



**Kereskedelmi és Hitelbank Zártkörűen Működő
Részvénytársaság**

ANNUAL REPORT

31 December 2015

K&H BANK ZRT.

ANNUAL REPORT
31 DECEMBER 2015

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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 2015 Annual Report and the Year 2015 Consolidated Annual Report of K&H Bank Zrt. have been prepared to the best of the Issuer's knowledge, in compliance with the applicable accounting laws and regulations, and the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profitability of K&H Bank Zrt. and the companies involved in the consolidation, and the Management Report and Consolidated Management Report show a true and fair picture of the position, development and performance of K&H Bank Zrt. and the companies involved in the consolidation, including the major risks and uncertainties factors.

Budapest, April 29 2016

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

This is a translation of the Hungarian Report

Independent Auditors' Report

To the Shareholder of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

Report on financial statements

1.) We have audited the accompanying 2015 annual financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság ("the Company"), which comprise the balance sheet as at 31 December 2015 - showing a balance sheet total of HUF 2,607,217 million and a profit for the year of HUF 28,873 million -, the related profit and loss account for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

2.) Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with the Hungarian Accounting Law, 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.

Auditors' responsibility

3.) Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Hungarian National Auditing Standards and with applicable laws and regulations in Hungary. 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.

4.) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

6.) In our opinion the annual financial statements give a true and fair view of the equity and financial position of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság as at 31 December 2015 and of the results of its operations for the year then ended in accordance with the Hungarian Accounting Law.

Other matters

7.) This independent auditor's report has been issued for consideration by the forthcoming shareholders' meeting for decision making purposes and, as such, does not reflect the impact, if any, of the resolutions to be adopted at that meeting.

Other reporting requirement- Report on the business report

8.) We have reviewed the business report of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság for 2015. Management is responsible for the preparation of the business report in accordance with the Hungarian Accounting Law. Our responsibility is to assess whether the business report is consistent with the financial statements for the same financial year. Our work regarding the business report has been restricted to assessing whether the business report is consistent with the financial statements and did not include reviewing other information originated from non-audited financial records. In our opinion, the business report of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság for 2015 corresponds to the disclosures in the 2015 financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság.

Budapest, 12 April 2016

(The original Hungarian language version has been signed.)

Virágh Gabriella
Ernst & Young Kft.
Registration No.: 001165

Virágh Gabriella
Registered auditor
Chamber membership No.: 004245

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság
Balance Sheet (Credit Institutions) – Assets

HUF millions

No.	Description	Previous year 31.12.2014.	Reporting year 31.12.2015.
a	b	c	d
01.	1. CASH AND EQUIVALENTS	413 056	580 907
02.	2. GOVERNMENT SECURITIES	572 631	600 233
03.	a) held for trading	107 386	114 267
04.	b) held for investment	465 245	485 966
05.	2/A. VALUATION DIFFERENCE OF GOVERNMENT SECURITIES	- 253	- 28
06.	3. AMOUNTS DUE FROM CREDIT INSTITUTIONS	67 759	84 482
07.	a) on demand	40 584	26 449
08.	b) other receivables from financial services	27 175	58 033
09.	ba) short-term	12 720	55 032
10.	of which: - from affiliated undertakings		46 618
11.	- from other associated undertakings		
12.	- from the NBH		
13.	- from the clearing house		
14.	bb) long-term	14 455	3 001
15.	of which: - from affiliated undertakings		
16.	- from other associated undertakings		
17.	- from the NBH		
18.	- from the clearing house		
19.	c) from investment services		
20.	of which: - from affiliated undertakings		
21.	- from other associated undertakings		
22.	- from the clearing house		
23.	3/A. VALUATION DIFFERENCE OF AMOUNTS DUE FROM CREDIT INSTITUTIONS		
24.	4. AMOUNTS DUE FROM CLIENTS	1 283 055	1 163 434
25.	a) from financial services	1 282 541	1 162 909
26.	aa) short-term	453 573	393 229
27.	of which: - from affiliated undertakings	12 637	4 219
28.	- from other associated undertakings		
29.	ab) long-term	828 968	769 680
30.	of which: - from affiliated undertakings	27 242	25 210
31.	- from other associated undertakings		
32.	b) from investment services	514	525
33.	of which: - from affiliated undertakings		
34.	- from other associated undertakings		
35.	ba) receivables from stock exchange investment services		
36.	bb) receivables from over-the-counter investment services		
37.	bc) amounts due from clients, arising from investment services	509	520
38.	bd) amounts due from the clearing house	5	5
39.	be) other receivables from investment services		
40.	4/A. VALUATION DIFFERENCE OF AMOUNTS DUE FROM CLIENTS		
41.	5. DEBT SECURITIES, INCLUDING THOSE WITH A FIXED INTEREST RATE	2 722	16 295
42.	a) securities issued by local municipalities and other administrative institutions (excluding government securities)	2 393	1 428
43.	aa) held for trading		
44.	ab) held for investment	2 393	1 428
45.	b) securities issued by third-party issuers	329	14 867
46.	ba) held for trading	329	431
47.	of which: - issued by affiliated undertakings		
48.	- issued by other associated undertakings		
49.	- Treasury stock		
50.	bb) held for investment		14 436
51.	of which: - issued by affiliated undertakings		
52.	- issued by other associated undertakings		
53.	5/A. VALUATION DIFFERENCE OF DEBT SECURITIES	153	150

No.	Description	Previous year 31.12.2014.	Reporting year 31.12.2015.
a	b	c	d
54.	6. SHARES AND OTHER VARIABLE YIELD SECURITIES	2 033	464
55.	a) shares and participations held for trading		
56.	of which: - issued by affiliated undertakings		
57.	- issued by other associated undertakings		
58.	b) variable yield securities	2 033	464
59.	ba) held for trading	2 033	464
60.	bb) held for investment		
61.	6/A. VALUATION DIFFERENCE OF SHARES AND OTHER VARIABLE YIELD SECURITIES	138	- 3
62.	7. SHARES AND PARTICIPATIONS HELD FOR INVESTMENT	646	646
63.	a) shares and participations held for investment	646	646
64.	of which: - participations in credit institutions		
65.	b) adjustments to the value of shares and participations held for investment		
66.	of which: - participations in credit institutions		
67.	7/A. VALUATION DIFFERENCE OF SHARES AND PARTICIPATIONS		
68.	8. SHARES AND PARTICIPATIONS IN AFFILIATED UNDERTAKINGS	4 429	7 206
69.	a) shares and participations held for investment	4 429	7 206
70.	of which: - participations in credit institutions		
71.	b) adjustments to the value of shares and participations held for investment		
72.	of which: - participations in credit institutions		
73.	9. INTANGIBLE ASSETS	13 775	14 258
74.	a) intangible assets	13 775	14 258
75.	b) adjustments to the value of intangible assets		
76.	10. TANGIBLE ASSETS	38 643	38 087
77.	a) tangible assets used in financial and investment services	38 579	38 023
78.	aa) land and buildings	32 569	30 917
79.	ab) technical equipment, machinery and vehicles	4 663	5 242
80.	ac) capital expenditure	1 347	1 864
81.	ad) advances for capital investments		
82.	b) tangible assets not directly used in financial and investment services	64	64
83.	ba) land and buildings		
84.	bb) technical equipment, machinery and vehicles	64	64
85.	bc) capital expenditure		
86.	bd) advances for capital investments		
87.	c) adjