instruments	2 629	-	-	-	2 629
Other	-	-	-	2 648	2 648
Total carrying value	60 400	155 663	1 477	2 550 137	2 767 677

\*Of which HUF 232 187 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 21 934 million.

**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 2010 was HUF 48 476 million, of which HUF 35 266 million (reported as short positions in the consolidated statement of financial position) has been sold (31 December 2009 HUF 2 722 million and HUF 2 629 million respectively).

The carrying amount of Hungarian government bonds pledged as collateral for repo liabilities amounted to HUF 69 782 million as at 31 December 2010 (HUF 22 866 million as at 31 December 2009).

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**(continued)**

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

*Equity and debt instruments*

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
<u>Held for trading</u>		
Treasury bills	103 497	42 879
Government bonds issued in HUF	27 291	26 188
Government bonds issued in foreign currency	7 890	-
Listed equity instruments	5 994	6 491
Unlisted equity instruments	3 645	911
Total held for trading securities	<u>148 317</u>	<u>76 469</u>

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
<u>Available for sale</u>		
Treasury bills	118 552	168 708
Consolidation bonds issued in HUF	-	112 719
Other government bonds issued in HUF	592 130	747 247
Bonds issued by municipality - issued in HUF	-	31 234
Bonds issued by municipality - issued in foreign currency	47 317	11 993
Other bonds – listed issued in HUF	-	3 193
Unlisted equity instruments	910	884
Total available for sale	<u>758 909</u>	<u>1 075 978</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 17 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT**  
**(continued)**

	<u>2010</u> <b>MHUF</b>	<u>2009</u> <b>MHUF</b>
<u>Loans and receivables</u>		
Bonds issued by municipality - issued in HUF	4 987	-
Bonds issued by municipality - issued in foreign currency	<u>20 862</u>	<u>-</u>
Total loans and receivables debt instruments	<u><u>25 849</u></u>	<u><u>-</u></u>
	<u>2010</u> <b>MHUF</b>	<u>2009</u> <b>MHUF</b>
<u>Held to maturity</u>		
Treasury bills	6 251	-
Consolidation bonds issued in HUF	112 025	-
Government bonds issued in HUF	<u>290 325</u>	<u>-</u>
Total held to maturity	<u><u>408 601</u></u>	<u><u>-</u></u>

Due to the changes of the Group's intention concerning available-for-sale securities the proportion of the portfolios in the total security position and the structure of the portfolios were revised. Consolidation bonds in amount of HUF 110 654 million and government bonds issued in HUF in amount of HUF 148 519 million included in the available-for-sale portfolio in 2009 were reclassified into the reopened held-to-maturity portfolio. The remaining part of held-to-maturity government bonds issued in HUF results from new purchases, just like held-to-maturity treasury bills.

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 both in 2010 and 2009. As they are repriced regularly Management believe that amortized historical cost is the most appropriate estimation of their fair value.

Available-for-sale equity instruments contain as at 31 December 2010 unlisted equity instruments in a value of HUF 910 million (HUF 884 million at the end of 2009) for which a fair value cannot 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. These participations are not consolidated as either a subsidiary or through equity consolidation.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 17 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT**  
**(continued)**

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Hitelgarancia Zrt.	640	640
VISA Inc.	265	239
SWIFT S.C.	5	5
	<u>910</u>	<u>884</u>

The table does not contain Risk Kft., as it is fully impaired as at the end of 2010 and 2009.

*Refinancing credits*

The Bank has entered into several refinancing credit facilities with financial institutions (such as EIB, FHB – Mortgage Bank, MFB – Development Bank, EXIM Bank) for the purpose of funding portions of the Bank's activities. There are several covenants governing the determination of qualified recipients, the on-going monitoring process of the ultimate recipients and the repayment process. In all cases the Bank assumes all credit risk related to the ultimate borrower and must check compliance with all covenants. At 31 December 2010, Management believes that the Bank is in compliance with all significant covenants. Refinancing credits are presented as financial liabilities at amortised cost in the consolidated statement of financial position.

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Refinancing credits	<u>170 462</u>	<u>181 931</u>

*Non-convertible subordinated liabilities*

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Subordinated loan from KBC Group	16 684	16 204
Bonds issued to the State	<u>4 714</u>	<u>4 714</u>
	<u>21 398</u>	<u>20 918</u>

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

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 18 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES**

The table below presents information concerning the fair value of financial assets and liabilities for year 2010:

	At fair value		Valuation techniques - non market observable inputs MHUF	At amortised cost MHUF	Total carrying amount MHUF	Recognised in profit or loss - non market observable inputs MHUF	Fair value MHUF	Unrecognised gain/(loss) MHUF
	Quoted market price MHUF	Valuation techniques - market observable inputs MHUF						
Financial assets								
Held for trading	138 656	37 193	2 103	-	177 952	536	177 952	-
Designated at fair value through profit or loss	-	6 416	-	-	6 416	-	6 416	-
Available for sale	710 682	-	47 317	910	758 909	-	758 909	-
Loans and receivables	-	-	-	1 681 112	1 681 112	-	1 681 117	5
Held to maturity	-	-	-	408 601	408 601	-	398 427	(10 174)
Hedging derivatives	-	49	-	-	49	-	49	-
Total financial assets	849 338	43 658	49 420	2 090 623	3 033 039	536	3 022 870	(10 169)
Financial liabilities								
Held for trading	35 266	133 484	2 103	-	170 853	(536)	170 853	-
Designated at fair value through profit or loss	-	193 069	-	-	193 069	-	193 069	-
Measured at amortised cost	-	-	-	2 572 896	2 572 896	-	2 572 885	11
Hedging derivatives	-	865	-	-	865	-	865	-
Total financial liabilities	35 266	327 418	2 103	2 572 896	2 937 683	(536)	2 937 672	11

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.



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

The table below presents information concerning the fair value of financial assets and liabilities for year 2009:

	At fair value		Valuation techniques - non market observable inputs		At amortised cost	Total carrying amount	Recognised in profit or loss - non market observable inputs	Fair value	Unrecognised gain/(loss)
	Quoted market price	Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs						
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
<b>Financial assets</b>									
Held for trading	75 537	39 633	2 488	-	-	117 658	(539)	117 658	-
Designated at fair value through profit or loss	-	8 851	294	-	-	9 145	-	9 145	-
Available for sale	915 955	113 261	45 879	884	1 075 979	1 075 979	-	1 075 979	-
Loans and receivables	-	-	-	1 636 614	1 636 614	1 636 629	-	1 636 629	15
Hedging derivatives	-	347	-	-	347	347	-	347	-
<b>Total financial assets</b>	<b>991 492</b>	<b>162 092</b>	<b>48 661</b>	<b>1 637 498</b>	<b>2 839 743</b>	<b>2 839 758</b>	<b>(539)</b>	<b>2 839 758</b>	<b>15</b>
<b>Financial liabilities</b>									
Held for trading	2 629	55 283	2 488	-	-	60 400	485	60 400	-
Designated at fair value through profit or loss	-	155 627	36	-	-	155 663	(2 174)	155 663	-
Measured at amortised cost	-	-	-	2 550 137	2 550 137	2 550 136	-	2 550 136	(1)
Hedging derivatives	-	1 477	-	-	1 477	1 477	-	1 477	-
<b>Total financial liabilities</b>	<b>2 629</b>	<b>212 387</b>	<b>2 524</b>	<b>2 550 137</b>	<b>2 767 677</b>	<b>2 767 676</b>	<b>(1 689)</b>	<b>2 767 676</b>	<b>(1)</b>

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

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

	Held-for trading-derivatives	Corporate bonds at fair value through profit or loss	Available-for-sale debt instruments issued by public bodies	Total
Financial assets	MHUF	MHUF	MHUF	MHUF
Balance as at 31 December 2009	2 488	294	45 879	48 661
Net gains / (losses)				
In profit or loss	285	(7 595)	8 337	1 027
In other comprehensive income	-	-	(6 526)	(6 526)
Acquisitions	-	7 301	-	7 301
Settlement	(670)	-	(373)	(1 043)
Balance as at 31 December 2010	2 103	-	47 317	49 420

	Held-for-trading derivatives	Corporate bonds at fair value through profit or loss	Available-for-sale debt instruments issued by public bodies	Total
Financial assets	MHUF	MHUF	MHUF	MHUF
Balance as at 31 December 2008	21 938	78	42 363	64 379
Net gains / (losses)				
In profit or loss	(4 330)	(10 503)	4 432	(10 401)
In other comprehensive income	-	-	(1 680)	(1 680)
Acquisitions	-	10 719	800	11 519
Settlement	(15 120)	-	(36)	(15 156)
Balance as at 31 December 2009	2 488	294	45 879	48 661

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**NOTES TO THE FINANCIAL STATEMENTS**

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

	Held-for-trading derivatives	Non-convertible bonds at fair value through profit or loss	Total
Financial liabilities	MHUF	MHUF	MHUF
Balance as at 31 December 2009	2 488	36	2 524
Net (gains) / losses			
In profit or loss	285	985	1 270
In other comprehensive income	-	-	-
Acquisitions	-	-	-
Settlement	(670)	(1 021)	(1 691)
Balance as at 31 December 2010	2 103	-	2 103

	Held-for-trading derivatives	Non-convertible bonds at fair value through profit or loss	Total
Financial liabilities	MHUF	MHUF	MHUF
Balance as at 31 December 2008	22 005	96	22 101
Net (gains) / losses			
In profit or loss	(4 515)	1 498	(3 017)
In other comprehensive income	-	-	-
Acquisitions	-	-	-
Settlement	(15 002)	(1 558)	(16 560)
Balance as at 31 December 2009	2 488	36	2 524

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 18 – 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 regularly 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 are used in case of held-for-trading exotic derivatives, fixed rate corporate bonds at fair value through profit or loss, issued bonds at fair value through profit or loss linked to these instruments, and available-for-sale debt instruments issued by public bodies (municipality bonds).

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

The Group provides exotic derivatives on back to back basis, accordingly no result is recorded on held-for-trading exotic derivatives in the consolidated income statement.

Fixed rate corporate bonds at fair value through profit or loss used to be revalued using models developed and validated by KBC. Calculated prices have been distributed and used consistently within KBC group. However, since 2009 the value of these instruments is permanently zero in the Group.

Portion of issued bonds designated at fair value through profit or loss is linked to fixed rate corporate bonds (see previous paragraph) which bonds are valued at zero in the consolidated financial statement and as a consequence of this issued bonds are also valued at zero.

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

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

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**NOTES TO THE FINANCIAL STATEMENTS**

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

The municipality bond as such can be split to two components which fair values give the total fair value of the bond. The two instruments are (1) bonds and, (2) swaptions. The market value of the bonds is calculated using discounted present value of the future cash flows. The future cash flow of the bond is predicted by the default money market yield curve. In 2009 the Group introduced a more sophisticated method to determine the discount yield curves: while in 2008 the discount yield curve was the money market swap curve shifted with a liquidity spread, from 2009 the Group determines the yield curve from Hungarian Government Bond benchmark yield curves shifted with a credit spread determined by the Group for all municipalities individually. The value of swaptions is calculated regularly and if the value reaches a predetermined materiality level the amount is booked as net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange in the consolidated income statement.

*Alternative assumptions*

There is no active market for these municipality bonds to get market observable parameters for the revaluation especially not regarding to the determine credit spread which is a risk on the top of the Hungarian Government bonds. To challenge the fair valuation model, the Group uses a reasonably possible alternative assumption to increase the applied credit spread.

The credit spread was shifted with the CDS difference between the current PD (probability of default) rating of the municipality and one notch worse class. For determining the CDS of a given rating, KBC master scale is used which assigns a percentage value of default probability to each rating class. The LGD ratio used in the calculation is 45% which is the standard LGD ratio in capital calculation. Between the PD rating categories there is a 13 bp, 25 bp and 52 bp difference respectively which was added to the existing margin based credit spread assuming one notch downgrade of each municipality. This would assume migration in PD classes. This alternative valuation would reduce the current carrying value by HUF 513 million (HUF 1 710 million decrease in 2009).

The difference between the fair value and the transaction price of financial instruments not recognised in profit or loss was immaterial in both 2010 and in 2009.

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.

*Available-for-sale equity instruments held at cost*

Available-for-sale equity instruments contain as at 31 December 2010 unlisted equity instruments in a value of HUF 910 million (HUF 883 million at the end of 2009) which fair value cannot be measured reliably. These investments are not traded on active markets. Management believes that the carrying value of these investments approximates their fair value (for more information see Note 17).

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.

*Held-to-maturity instruments*

Held-to-maturity instruments include treasury bills, government bonds and consolidation bonds issued in HUF. The fair value of held-to-maturity treasury bills and government bonds disclosed in this Note is calculated based on regularly quoted market prices, since these instruments have an active market.

Consolidation bonds classified as held to maturity 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.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

*Loans and receivables and financial liabilities measured at amortized cost*

For financial assets and financial liabilities that are liquid or have a short term remaining maturity (less than one year) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity, and variable rate financial instruments.

Loans with a net book value of HUF 31 012 million (HUF 36 188 million at 31 December 2009), 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.

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.

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
<u>Financial assets designated at fair value through profit or loss</u>		
Government bonds issued in foreign currencies	5 094	6 523
Corporate bonds – unlisted issued in HUF	-	200
Corporate bonds – unlisted issued in foreign currency	-	93
Loans to customers	1 322	2 329
	<u>6 416</u>	<u>9 145</u>
	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
<u>Financial liabilities designated at fair value through profit or loss</u>		
Term deposits:		
- retail	9 812	9 035
- corporate	5 977	2 743
- investment funds	176 006	137 102
Issued bonds designated at fair value due to accounting mismatch	-	36
Other issued bonds	1 274	6 747
	<u>193 069</u>	<u>155 663</u>

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 amounted to HUF 871 million loss in 2010 (immaterial in 2009).

The maximum credit risk exposure of the loan designated at fair value through profit or loss is its gross fair value, which was HUF 1 322 million as at 31 December 2010 (HUF 2 329 million as at 31 December 2009).

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

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

Upon initial recognition the bonds are designated by the Bank at fair value through profit or loss as:

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

The fair value changes of issued bonds recognised in the consolidated income statement due to credit risk was immaterial in 2010 and cumulatively (immaterial in 2009 and HUF 1 452 million gain cumulatively).

Included in financial liabilities designated at fair value through profit or loss are retail and corporate term deposits combined with currency options which are as accounted for 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, and 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 2010 and 2009.

The amount that the Group would contractually be required to pay at maturity is HUF 1 868 million less than the fair value of the deposits and issued bonds (HUF 1 304 million less in 2009).



# **CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010**

## **NOTES TO THE FINANCIAL STATEMENTS**

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

The Group's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2010 can be analysed by the following geographical regions.

	Held for trading MHUF	Designated at fair value through profit or loss MHUF	Available for sale MHUF	Loans and receivables MHUF	Held to maturity MHUF	Hedging derivatives MHUF	Measured at amortised cost MHUF	Total MHUF
Financial assets								
Hungary	139 893	6 416	756 183	1 605 139	383 382	14	-	2 891 027
EMU countries	20 670	-	503	21 419	19 249	35	-	61 876
East-European countries	137	-	-	12 666	1 092	-	-	13 895
Russia	-	-	-	7 562	-	-	-	7 562
Other European countries	17 174	-	1 876	31 268	4 571	-	-	54 889
Non-European countries	78	-	347	3 058	307	-	-	3 790
Total	177 952	6 416	758 909	1 681 112	408 601	49	-	3 033 039
Financial liabilities								
Hungary	42 721	192 150	-	-	-	249	1 484 763	1 719 883
EMU countries	96 658	644	-	-	-	616	1 008 203	1 106 121
East-European countries	142	25	-	-	-	-	5 136	5 303
Russia	-	45	-	-	-	-	5 319	5 364
Other European countries	29 961	205	-	-	-	-	43 683	73 849
Non-European countries	1 371	-	-	-	-	-	25 792	27 163
Total	170 853	193 069	-	-	-	865	2 572 896	2 937 683

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

**K&H BANK ZRT.**

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**NOTES TO THE FINANCIAL STATEMENTS**

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

The geographical breakdown of financial assets and financial liabilities as at 31 December 2009 is presented below:

	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	89 663	9 145	1 075 734	1 586 343	132	-	2 761 017
EMU countries	20 240	-	-	22 666	194	-	43 105
East-European countries	1 104	-	-	13 295	-	-	14 399
Russia	-	-	-	4 727	-	-	4 727
Other European countries	6 448	-	-	5 470	21	-	11 939
Non-European countries	203	-	239	4 113	-	-	4 555
Total	117 658	9 145	1 075 978	1 636 614	347	-	2 839 742
Financial liabilities							
Hungary	13 761	155 580	-	-	721	1 596 277	1 766 339
EMU countries	37 909	-	-	-	499	908 625	947 033
East-European countries	170	37	-	-	-	17 934	18 141
Russia	-	-	-	-	-	5 952	5 952
Other European countries	7 250	-	-	-	257	6 218	13 725
Non-European countries	1 310	46	-	-	-	15 131	16 487
Total	60 400	155 663	-	-	1 477	2 550 137	2 767 677

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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**NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY**

**Credit quality per class of financial assets**

The table below presents the credit quality by asset classes as at 31 December 2010:

	Held for trading MHUF	Designated at fair value through profit or loss MHUF	Available for sale MHUF	Loans and receivables MHUF	Held to maturity MHUF	Hedging derivatives MHUF	Total MHUF
Unimpaired assets	177 952	6 416	758 909	1 479 427	408 601	49	2 831 354
Impaired assets	-	-	513	307 389	-	-	307 902
Impairment	-	-	(513)	(105 704)	-	-	(106 217)
Total carrying value	117 952	6 416	758 909	1 681 112	408 601	49	3 033 039

The credit quality of assets as at 31 December 2009 can be presented as follows:

	Held for trading MHUF	Designated at fair value through profit or loss MHUF	Available for sale MHUF	Loans and receivables MHUF	Hedging derivatives MHUF	Total MHUF
Unimpaired assets	117 658	9 145	1 075 978	1 479 817	347	2 682 945
Impaired assets	-	-	513	231 090	-	231 603
Impairment	-	-	(513)	(74 293)	-	(74 806)
Total carrying value	117 658	9 145	1 075 978	1 636 614	347	2 839 742

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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

The balance of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2010 are shown in the following table.

	<b>Available- for-sale equity instruments</b>	<b>Loans and receivables</b>	<b>Commitments and contingent liabilities</b>	<b>Total</b>
	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>
Individually impaired assets	513	129 803	11 185	141 501
Individually assessed impairment	(513)	(61 098)	(2 027)	(63 638)
<b>Total</b>	<b>-</b>	<b>68 705</b>	<b>9 158</b>	<b>77 863</b>

The balance of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2009 are presented in the table below.

	<b>Available- for-sale equity instruments</b>	<b>Loans and receivables</b>	<b>Commitments and contingent liabilities</b>	<b>Total</b>
	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>
Individually impaired assets	513	121 511	17 840	139 864
Individually assessed impairment	(513)	(49 974)	(2 565)	(53 052)
<b>Total</b>	<b>-</b>	<b>71 537</b>	<b>15 275</b>	<b>86 812</b>

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**NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY  
(continued)**
**Aging analysis of past due but not impaired loans per class of financial assets**

Aging analysis of past due but not impaired financial assets as at 31 December 2010 is as follows:

	<b>Less than 30 days MHUF</b>	<b>30 days or more, but less than 90 days MHUF</b>	<b>Total MHUF</b>
Loans to customers			
- Corporate	9 371	6 386	15 757
- Retail	74 065	27 475	101 540
Total	<u>83 436</u>	<u>33 861</u>	<u>117 297</u>

Aging analysis of past due but not impaired financial assets as at 31 December 2009 is as follows:

	<b>Less than 30 days MHUF</b>	<b>30 days or more, but less than 90 days MHUF</b>	<b>Total MHUF</b>
Loans to customers			
- Corporate	15 928	4 960	20 888
- Retail	60 799	23 153	83 952
Total	<u>76 727</u>	<u>28 113</u>	<u>104 840</u>

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

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**NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY  
(continued)**
**Maximum exposure to credit risk without taking into account of any collateral and credit enhancements**

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Equity instruments*	10 549	8 266
Debt instruments*	1 336 221	1 150 977
Loans and advances	1 754 230	1 769 559
of which designated at fair value through profit or loss*	1 322	2 329
Derivatives*	29 684	41 536
Other assets	31 694	31 205
<b>Total assets</b>	<b>3 163 700</b>	<b>3 003 892</b>
Commitments to extend credit	286 626	292 752
Guarantees	132 030	112 594
Letters of credit	8 533	2 259
<b>Total commitments and contingent liabilities</b>	<b>427 189</b>	<b>407 605</b>
<b>Total credit exposure</b>	<b>3 590 889</b>	<b>3 411 497</b>

\*For more information see Note 17.

The amounts shown above represent the current credit risk exposure, which may change over time as a result of changes in values (derivative financial instruments, financial investments, etc.) and changes in FX rates (due to FCY lending). The effect of collateral and other risk mitigation techniques is shown in Note 41.4.

**Risk concentration of the maximum exposure to credit risk**

Concentration of risk is managed by client/client group and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2010 was HUF 29 317 million (HUF 36 055 million as of 31 December 2009) before taking account of any collateral or other credit enhancements.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 22 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND REMAINING MATURITY**

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2010:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Not more than one year	126 948	1 836	605 670	556 589	28 051	49	-	1 319 143
More than one but not more than five years	32 185	4 580	78 056	492 251	250 229	-	-	857 301
More than five years	9 179	-	74 273	632 272	130 321	-	-	846 045
Without maturity	9 640	-	910	-	-	-	-	10 550
Total	177 952	6 416	758 909	1 681 112	408 601	49	-	3 033 039
Financial liabilities								
Not more than one year	51 757	90 672	-	-	-	865	2 345 160	2 488 454
More than one but not more than five years	103 134	102 397	-	-	-	-	151 219	356 750
More than five years	15 962	-	-	-	-	-	76 517	92 479
Without maturity	-	-	-	-	-	-	-	-
Total	170 853	193 069	-	-	-	865	2 572 896	2 937 683

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 22 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND REMAINING MATURITY (continued)**

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2009:

	Held for trading	Designated at fair value	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	70 613	4 339	724 009	512 443	182	-	1 311 586
More than one but not more than five years	30 059	1 525	218 461	506 526	165	-	756 736
More than five years	9 585	3 281	132 624	617 645	-	-	763 135
Without maturity	7 401	-	884	-	-	-	8 285
Total	117 658	9 145	1 075 978	1 636 614	347	-	2 839 742
Financial liabilities							
Not more than one year	22 950	53 842	-	-	796	2 246 108	2 323 696
More than one but not more than five years	26 394	101 785	-	-	681	198 064	326 924
More than five years	11 056	36	-	-	-	105 537	116 629
Without maturity	-	-	-	-	-	428	428
Total	60 400	155 663	-	-	1 477	2 550 137	2 767 677

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

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.



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**NOTE 23 – IMPAIRMENT ON AVAILABLE-FOR-SALE FINANCIAL ASSETS**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Opening balance	513	513
Impairment reversed	-	-
Closing balance	<u>513</u>	<u>513</u>

Risk Kft. (see Note 17 and Note 38) is fully impaired as at the end of 2010 and 2009.

**NOTE 24 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position)**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Breakdown by type		
Specific impairment for loans and receivables	94 326	65 230
Specific provision on credit commitments	2 027	2 565
Portfolio-based impairment and provision	<u>11 731</u>	<u>9 635</u>
Total impairment and provision on loans and receivables and credit commitments	<u>108 084</u>	<u>77 430</u>

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Breakdown by counterparty		
Impairments on loans and advances to banks	248	386
Impairment for loans and advances to customers (excluding banks)	105 456	73 907
Specific and portfolio based provision, credit commitments	<u>2 380</u>	<u>3 137</u>
Total impairment and provision on loans and receivables and credit commitments	<u>108 084</u>	<u>77 430</u>

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**NOTE 24 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS  
(statement of financial position - continued)**

	Specific impairment for loans and receivables	Specific provision on credit commitments	Portfolio-based impairments and provisions	Total
	MHUF	MHUF	MHUF	MHUF
Opening balance as at 1 January 2010	65 230	2 565	9 635	77 430
Movements with an impact on results				
Loan loss expenses	82 793	1 832	15 540	100 165
Loan loss recoveries	(47 292)	(2 622)	(14 563)	(64 477)
Interest accrued on impaired loans	3 255	-	-	3 255
Discount effect	(1 813)	239	-	(1 574)
Movements without an impact on results				
Write-offs	(9 316)	-	-	(9 316)
Other	1 469	13	1 119	2 601
Closing balance as at 31 December 2010	94 326	2 027	11 731	108 084

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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 24 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS  
(statement of financial position - continued)**

	Specific impairment for loans and receivables	Specific provision on credit commitments	Portfolio-based impairments and provisions	Total
	MHUF	MHUF	MHUF	MHUF
Opening balance as at 1 January 2009	41 647	2 898	5 983	50 528
Movements with an impact on results				
Loan loss expenses	39 212	1 061	4 049	44 322
Loan loss recoveries	(2 186)	(1 597)	(397)	(4 180)
Interest accrued on impaired loans	1 692	-	-	1 692
Discount effect	(489)	209	-	(280)
Movements without an impact on results				
Write-offs	(13 243)	-	-	(13 243)
Other	(1 403)	(6)	-	(1 409)
Closing balance as at 31 December 2009	65 230	2 565	9 635	77 430

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 25 – DERIVATIVE FINANCIAL INSTRUMENTS**

	Year ended 31 December 2010				Year ended 31 December 2009			
	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
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
<b>Derivatives held for trading</b>								
<b>Foreign exchange derivatives</b>								
Currency forwards	76 622	80 626	416	(1 850)	118 965	125 468	1 129	(3 475)
Currency futures	4 628	4 634	11	(11)	3 930	3 945	11	(11)
Currency swaps	307 925	315 806	2 229	(7 326)	369 335	370 713	6 215	(6 125)
Currency options	297 848	297 810	6 343	(6 360)	562 222	562 222	10 102	(10 355)
Total foreign exchange derivatives	687 023	698 876	8 999	(15 547)	1 054 452	1 062 348	17 457	(19 966)
<b>Interest rate derivatives</b>								
Interest rate swaps	1 301 642	1 301 642	19 514	(17 607)	1 328 626	1 328 626	22 240	(18 747)
Cross currency interest rate swaps	598 258	701 439	616	(100 571)	617 866	632 658	499	(17 075)
Interest rate options	71 787	71 787	394	(394)	67 710	67 710	484	(484)
Forward rate agreements	325 000	158 286	61	(386)	155 700	172 723	458	(540)
Total interest rate derivatives	2 296 687	2 233 154	20 585	(118 958)	2 169 902	2 201 717	23 681	(36 846)
Equity options	465	8 215	47	(1 078)	15	4 318	4	(912)
Commodity swaps	79	79	4	(4)	170	170	47	(47)
<b>Total derivatives held for trading</b>	<u>2 984 254</u>	<u>2 940 324</u>	<u>29 635</u>	<u>(135 587)</u>	<u>3 224 539</u>	<u>3 268 553</u>	<u>41 189</u>	<u>(57 771)</u>
<b>Derivatives designated as cash flow hedges</b>								
Currency options	29 579	33 938	49	(865)	68 360	74 895	347	(1 477)
<b>Total derivatives held for hedging</b>	<u>29 579</u>	<u>33 938</u>	<u>49</u>	<u>(865)</u>	<u>68 360</u>	<u>74 895</u>	<u>347</u>	<u>(1 477)</u>
<b>Total derivative financial instruments</b>	<u>3 013 833</u>	<u>2 974 262</u>	<u>29 684</u>	<u>(136 452)</u>	<u>3 292 899</u>	<u>3 343 448</u>	<u>41 536</u>	<u>(59 248)</u>

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 25 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)**

**Options**

Although options 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 2010 HUF 707 million loss was transferred from cash flow hedge reserve to “Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange” in the consolidated income statement (HUF 598 million loss in 2009).

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

	<b>2010</b>		<b>2009</b>	
	<b>Expected cash flows</b>		<b>Expected cash flows</b>	
	<b>Inflow</b>	<b>Outflow</b>	<b>Inflow</b>	<b>Outflow</b>
	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>	<b>MHUF</b>
< 3 months	15	(191)	16	(121)
3-6 months	11	(313)	34	(165)
6 months - 1 year	25	(376)	139	(537)
1-2 years	-	-	182	(743)
Total	<u>51</u>	<u>(880)</u>	<u>371</u>	<u>(1 566)</u>

Forecast transactions for which hedge accounting had previously been used but which is no longer expected to occur amounted to HUF 420 million as at 31 December 2010.

**NOTE 26 – OTHER ASSETS**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Receivables from investment services	291	1 116
Prepayments	266	228
Trade receivables	1 308	1 078
Receivables from employees	23	36
Receivables from bankcard service	2 085	2 225
Items in transit due to payment services	122	163
Receivables from compensation (see Note 31)	19 826	17 300
Items in transit due to trading in securities	21	85
Income accruals and cost prepayments	5 536	6 011
Inventories	809	2 330
Other receivables	<u>1 407</u>	<u>633</u>
	<u>31 694</u>	<u>31 205</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 27 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES**

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

For the period ended 31 December 2010:

	<b>Assets</b>	<b>Liabilities</b>	<b>Income</b>	<b>Equity</b>
	<b>MHUF</b>	<b>MHUF</b>	<b>statement</b>	<b>MHUF</b>
			<b>MHUF</b>	
Employee benefits	172	-	70	-
Losses carry forward	724	(188)	114	-
Tangibles and intangibles assets	274	134	(73)	-
Provisions for risk and charges	102	97	(199)	-
Impairment for losses on loans and advances	(869)	-	943	-
Financial instruments at fair value	293	-	(2 673)	-
Fair value adjustments AFS	1 327	-	-	627
Cash flow hedge	76	-	-	-
Other	(1 167)	82	3 862	-
<b>Total</b>	<b>932</b>	<b>125</b>	<b>2 044</b>	<b>627</b>

For the year ended 31 December 2009:

	<b>Assets</b>	<b>Liabilities</b>	<b>Income</b>	<b>Equity</b>
	<b>MHUF</b>	<b>MHUF</b>	<b>statement</b>	<b>MHUF</b>
			<b>MHUF</b>	
Employee benefits	-	(101)	(12)	-
Losses carry forward	798	-	486	-
Tangibles and intangibles	(214)	(428)	(10)	-
Provisions for risk and charges	-	(203)	9	-
Impairment for losses on loans and advances	148	1 960	1 400	-
Financial instruments at fair value	111	(2 856)	4 922	-
Fair value adjustments AFS	-	(701)	-	(1 846)
Cash flow hedge	11	(65)	-	(161)
Other	(106)	5 036	(3 159)	-
<b>Total</b>	<b>748</b>	<b>2 642</b>	<b>3 636</b>	<b>(2 007)</b>

In 2009 deferred income taxes are calculated on all temporary differences under the asset and liability method using a principal rate of 20.62% (19% corporate income tax and 1.62% local business tax). In 2010, based on the corporate income tax law effective from 1 January 2010 on the Group applies a tax rate of 20.62% on temporary differences expected to be realised before the end of 2012. (For details of the corporate income tax law effective from 1 January 2010 on see Note 15.) Deferred tax of temporary differences to be realised on or after 1 January 2013 are calculated at 10% or 11.8% (10% effected by local business tax, if applicable).

Deferred income tax for tax losses carried forward is calculated to the extent that realisation of the related tax benefit is assessed as probable. There is no time limitation for the realisation of the tax benefit.

From the total of HUF 14 748 million tax losses carried forward as at 31 December 2010 (HUF 4 068 million at 31 December 2009), HUF 5 631 million (HUF 198 million at 31 December 2009) has been assessed as not being probable, and therefore was not included in the base of the deferred tax calculation. Tax loss carried forward for which the tax asset was recognised in the consolidated statement of financial position amounted to HUF 9 116 million as at 31 December 2010 (HUF 3 870 million as at 31 December 2009).

Based on the group members' financial plans management believes that the unused tax loss for which deferred tax asset was recorded in the consolidated income statement can be used as income tax base decreasing item in the future periods.

The accompanying notes on pages 10 to 101 are an integral part of these financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 28 – INVESTMENTS IN ASSOCIATED COMPANIES**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
GIRO Elszámolásforgalmi Zrt.	1 547	1 583
HAGE Zrt.	542	542
Kvantum KK Rt. "v.a."	81	-
Lizingház Zrt. "v.a."	(66)	-
Total	<u>2 104</u>	<u>2 125</u>

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Opening balance	2 125	2 212
- Carrying value, transfers, liquidation	15	(98)
- Share in the result for the period	379	454
- Dividends paid	(415)	(443)
Closing balance	<u>2 104</u>	<u>2 125</u>

As Lizingház Zrt. and Kvantum KK Rt. were under liquidation as at 31 December 2010, they were consolidated using the equity method according to the Group's accounting policy, notwithstanding that the Group's shares in the companies exceed 50% and which normally would indicate full consolidation. The liquidation procedure of Kvantum KK Rt. was completed on 15 February 2011.

The Group does not have any share of the contingent liabilities of its associates incurred jointly with other investor.

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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 29 – PROPERTY AND EQUIPMENT**

	Land and buildings MHUF	IT equipment MHUF	Office equipment MHUF	Other MHUF	Total MHUF
<b>At 1 January 2009</b>					
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
<b>Movements in 2009</b>					
Additions	4 013	1 640	439	2 240	8 332
Disposals - net	(85)	-	(3)	(88)	(176)
Impairment charge	(166)	-	(7)	-	(173)
Depreciation charge	(1 254)	(1 619)	(1 517)	(475)	(4 865)
Other	466	911	(699)	(4 913)	(4 235)
<b>At 31 December 2009</b>					
Cost	26 562	19 427	10 868	4 375	61 232
Accumulated depreciation	(8 764)	(16 015)	(6 354)	(831)	(31 964)
Net book value	17 798	3 412	4 514	3 544	29 268
<b>Movements in 2010</b>					
Additions	8 146	1 194	451	1 712	11 503
Disposals - net	(60)	-	(1)	(263)	(324)
Impairment charge	(130)	-	(3)	-	(133)
Depreciation charge	(1 190)	(1 850)	(1 304)	(287)	(4 631)
Other	120	(243)	108	(335)	(350)
<b>At 31 December 2010</b>					
Cost	34 403	18 153	11 123	5 601	69 280
Accumulated depreciation	(9 719)	(15 640)	(7 358)	(1 230)	(33 947)
Net book value	24 684	2 513	3 765	4 371	35 333

Expenditure on items in the course of construction amounted to HUF 12 306 million as at 31 December 2010 (HUF 5 808 million as at 31 December 2009).

During 2009 the Group entered into a contract for the construction of a new headquarter building with completion expected in 2012. The net amount of the contractual commitment is EUR 38.89 million (HUF 10 841 million) as at 31 December 2010 (EUR 67.21 million, HUF 18 202 million as at 31 December 2009).



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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 30 – INTANGIBLE ASSETS**

	<b>Acquired software MHUF</b>	<b>Other intangible assets MHUF</b>	<b>Total MHUF</b>
<b>At 1 January 2009</b>			
Cost	32 843	539	33 382
Accumulated depreciation	(28 943)	(2)	(28 945)
Net book value	3 900	537	4 437
<b>Movements in 2009</b>			
Additions	4 098	-	4 098
Impairment charge	(4)	-	(4)
Depreciation charge	(1 555)	(1 560)	(3 115)
Other	(1 321)	3 701	2 380
<b>At 31 December 2009</b>			
Cost	35 155	4 308	39 463
Accumulated depreciation	(30 037)	(1 630)	(31 667)
Net book value	5 118	2 678	7 796
<b>Movements in 2010</b>			
Additions	2 663	-	2 663
Impairment charge	(2)	-	(2)
Depreciation charge	(1 551)	(889)	(2 440)
Other	(2 140)	2 298	158
<b>At 31 December 2010</b>			
Cost	27 779	6 436	34 215
Accumulated depreciation	(23 691)	(2 349)	(26 040)
Net book value	4 088	4 087	8 175

Fully amortised intangible assets which were still in use amounted to HUF 17 538 million as at 31 December 2010 (HUF 25 686 million as at 31 December 2009).

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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 31 – PROVISIONS FOR RISK AND CHARGES**

	Provision for restructuring MHUF	Provision for tax litigation and pending legal disputes MHUF	Other MHUF	Total MHUF
<b>Balance as at 1 January 2009</b>	1 003	42 070	1 038	44 111
Amounts allocated	84	12 713	1 812	14 609
Amounts used	(103)	(12 992)	(155)	(13 250)
Unused amounts reversed	(899)	(5 132)	(820)	(6 851)
Discount effect	-	858	-	858
Other (foreign exchange revaluation)	(1)	(802)	-	(803)
<b>Balance as at 31 December 2009</b>	84	36 715	1 875	38 674
Amounts allocated	653	2 963	428	4 044
Amounts used	(67)	(9 635)	-	(9 702)
Unused amounts reversed	(17)	(1 258)	(99)	(1 374)
Discount effect	-	644	-	644
Other (foreign exchange revaluation)	-	1 900	(1 830)	70
<b>Balance as at 31 December 2010</b>	653	31 329	374	32 356

From the total of HUF 31 329 million provision for pending legal disputes the Group has a provision of HUF 27 484 million (HUF 25 529 million in 2009) for its liability to clients as a result of the fraud that occurred at K&H Equities during and prior to 2003. 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 the Bank. 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 for pending legal disputes HUF 250 million in 2010 (HUF 191 million in 2009).

The Group has during 2010 further revised its previous estimate for the fraud case and increased the provision by HUF 1 560 million (HUF 999 million increase in 2009).

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 reimburses the loss of the Group resulting from compensation payments to clients. In order to recognise the indemnity provided by ABN Amro N.V. and the insurance company the Group recorded an asset of HUF 19 826 million as at 31 December 2010 (HUF 17 300 million as at 31 December 2009) for amounts expected to be received as part of the indemnity agreement.

The change in provision and the asset itself are presented net in the consolidated income statement (HUF 1 066 million gain in 2010 and HUF 80 million gain in 2009). From 2007 the calculation of provision is based on an effective interest rate method which results in a HUF 644 million increase recorded as interest expense in the consolidated income statement (HUF 858 million increase in 2009).

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**NOTES TO THE FINANCIAL STATEMENTS**


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**NOTE 31 – 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, and 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 was in a settlement dispute with the insurance company. In 2008 the insurer rejected the claim of K&H Equities in the amount of HUF 1 028 million and related penalty interest due to faulty settlement. The insurer also announced a counter claims toward K&H Equities in the amount of HUF 615 million and related penalty interest which were not accepted by K&H Equities. In 2010 these legal issues have been closed, the insurer accepted and settled the claim and the related penalty interest of HUF 1 301 million. Simultaneously the claim toward K&H Equities was withdrawn. The Group has not made any provision for the claim of the insurer in the previous periods.

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 3 845 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2010 ( HUF 11 286 million at 31 December 2009) has been created relating to commercial litigations as a consequence of the sale of investment products to clients in the past. In 2009 commercial compensation was offered to clients and in the majority of the cases a settlement has been reached for which the cost was recorded. In 2010 the Group continued to offer compensation to the clients and reached further settlements. Management considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 2 380 million as at 31 December 2010 (HUF 3 137 million as at 31 December 2009) is presented in Note 24.

**NOTE 32 – OTHER LIABILITIES**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Trade creditors	4 703	3 333
Lease liabilities	1	1
Items in transit due to payment services	12 468	19 131
Vostro accounts	157	515
Items in transit due to lending activity	385	673
Liabilities from bankcard service	1 243	1 299
Liabilities from brokerage services	2 835	5 377
Other	13 200	11 257
	<hr/>	<hr/>
Total other liabilities	<b>34 992</b>	<b>41 586</b>
	<hr/>	<hr/>

**NOTE 33 – SHARE CAPITAL**

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Ordinary shares issued and outstanding	<b>73 709</b>	<b>73 709</b>
	<hr/>	<hr/>

The nominal value of the ordinary shares issued and outstanding at 31 December 2010 is HUF 1 per share (2009: HUF 1).

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 33 - SHARE CAPITAL (continued)**

Shareholders of the Bank:

	<b>2010 Shares held (millions)</b>	<b>2010 Shareholding %</b>	<b>2009 Shareholding %</b>
KBC Bank N. V.	73 709	100.00%	100.00%
	<u>73 709</u>	<u>100.00%</u>	<u>100.00%</u>

**NOTE 34 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES**

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

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

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

Financial guarantees are conditional commitments issued by the 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 credit 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.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 34 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)**

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Credit commitments – undrawn amount		
Received	5 512	7 944
Given		
Irrevocable	158 594	172 433
Revocable	128 135	120 337
Total given	<u>286 729</u>	<u>292 770</u>
Financial guarantees		
Given	142 839	117 971
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets	442 521	330 864
Financial assets	17 261	1 183
For assets that are not impaired or past due		
Non-financial assets	1 526 096	1 518 877
Financial assets	28 842	16 448
Total guarantees received/collateral	<u>2 014 720</u>	<u>1 867 372</u>

**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 the amount of HUF 11 358 million (HUF 10 573 million as at 31 December 2009) where the Group has been advised by its legal advisor that it is possible, but not probable, that the action will succeed. Accordingly no provision for these claims has been made in these consolidated financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 35 – 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:

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	19 115	27 853
one to five years	22 602	25 339
more than five years	3 715	6 119
	<u>45 432</u>	<u>59 311</u>
The present value of minimum lease payments receivables*:		
less than one year	13 181	17 610
one to five years	20 518	22 583
more than five years	2 706	4 367
	<u>36 405</u>	<u>44 560</u>
Unearned finance income	3 583	10 267
Contingent rents recognized as income - gross	2 637	4 018
Non-guaranteed residual values	2 607	4 007

\*Net of impairment.

The total impairment recorded on financial lease receivables amounted to HUF 3 483 million as at 31 December 2010 (HUF 4 474 million as at 31 December 2009).

The term of the new contracts is between 3 and 120 months. Interest rates are in BUBOR and in EURO LIBOR plus an average margin of 3.04% (3.14% in 2009).

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 35 – FINANCE AND OPERATING LEASES (continued)**

In 2009 the Group entered into new lease contracts with third parties that do not comply with the definition of a financial lease under IFRS, such contracts are treated as operating leases in the consolidated financial statements:

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Total of futures minimum lease payments:		
less than one year	529	805
one to five years	2 566	1 004
more than five years	-	-
	<u>3 095</u>	<u>1 809</u>
Contingent rents recognised as income - gross	481	833

The net carrying amount of property and equipment held for operating lease purposes is presented as follows:

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Office equipment	-	35
Other	2 780	1 789
Total carrying amount	<u>2 780</u>	<u>1 824</u>
Accumulated depreciation	458	779

***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:

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	1 292	2 390
one to five years	6 799	6 228
more than five years	5 426	3 033
	<u>13 517</u>	<u>11 651</u>

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Minimum lease payments recognized as expense	5 129	5 067

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

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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 36 – 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 (2009: 100.00%). The ultimate parent of the Group is KBC Group N.V.

*Subsidiaries:*

See list of subsidiaries in Note 38.

*Associates:*

See list of associates in Note 38.

*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.  
Garantiqua Hitelgarancia Kft.  
Gulliver Kft.  
Hanover Street Ltd  
KBC Bank Ireland Plc. (formerly Irish Intercontinental Bank)  
KBC Asset Management Ltd  
KBC Asset Management N.V.  
KBC Bank Deutschland AG.  
KBC Global Services N.V. (formerly KBC Exploitation N.V.)  
KBC EQUITAS Bróker Zrt.  
KBC Internationale Financieringsmij N.V.  
KBC Lease Holding N.V.  
KBC Private Equity Tanácsadó Kft.  
KBC Securities N.V.  
K&H Biztosító Zrt.  
Kredyt Bank SA  
KBL European Private Bankers SA (formerly Kredietbank SA Luxembourgeoise)  
Pembroke Square Ltd  
Regent Street Ltd  
Sydney Finance Street Ltd  
VIV Docu Kft.  
VIV Server I. Kft.

*Other related parties through key management*

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

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



**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 36 - RELATED PARTY TRANSACTIONS (continued)**

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

	Parent MHUF	Associ- ates MHUF	Other related parties (KBC Group) MHUF	Other related parties (through key management) MHUF	Total MHUF
As at 31 December 2010					
Assets					
Loans and advances	3 844	204	2 728	5 625	12 401
Current accounts	303	-	2 621	285	3 209
Term loans	3 541	204	-	5 340	9 085
Finance leases	-	-	107	-	107
Other receivables	2	-	301	-	303
Total assets	<u>3 846</u>	<u>204</u>	<u>3 029</u>	<u>5 625</u>	<u>12 704</u>
Liabilities					
Deposits	893 599	14	24 093	8 325	926 031
Current accounts	182 810	14	10 555	161	193 540
Term deposits (with agreed maturity)	710 789	-	13 538	8 164	732 491
Subordinated liabilities	16 684	-	-	-	16 684
Other liabilities	237	333	1 856	-	2 426
Total liabilities	<u>910 520</u>	<u>347</u>	<u>25 949</u>	<u>8 325</u>	<u>945 141</u>
Income statement					
Net interest income	(7 153)	(12)	(290)	(33)	(7 488)
Interest income	86	15	901	259	1 261
Interest expense	(7 239)	(27)	(1 191)	(292)	(8 749)
Net fee and commission income	(575)	(287)	591	28	(243)
Fee and commission income	306	3	1 928	29	2 266
Fee and commission expense	(881)	(290)	(1 337)	(1)	(2 509)
Other net income	41	(11)	(5 015)	-	(4 985)
Other income	49	-	1 103	-	1 152
Other expense	(8)	(11)	(6 118)	-	(6 137)
Total income statement	<u>(7 687)</u>	<u>(310)</u>	<u>(4 714)</u>	<u>(5)</u>	<u>(12 716)</u>
Off-statement of financial position items					
Commitments and contingent liabilities	10 655	-	30 478	1 122	42 255
Guarantees received	19 523	-	-	106	19 629
Notional amount of derivatives	1 365 822	-	5 277	-	1 371 099

The table does not contain transactions with subsidiaries, since they are fully eliminated.

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**NOTE 36 - RELATED PARTY TRANSACTIONS (continued)**

	Parent MHUF	Associates MHUF	Other related parties (KBC Group) MHUF	Other related parties (through key management) MHUF	Total MHUF
As at 31 December 2009					
Assets					
Loans and advances	1 812	205	1 335	7 653	11 005
Current accounts	1 072	-	669	451	2 192
Term loans	740	205	549	7 202	8 696
Debt instruments designated at fair value through profit or loss	-	-	117	-	117
Other receivables	2	-	247	-	249
Total assets	1 814	205	1 582	7 653	11 254
Liabilities					
Deposits	723 906	661	38 359	5 646	768 572
Current accounts	220 694	661	5 628	94	227 077
Term deposits (with agreed maturity)	503 212	-	32 731	5 552	541 495
Subordinated liabilities	16 204	-	-	-	16 204
Other liabilities	330	28	1 016	-	1 374
Total liabilities	740 440	689	39 375	5 646	786 150
Income statement					
Net interest income	(11 457)	13	(7 123)	(288)	(18 855)
Interest income	62	38	776	350	1 226
Interest expense	(11 519)	(25)	(7 899)	(638)	(20 081)
Net fee and commission income	(638)	(322)	550	34	(376)
Fee and commission income	468	7	1 707	37	2 219
Fee and commission expense	(1 106)	(329)	(1 157)	(3)	(2 595)
Other net income	34	(1)	(5 025)	-	(4 992)
Other income	49	-	932	-	981
Other expense	(15)	(1)	(5 957)	-	(5 973)
Total income statement	(12 061)	(310)	(11 598)	(254)	(24 223)
Off-statement of financial position items					
Commitments and contingent liabilities	10 822	-	27 103	1 381	39 306
Guarantees received	3 343	-	-	536	3 879
Notional amount of derivatives	1 587 488	-	37 263	-	1 624 751

The table does not contain transactions with subsidiaries, since they are fully eliminated.

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**NOTE 36 - RELATED PARTY TRANSACTIONS (continued)*****Transactions with key management***

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

***Loans***

In accordance with the Group's internal policy, key management may apply for interest-free loans or for loans with favourable conditions. Interest-free loans are only provided in line with relevant local laws (i.e. for housing, if the claimant and the property fit pre-defined requirements). Favourable conditions include a waiver of handling fees and lower than market interest rates.

The outstanding amount of such housing loans at 31 December 2010 was HUF 412 million (HUF 384 million at 31 December 2009), with the long-term maturity obligations ranging from 15-20 years.

***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%, with a maximum of the basic interest rate of the Hungarian National Bank less 0.5%.

At 31 December 2010 the outstanding amount of deposits was HUF 838 million (HUF 768 million at 31 December 2009). In 2010 the Bank paid HUF 44 million interest on these deposits (HUF 42 million in 2009).

The following amounts have been granted to key management personnel:

<b>Type of benefit</b>	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
Short-term employee benefits	2 219	1 914
Other long-term benefits	142	130
Termination benefits	7	-
Total benefits	<u>2 368</u>	<u>2 044</u>

**NOTE 37 – AUDITOR'S REMUNERATION**

The remuneration recognised due to the audit of annual accounts performed by Ernst & Young Audit Kft. amounted to HUF 191 million in 2010 (HUF 170 million in 2009). In 2010 an additional remuneration of HUF 15 million was either accrued or paid to the auditor for other services, such as data custody and delivery of tax service in relation to the Equities fraud (HUF 30 million in 2009).

## K&H BANK ZRT.

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#### NOTES TO THE FINANCIAL STATEMENTS

##### NOTE 38 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2010 %	Effective Shareholding 2009 %
<b>Fully consolidated subsidiaries</b>			
K&H Pannonlizing 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 Eszközlizing Kft.	Operative lease	100	100
K&H Alkusz Kft.	Insurance broker	100	100
K&H Lizing Zrt.	Finance lease	100	100
K&H Lizingadminisztrációs Zrt. "v.a."	Dormant	-	100
K&H Ingatlanlizing Zrt.	Finance lease	100	100
K&H Befektetési Alapkezelő Zrt.	Fund manager	100	100
K&H Csoportszolgáltató Kft.	Group service center	100	100
K&H Equities Zrt.	Business and management consultancy	100	100
K&H Faktor Zrt.	Other financial services	100	100
<b>Associates consolidated using the equity method</b>			
Giro Elszámolásforgalmi Zrt.	Clearing house	21	21
HAGE Zrt.	Meat processing	25	25
K&H Lizingház Zrt. "v.a."	Under liquidation	100	100
Kvantum KK Rt. "v.a."	Under liquidation	100	100
<b>Immaterial, non consolidated investment</b>			
Risk Kft. "f.a."	Under liquidation	100	100

During 2010, K&H Lizingadminisztrációs Zrt. was liquidated with no profit or loss realized on final liquidation.

As Lizingház Zrt. and Kvantum KK Rt. were under liquidation as at 31 December 2010, they were consolidated using the equity method according to the Group's accounting policy, notwithstanding that the Group's shares in the companies exceed 50% and which normally would indicate full consolidation.

##### NOTE 39 – SUBSEQUENT EVENTS

In February 2011 the Hungarian Government announced possible changes of corporate income tax law. According to the corporate income tax law enacted as at 31 December 2010 corporate income tax is payable at 10% on yearly taxable profits below a limit of HUF 500 million and 19% on profits above the limit in 2010, 2011 and 2012. From 2013 on limits are revoked, and a sole corporate income tax rate of 10% is applicable.

Based on the announcement it is probable that the Government will cancel or delay the introduction of the sole corporate income tax rate of 10% previously enacted as effective from 2013 onwards.

On 24 March 2011 KBC Bank N.V. took a shareholder's resolution to increase the share capital of the Bank by HUF 67 269 million to HUF 140 978 million.

For dividend proposed on ordinary shares see Note 42.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 40 – RECONCILIATION OF STATUTORY ACCOUNTS TO IFRS ACCOUNTS**

	<b>Profit for the year MHUF</b>	<b>Shareholders' equity<sup>1</sup> MHUF</b>	<b>Assets MHUF</b>	<b>Subordinated debt and liabilities MHUF</b>
Bank accounts prepared under Hungarian Accounting Rules	28 929	181 585	3 213 379	3 002 865
<u>Adjustments for IFRS accounts</u>				
Capitalization of VAT, financial leases and revaluation of real estates	(20)	714	791	97
Portfolio-based allowance for loan losses	2 288	8 395	(2 106)	(12 789)
Specific allowance for loan losses	(3 629)	3 368	(609)	(348)
Adjustment on repos	(2 402)	9 699	25 447	18 150
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	(314)	(918)	(7 285)	(6 053)
Fair valuation of AFS portfolio	123	(10 547)	(10 424)	-
Holiday accruals	55	(55)	-	-
Amortisation of loan origination fees	133	1 029	1 121	(41)
Deferred tax	2 135	(2 083)	52	-
Bank standalone IFRS	27 298	191 187	3 220 366	3 001 881
Subsidiaries accounts prepared under Hungarian Accounting Standards	(3 194)	10 928	158 564	150 830
<u>Adjustments for IFRS accounts</u>				
Portfolio-based allowance for loan losses	(73)	(898)	(971)	-
Financial leases	295	430	713	(12)
Specific allowance for loan losses	744	275	1 018	(1)
Provisions for risk and charges	512	-	19 826	19 314
Cash flow hedge on FX options	-	-	263	263
Deferred tax	(65)	659	719	125
Subsidiaries standalone IFRS	(1 781)	11 394	180 132	170 519
Adjustments for consolidation	1 706	(8 560)	(171 558)	(164 704)
Balance per IFRS report	27 223	194 021	3 228 940	3 007 696

<sup>1</sup> Excluding the current year profit

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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 41 – RISK MANAGEMENT**

***41.1 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. The challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value.

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

- Value, risk and capital management are inextricably linked to one another.
- Risk management is approached from a comprehensive, enterprise- wide angle, taking into account all the risks a company is exposed to and all the activities it engages in.
- Primary responsibility for value and risk management lies with line management, while a separate Value and Risk Management Division – 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 (BoD), the Audit, Risk and Compliance Committee (ARCC), the Executive Committee (ExCo), the Country Team (CT) and the Capital and Risk Oversight Committee (CROC). These committees concentrate on overarching risk management and on monitoring value creation.
- Specialised risk councils (Credit Risk Council (CRC), Trading Risk Councils (TRC), Operational Risk Councils (ORC)) concentrate on implementing a group-wide framework for one particular type of risk and monitoring the associated risk management process. The risk councils are composed of representatives from line management and Value and Risk Management Division.
- Line management and activity-specific committees have primary responsibility for value and risk management on the operational level. Whereas Value and Risk Management Division measures risks, economic capital and value creation for all relevant business entities and reports its findings directly to line management and the relevant activity-specific committees.
- Within Risk Management Division the newly set up Integrated Risk Department is dedicated to overarch the three existing risk centers of competence (Credit Risk, Market and Liquidity Risk and Non-financial Risks), enhance coordination and transfer synthesized message to senior management regarding value creation, risk and capital.

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

***Risk measurement and – monitoring***

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

- Identification of risks; is a process of discovering and defining material risks, namely those risks that could have a positive or negative impact on the financial position of the Group. Identification of risks is further ensured with setting up New and Active Product Committees in all business domains.

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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 41 – RISK MANAGEMENT (continued)**

- Measurement of risks; qualitative and quantitative assessment of exposure to risk. The Group uses amongst others the following risk measures for the following most significant risk types:
  - Credit default and migration risks: nominal positions (outstanding/exposure), PD (probability of default), LGD/EL (loss given default/expected loss), credit concentration ratios, loan delinquency ratios, restructured loan ratios, credit loss ratios, RWA, stress test results.
  - Trading risk: BPV (basis point value), historic VaR (value at risk), and stress test results.
  - ALM (asset-liability management) risk: BPV, results of stress test on interest income, parametric VaR
  - Operational risk: KRI (key risk indicator), results of risk self assessment, level of compliance with Group Standards, availability of crisis management plans
  - Liquidity risk: liquidity gaps, loan-to-deposit ratio, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), liquidity concentration ratios, stress test results.
- Setting limits; is a way of authorizing specific forms of risk taking. A limit indicates how much risk the Group considers being 'an acceptable maximum' for a portfolio or a segment of a portfolio. They reflect the general risk appetite, set by the Board of Directors. This general risk appetite cascades down in specific risk limits or tolerances that reflect the degree of acceptable variation to the achievement of objectives. Risk limits are agreed upon by the Board of Directors.
- Reporting; delivery of risk measurement results and compliance with the limits (comparison of risk exposure with the risk limit) to the decision makers (relevant risk committees) in a structured format. The main types of reports used in the Group:
  - exposures to key risk types,
  - key risk indicators,
  - limit breaches,
  - losses,
  - advice from risk management department regarding the risk response.

A dual reporting system by the local value and risk departments exists: hierarchical reporting to the local Executive Committee via the local risk committees, and functional reporting via the KBC Group Value and Risk Management 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 constrain threats and take advantage of the opportunities. Management (or respective decision makers) need to come up with a response to risk and define, implement and execute controls instruments that help to achieve a residual risk level aligned with the Group's risk limits.

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

***41.2 Liquidity risk and funding management***

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

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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 41 – RISK MANAGEMENT (continued)**

The objective of the liquidity risk management framework is to limit liquidity risks by taking into account an adequate level of funding, the potential growth of the Group, and in 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 assesses the following liquidity risk aspects:

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

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

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

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

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



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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

The following tables present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2010.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	-	-	855 376	855 376
Less than three months	14 814	-	31 540	191	1 404 119	1 450 664
More than three months but not more than one year	19 113	17 830	62 146	313	101 832	201 234
More than one but not more than five years	95 844	6 926	115 886	376	167 104	386 136
More than five years	5 816	9 759	52	-	83 026	98 653
Total	<u>135 587</u>	<u>34 515</u>	<u>209 624</u>	<u>880</u>	<u>2 611 457</u>	<u>2 992 063</u>

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	286 729	133 244	638	420 611
Less than three months	-	752	7 895	8 647
More than three months but not more than one year	-	305	-	305
More than one but not more than five years	-	5	-	5
More than five years	-	-	-	-
Total	<u>286 729</u>	<u>134 306</u>	<u>8 533</u>	<u>429 568</u>

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**NOTE 41 – RISK MANAGEMENT (continued)**

The tables below present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2009.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	-	-	511 246	511 246
Less than three months	12 133	-	13 956	121	1 616 947	1 643 157
More than three months but not more than one year	10 422	-	33 788	165	118 390	162 765
More than one but not more than five years	24 868	-	94 881	537	180 596	300 882
More than five years	10 348	2 414	1 453	743	105 537	120 495
Total	<u>57 771</u>	<u>2 414</u>	<u>144 078</u>	<u>1 566</u>	<u>2 532 716</u>	<u>2 738 545</u>

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	292 770	114 669	929	408 368
Less than three months	-	875	3	878
More than three months but not more than one year	-	164	251	415
More than one but not more than five years	-	5	1 076	1 081
More than five years	-	-	-	-
Total	<u>292 770</u>	<u>115 713</u>	<u>2 259</u>	<u>410 742</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 41 – RISK MANAGEMENT (continued)**

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 a structural liquidity point of view a group wide loan-to-deposit ratio and a stable funding ratio is used. The Group is also analysing liquidity stress test results.

*Operational liquidity* is measured by the unsecured liquidity gap limit. The operational liquidity gap is the difference between the cash in and outflows in different time horizons (5 day, 30-day and 90-days) and an internal limit was set for the gap to be covered by National Bank of Hungary eligible collaterals. The Group had no uncovered operational liquidity gap in 2010, its operational liquidity situation being both sound and stable during 2010 despite the persistence of global economic crisis.

Structural liquidity is measured via the loan-to-deposit (LTD) ratio, being a secondary key performance indicator (KPI) until the net stable funding ratio (NSFR) definition has been agreed upon with the banking sector supervisor. 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 reliant the Bank is on borrowed wholesale funds. The loan to deposit ratio was 91.1% in 2009 and 93.7% in 2010.

**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 Central Europe specific scenarios. Under both scenarios the Group would achieve the internally set survival period of one month.

**Basel III ratios**

Ratios prescribed in consultative document of Basel III on liquidity measurement are calculated and reported regularly as a pilot risk measure even until the method comes into law (expected in 2015). Based on own calculations in 2010 the Group fulfilled the unofficial 100% limit for both liquidity coverage and net stable funding ratios.

**41.3 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 Group classifies exposures to market risk into either trading or non-trading portfolios.

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 41 – RISK MANAGEMENT (continued)**
*Market risk – trading*

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

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

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

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

VaR results can be presented as follows:

	<b>Foreign exchange MHUF</b>	<b>Interest rate MHUF</b>	<b>Total VAR MHUF</b>
2010 – 31 December	186	401	415
2010 – Average daily	173	630	666
2010 – Highest	873	1 044	1 222
2010 – Lowest	12	320	357
2009 – 31 December	95	311	374
2009 – Average daily	215	739	772
2009 – Highest	543	1 684	1 591
2009 – Lowest	4	311	374

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

The Group's hVaR exposure decreased significantly in 2010 compared to the year 2009, characterised by reduced risk appetite and the expired 2008 October hVaR scenarios. The average limit utilization was well below the hVaR limit of the Group.

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

*Market risk – Non-trading*

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

Majority of the Group's ALM risks are interest rate related risks; consequently the tolerance level is limited in BPV terms. The interest rate risk is also measured with scenario analyses. Next to the trading book the Group also applies the VaR methodology also for the banking book. However, currently the VaR calculations are undertaken using a parametric VaR approach and are limited to the interest rate risk of the banking book since the Group does not assume any foreign currency, equity or real-estate risk in the banking book.

The BPV tables below present the results of reasonable possible changes of the economic value of the banking book on 31 December 2010 and 2009. Possible alternatives were calculated based on the scenarios of 10, 100, and 200 basis point parallel shifts in yield curves. The banking book is limited in BPV by an internally set limit; the Group performed within the imposed limit during 2010. Significant improvement of risk figures was achieved due to increasing data quality actions and improved risk measurement.

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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 41 – RISK MANAGEMENT (continued)**

UP Scenarios, 31 December 2010	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel up	CHF	(7)	5	(2)
	EUR	(1)	18	17
	HUF	(400)	(243)	(643)
	USD	-	2	2
10 bp parallel up total		(408)	(218)	(626)
100 bp parallel up	CHF	(67)	48	(19)
	EUR	(8)	168	160
	HUF	(3 912)	(2 371)	(6 283)
	USD	-	24	24
100 bp parallel up total		(3 987)	(2 131)	(6 118)
200 bp parallel up	CHF	(134)	96	(38)
	EUR	(17)	310	293
	HUF	(7 620)	(4 591)	(12 211)
	USD	-	48	48
200 bp parallel up total		(7 771)	(4 137)	(11 908)
DOWN Scenarios, 31 December 2010	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel down	CHF	7	(5)	2
	EUR	-	(18)	(18)
	HUF	404	247	651
	USD	-	(2)	(2)
10 bp parallel down Total		411	222	633
100 bp parallel down	CHF	22	(7)	15
	EUR	7	(228)	(221)
	HUF	4 137	2 539	6 676
	USD	-	(26)	(26)
100 bp parallel down total		4 166	2 278	6 444
200 bp parallel down	CHF	22	(7)	15
	EUR	8	(466)	(458)
	HUF	8 513	5 259	13 772
	USD	-	(26)	(26)
200 bp parallel down total		8 543	4 761	13 303

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

UP Scenarios, 31 December 2009	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up	CHF	(86)	(3)	(89)
	EUR	-	66	66
	HUF	(843)	651	(192)
	USD	-	(28)	(28)
10 bp parallel up total		(929)	686	(243)
100 bp parallel up	CHF	(841)	(33)	(875)
	EUR	-	609	609
	HUF	(8 283)	6 287	(1 996)
	USD	-	(282)	(282)
100 bp parallel up total		(9 124)	6 581	(2 544)
200 bp parallel up	CHF	(1 545)	(179)	(1 725)
	EUR	-	1 160	1 160
	HUF	(16 130)	12 218	(3 912)
	USD	-	(557)	(557)
200 bp parallel up total		(17 675)	12 642	(5 034)
DOWN Scenarios, 31 December 2009	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down	CHF	85	4	89
	EUR	-	(60)	(60)
	HUF	862	(642)	220
	USD	-	29	29
10 bp parallel down Total		947	(669)	278
100 bp parallel down	CHF	987	(202)	785
	EUR	-	(910)	(910)
	HUF	8 780	(6 654)	2 126
	USD	-	286	286
100 bp parallel down total		9 767	(7 480)	2 287
200 bp parallel down	CHF	2 169	(1 391)	778
	EUR	-	(2 137)	(2 137)
	HUF	18 083	(13 731)	4 351
	USD	-	346	346
200 bp parallel down total		20 252	(16 913)	3 338

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

*Currency risk*

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

*Fair valuation*

One of the building blocks of a sound market risk management is also the prudent valuation of positions valued at Fair Value. This applies to *HFT instruments*: Held For Trading (adjustments impact P&L), *FIFV instruments*: financial instruments subject to the Fair Value option (adjustments impact P&L) and *AFS instruments*: Available for Sale (adjustments impact equity).

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

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

The final element of fair valuation then consists of a Market Value Adjustment (MVA) policy, that addresses the issue of valuation adjustments and reserves, and which induces a further refinement in the valuation of positions. Adjustments cover close-out costs, adjustments for less liquid positions or markets, model linked valuation adjustments, counterparty risk and operation related costs, as well as transaction specific adjustments. The MVA policy is reviewed yearly, with the latest (as of December 2009) amendments to the policy incorporating close-out and liquidity MVA of all products, counterparty value adjustments and ageing MVA.

**41.4 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 consolidated statement of financial position. 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.



**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 41 – RISK MANAGEMENT (continued)**
**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. The Group deems the client rating calculated on the basis of default-adjusted PD (probability of default) algorithm as the governing rating. The calculation of default-adjusted PD is the automatic calculation of certain criteria of the default concept listed below, based on the figures available in the internal systems of the Group. This facilitates the partially automated default recognition within the clientele with active covenants. Group'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.

(PD) Debtor rating category	IFRS7 asset class category	Facility rating category
1	High grade	Problem-free, low risk
2		
3		
4	Standard grade	Problem-free, medium risk
5		
6		
7	Sub-standard grade	Problem-free, high risk
8		
9		
10	Impaired	Monitor
11		Substandard
12		Doubtful
		Bad

**Credit risk management at transactional level**
**Acceptance**

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

**Supervision and monitoring**

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

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

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

- Specific provision has been raised in relation to the client (for at least one exposure item) or part of its exposure was charged off within one year.
- The credit institution consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by material forgiveness or postponement of principal, interest or –where relevant – fees.
- If K&H Group or another KBC Bank entity has suspended one or more credit lines, or the continued drawing of a certain credit line, or if K&H Bank receives official information that any other financial institution having a relationship with the client, has suspended one or more credit lines, or the continued drawing of a certain credit line.
- Classes 11 and 12 are for 'non-performing' borrowers. Class 11 groups borrowers that have any material amount payable by the client to any member of the KBC Group and that has been overdue for more than 90 days. For overdrafts days past due commence, once an obligor has breached an advised limit or has drawn credit without authorisation and the underlying amount is material. For credit cards the start date of days past due is the due date of the minimum repayment obligation.

Class 12 comprises borrowers if:

- Any member of the KBC Group has fully or partially terminated any exposure in relation with the client.
- Bankruptcy proceedings have been launched against the client.
- Liquidation proceedings have been launched against the client or K&H Bank initiated a liquidation procedure against the client.
- Debt settlement proceedings are in progress against the client.

**Credit risk management at portfolio level**

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

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**
**NOTE 41 – RISK MANAGEMENT (continued)**
**Country risk, banking**

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

The following risks are included:

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

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

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

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

	<b>2010</b>	<b>2009</b>
	<b>MHUF</b>	<b>MHUF</b>
<u>Industry sector</u>		
Service industry	333 010	335 615
Agriculture	60 165	75 095
Manufacturing and building	185 757	235 499
Food processing	48 939	48 467
Wholesale and retail	102 569	114 072
Power industry	41 411	42 871
Other	352	3 477
Individuals	870 777	808 979
Credit institutions	117 913	46 692
Gross loans	1 760 893	1 710 767
Portfolio-based impairment for loan losses	(11 378)	(9 063)
Specific impairment for loan losses	(94 326)	(65 230)
Impairment on loans and receivables (see Note 24)	(105 704)	(74 293)
Loans to customers	1 655 189	1 636 474

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

## Collateral and other credit enhancements

In compliance with its business policy the Group does not grant collateral-based financing (i.e. financing that is not based on the loan repayment capacity of the client), however, there is one exception to this rule in case of a special credit type when the loan is collateralized with cash deposit. The borrower's cash flow represents the primary – direct – source of loan repayment to the Group.

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), and pledge on inventory and trade receivables,
- for securities lending cash deposits or security pledges.

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

Relationship-managers monitor the market value of collaterals, regularly request for a review of the concerning collateral or requests additional collateral behind the deal if necessary. For defaulted counterparties, collaterals are assessed thoroughly to estimate expected recovery in order to set necessary level of impairments.

The carrying amount of property, plant and equipment, which was obtained by the Group by taking possession amounted to HUF 554 million as at 31 December 2010 (HUF 1 354 million in 2009).

**Credit quality of not impaired nor past due assets**

The credit quality of unimpaired and not past due assets as at 31 December 2010 is presented in the table below:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	138 678	5 093	710 682	510	408 601	-	1 263 564
Standard grade	39 274	-	48 227	968 478	-	49	1 056 028
Sub-standard grade	-	1 323	-	393 142	-	-	394 465
Total carrying value	<u>177 952</u>	<u>6 416</u>	<u>758 909</u>	<u>1 362 130</u>	<u>408 601</u>	<u>49</u>	<u>2 714 057</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

The credit quality of unimpaired and not past due assets as at 31 December 2009 is presented in the table below:

	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
High grade	69 068	6 816	1 028 673	13 454	-	1 118 011
Standard grade	48 590	-	47 305	882 131	347	978 373
Sub-standard grade	-	2 329	-	479 392	-	481 721
Total carrying value	<u>117 658</u>	<u>9 145</u>	<u>1 075 978</u>	<u>1 374 977</u>	<u>347</u>	<u>2 578 105</u>

**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 2010	Total 2010 MHUF	Average unsecured share of exposure 2009	Total 2009 MHUF
	%	%		%	
High grade	0.00	89.35	85 947	80.86	66 481
Standard grade	0.28	31.83	1 199 485	34.26	1 121 929
Sub-standard grade	0.13	24.19	550 293	66.92	656 975
Impaired	100.00	29.96	313 178	46.38	248 047
Total			<u>2 148 902</u>		<u>2 093 432</u>

\* Impaired portfolio per credit grades compared to last years total non-impaired portfolio.

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

*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.

	<u>2010</u> <b>MHUF</b>	<u>2009</u> <b>MHUF</b>
Loans to customers		
- Corporate lending	102 850	43 093
- Small business lending	8 861	4 338
- Consumer lending	80 479	40 993
Total	<u>192 190</u>	<u>88 424</u>

**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**

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

**Statistical impairment**

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

**Individually assessed impairments**

Impairments are assessed individually on loans and advances and on loan commitments that are individually significant (> EUR 1,25 million), if there is objective evidence that an impairment loss has incurred (PD10-12).

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**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 41 – RISK MANAGEMENT (continued)**

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

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

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

**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 entire KBC Group (for instance, the models for governments, banks, large companies and project finance), while others have been designed for specific segments (SMEs, private individuals, etc.). The same internal rating scale is used throughout the KBC Group.

From January 2011, these models are also used for calculating the regulatory capital requirements for credit risk according to the Internal Rating Based (IRB) Approach. The Bank uses the IRB 'Foundation' Approach, but a switch to the 'Advanced' approach is envisaged in 2013 (it is subject to regulatory approval).

The switch to the Basel II IRB Foundation approach is taking place in stages, with the Bank switching over in 2011, 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 branch network has not only stimulated risk-awareness, it has also resulted in the models themselves being constantly tested against the market. Indeed, keeping the rating models up to date is just as important as developing them. An appropriate framework for the governance of the life cycle of risk models is thus in place, with model ownership (the credit function) being separate from responsibility for model validation (the Value and Risk Management Directorate). A central validation unit at KBC Group level and the Chief Risk Officer on local level is responsible for the final validation and approval of all models.

***41.5 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.

**CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 41 – RISK MANAGEMENT (continued)**

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 which is used to determine the gap between the Group Standards' requirements and the local practice. The derived action plans are continuously monitored and reported to the Capital and Risk Oversight Committee and Operational Risk Councils. The Local line management is responsible for translating the Group Standards into local procedures as well as for the timely and proper implementation of action plans.

*Risk Self-Assessments* aim to identify and assess the operational risk inherent in all material products, activities, processes and systems by the line management with the involvement of other concerned parties.

A '*Case Study Assessment*' is the process of testing the level of the protection of the current control environment against severe operational risk events that have actually happened in the banking and insurance industry by detecting gaps in subsequent control layers.

In line with the guidelines of KBC, the Group collects the *operational loss events* in a unified and integrated database which is also used for reporting purposes.

The method and framework of *Key Risk Indicators* were implemented in 2009. These are measurable metrics or indicators which help the organization with monitoring the inherent and / or residual exposure to certain key risks, and combine the measurement of risk with the actual management of risk.

Risk scans for operational and business risks were performed in the three main business lines, Corporate, Retail and Treasury to assess the most important risks using top-down approach.

**NOTE 42 – SOLVENCY AND CAPITAL**

In accordance with Act CXII of 1996 on Credit Institutions and Financial Enterprises (banking law), the Bank must have a minimum capital amount higher than 8% of risk weighted assets. According to the Act, the capital adequacy ratio calculation is prepared based on Hungarian accounting standards. The main differences between statutory and IFRS accounts are presented in Note 40. 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 level of capital adequacy situation to the Hungarian Financial Supervisory Authority (HFSA) each month and also prepares monthly forecasts to the Capital and Risk Oversight Committee (CROC) of the Bank. When needed, the Bank's Executive Committee decides and proposes to KBC Group any necessary steps that the Committee believes need to be taken (such as capital increase, dividend payment etc).

As of January 2008, the Bank has applied the Basel II Standardized approach in its capital adequacy calculations, at the same time introducing an Operational Risk related capital charge (on top of Credit and Market Risk).

According to Hungarian capital adequacy regulations, the Bank's capital adequacy ratio (tier 1 + tier 2; the latter includes subordinated debts) at 31 December 2010 was 8.38% (12.82% at 31 December 2009). The Bank fulfilled the capital requirements set by HFSA continuously during years 2010 and 2009 and at 31 December 2010 (and at 31 December 2009).



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**NOTES TO THE FINANCIAL STATEMENTS**

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**NOTE 42 – SOLVENCY AND CAPITAL (continued)**

The Bank is required to set aside 10% of its profit calculated in accordance with Hungarian Accounting standards as a statutory reserve for use against future losses. The balance of this reserve as at 31 December 2010 was HUF 15 429 million (HUF 12 536 million as at 31 December 2009).

According to Hungarian corporate and banking law, only the 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.

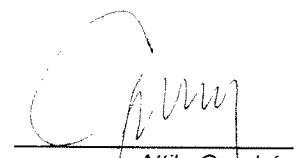
Accordingly, the Bank had distributable reserves of HUF 93 305 million as at 31 December 2010 (HUF 77 304 million as at 31 December 2009).

The dividend proposed on ordinary shares for approval by the shareholder (not recognized as a liability as at 31 December 2010) is HUF 93 305 million – 1.265856 HUF/share (HUF 10 035 million – 0.136143 HUF/share in 2009).

On 24 March 2011 KBC Bank N.V. took a shareholder's resolution to increase the share capital of the Bank by HUF 67 269 million to HUF 140 978 million.

Approved by the Board of Directors on 29 March 2011.

  
Hendrik Scheerlinck  
Chief Executive Officer  
Member of the Board

  
Attila Gombás  
Chief Financial Officer



**K&H Bank Zrt.**

**Management report (consolidated)**

**31 December 2010**

The Bank group's consolidated balance sheet footing of 31 December 2010 was HUF 3,229 bn. As a financial institution that provides both bank and insurance products, it offers a full range of financial services to its clients in its 243 branches nation-wide.

## 1. Strategic objectives

K&H Bank Group is a universal bancassurer, providing banking, leasing, asset management and insurance services for individuals and corporate (focusing on SME and Mid-cap) customers.

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

- we combine the best international practice with sound local knowledge;
- we provide our clients with a distinctively modern banking and insurance service which begins with their needs and concludes with the delivery of excellent solutions at competitive prices.

### Customer strategy:

Retail: customers are served based on the different segments' special needs.

Corporate clients: focus on cross-sales, intensify new client acquisition in selected areas.

### Product strategy:

Retail:

- Innovative saving products and add-on services to keep up our market leader status.
- Growth in lending, based on a good understanding of credit risk.
- Strong focus on transactional banking.

SME:

- More standard products fitting client needs with easy processes.
- Re-design of credit process.

Corporate:

- K&H Corporate is a full service provider, emphasis is on the distribution channel to provide tailored solutions to clients.

### Strategy on distribution channels:

Branch-centric multi-channel distribution approach: although the diversity of channels and the role of tied agent, 3rd party and remote channels are significant, the most important channel will remain our extensive branch network.

Key differentiators of the Bank Group:

- Being close to our clients: easy access both physically (see our large branch network) and virtually (see remote channels).
- Speaking our clients' language (investment to 'client-conform' communication).
- Clients' individual needs and profiles are permanently in focus (offered services always fit their real needs)
- K&H Group acts as 'one-stop-shop' for our clients (universal financial institution)

## 2. Key consolidated figures of the bank group

In 2010 the Bank Group's total assets increased by appr. 5%.

billion HUF	2009	2010	change
Balance sheet total	3,064.5	3,228.9	+5.4%
Loan portfolio	1,636.6	1,681.1	+2.7%
Client deposits and deposit certificates	1,810.4	1,623.2	-10.3%
Shareholders' equity	210.6	221.2	+5.0%

The operations, risk management practice, balance sheet and profit and loss statement of K&H Bank Zrt. are presented in detail in the (standalone) Business Report for 2010.

Key items in the consolidated balance sheet:

- During the year *Loans and receivables* increased by about 3%: retail loans increased by 10% (driven by FX rate changes), while corporate and leasing portfolio decreased in 2010.
- Total *client deposits* fell by 187 bln HUF (10.3%) during the year. While the overall total of retail savings did not change compared to the end of the previous year, its internal structure did experience a shift as 19% contraction in deposits was offset by the same rate of increase in mutual funds managed by K&H. Beyond retail deposits the decrease in deposits was due to deposits placed by investment funds managed by the shareholder KBC's affiliate, KBC Asset Management (deposits maturing).
- The 10.6 bln growth in *equity* is the balance of the following items: accounting for the dividends paid to the owner concerning 2009 (- HUF 10.0 billion), current year's profit (+ HUF 27.2 billion), decrease in cash flow hedge reserve and the revaluation reserve related to marketable financial instrument (HUF -6.6 billion).

The Bank Group's operating profit increased by 26% in 2010 (2010: HUF 71.5 billion, 2009: HUF 56.8 billion). Development of the main P&L components:

- The *net interest income* rose by 18% in 2009 primarily due to the favourable evolution of deposit margins (the interest income of previous year was negatively impacted by the bank's deposit campaigns) and the risk based adjustment in pricing of corporate loan portfolio.
- *Net fee and commission income* (2010: 30,3 billion, 2009: HUF 28,2 billion) increased by 8% primarily due to the *investment services* (mostly mutual funds) and *bankcard* related fee income.
- The significant decrease of *the net gains from financial instruments at fair value* (2010: 14.2 bln, 2009: HUF 20.0 billion) is due to the lower income on Treasury related activities.
- *Other income* contains 6.8 bln compensation income for covering the losses resulting from operational risks.

The Bank Group's operating expenses amounted to 86.6 bln, whereof 15.0 bln is due to newly introduced bank tax. (Disregarding bank tax, operating expenses decreased by 1.6 bln /2.2%/ compared to previous year.) Main items:

- *Staff expenses* increased by 0.9 bln (2.7%) compared to previous year,
- *Depreciation* decreased by 0.7 bln,
- *Other administrative expenses* decreased by 1.7 bln (primarily due to facilities, IT and business volume related costs).

The business performance of the Bank Group is illustrated by the following figures:

	2009	2010	variance
Cost / income	56.3%	54.8%	-1.5%
Non-interest type income/ total income	32.5%	34.7%	+2.2%
Commission income / total income	21.7%	19.2%	-2.5%
Operating income / average headcount	35.4	42.7	+20.6%
Operating costs* / average headcount	19.9	19.4	-2.8%
Operating profit* / average headcount	15.5	23.3	+50.7%
Credit cost ratio	2.06%	1.98%	-0.08%
Loan / deposit	91.1%	93.7%	+2.6%
Capital**/total liabilities	7.6%	7.5%	-0.1%
Solvency ratio (Basel II)***	12.82%	8.38%	-4.4%
ROE (based on average balance of equity)	4.8%	12.3%	+7.5%
ROA (based on average balance sheet total)	0.3%	0.9%	+0.6%

\* excluding bank tax

\*\* in addition to equity it also includes subordinated debt capital

\*\*\* according to the rules prescribed by the Hungarian supervisory authority

In respect of profitability and efficiency ratios K&H Bank's performance has further improved compared to previous year. The decreasing solvency ratio is related to the dividend payout of retained earnings (which will be compensated by share capital increase of the sole shareholder in H1 2011). Considering the liquidity ratios K&H Bank preserved its favourable position in the bank sector.

### 3. Description of the strategically important subsidiaries

#### Leasing group

Currently, the Leasing group consists of 9 legal entities.

Name	Main activity
K&H Pannonlízing Zrt	granting loans
K&H Autófinanszírozó Zrt.	financial leasing
K&H Autópark Kft.	operative leasing, fleet management
K&H Eszközfinanszírozó Zrt.	financial leasing
K&H Eszközlízing Kft.	operative leasing
K&H Ingatlanlízing Zrt.	financial leasing
K&H Alkusz Kft.	insurance brokerage

K&H Lízing Zrt. and K&H Lízingház Zrt. are only passive members of the Leasing group: they no longer conclude new agreements or have existing portfolios. Within the company integration process, the final settlement of K&H Lízingház Zrt. started in 2010 and is expected to be closed in 2011. The company integration will be continued in 2011 with the aim of allocating the activities to legal entities optimally.

The largest company of the group is K&H Pannonlízing Zrt. with 64% weight in the portfolio.

At the end of 2010 the portfolio of the **K&H Leasing group** was HUF 111 bn, which is 13% lower than the figure at the end of the previous year. Terminating the financing of retail cars at the end of 2008 has continuously reduced the portfolio of financing retail cars and car dealers. Based on the disbursement data of the leasing market in 2010, the Leasing group acquired a 3.8% share in the total leasing market, 8.8% in the fleet business line and 6% in the trucks, machinery and equipment (TME) business line, with new disbursements of HUF 11 bn.

Since 2009 the company has concentrated on corporate and SME clients, providing products in its TME and fleet financing business lines. Since 2010 it has again offered car leasing products to retail clients via the Bank's branch network. The sales strategy of 2010 was to increase sales through the sales network of K&H Bank. In 2010 the K&H Leasing group developed its systems and processes in line with the above and introduced a new offer-making software product to support the financing of TME and cars.

#### K&H Befektetési Alapkezelő Zrt. (Fund Manager)

The volume of savings managed by investment funds rose continuously during the year. The end-of-year portfolio of 2010 was 19% higher than the figure a year before, while the portfolio-managed assets increased 4%.

The operating profit of the company was higher than projected, due to good sales result, but partially also due to the stringent cost management. The innovation strategy started in the previous years was continued and the choice of open-end funds widened in addition to the issue of several new closed-end funds.

During the year the Fund Manager issued 14 new public closed-end and 1 public open-end fund. Last year the conversion of the expiring funds was continued with the aim of keeping the savings with the Bank. In 2010 the Fund Manager converted 12 closed-end funds into open-end funds. Also due to the sales campaigns related to the expiring funds, most of the expired funds (about HUF 44 bn) were still held in the investment funds.

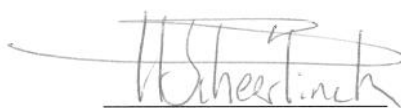
The number of clients of the asset-managed institutional portfolios increased and the co-operation with the existing partners further strengthened. At the end of 2010 the Fund Manager managed assets of HUF 796 bn (HUF 685 bn at the beginning of the year), of which the volume of investment funds amounted to HUF 629 bn (HUF 529 bn at the beginning of the year), based on which it is the second largest market player with a share of 20.2% in the market of investment funds. The Company maintains its market leader position in the segment of capital protected funds, where its market share has increased significantly (by nearly 12% to 50.0%) compared to the previous year.

## K&H Service Center

Under the direction of the 100% owner of K&H Service Center, K&H Bank, the K&H group decided to set up a group service center in 2005 in order to centralise and effectively organise the service activities closely linked to the basic activity and the additional service activities within the group. Full range of service activities provided for the Bank group: real estate management, logistics and bank safety & security tasks, business administration tasks (booking of trade receivables/payables, tangible assets etc.; tax; payroll calculation). Additional business activities: ensuring the full IT background of the Supershop Regular Customer Program, selling loyalty programs, ensuring the IT background through the developed General Loyalty Settlement System, co-operating in the issuance of cards in case of the loyalty programs of the Bank's clients. The company is the representative of the VAT group of the K&H group.

The Company concludes service level agreements and contracts with the group members with regard to each service. Since 2007 the services provided by K&H Service Center have also been used by the K&H Insurer and the members of the K&H Leasing group. Currently, K&H Service Center is the group service provider centre of 12 companies, including the Bank, too. Since 1 May 2008 K&H Service Centre has also been responsible for the financial-accounting tasks and the operational services of the Hungarian branch of KBC Global Services N.V. (KBC GSC) based on the SAP system of KBC. The Tender Consulting Directorate was formed on 1 January 2008 to provide advice and support with regard to EU tenders. In 2009 the range of the company's activities was extended with the financial-accounting services to be provided for RTI Invest Kft, which has buildings constructed for the regional server center of the KBC group, and K&H Factoring, which is fully owned by K&H.

Date: Budapest, 29 March 2011



Hendrik Scheerlinck  
Chief Executive Officer



Attila Gombás  
Chief Financial Officer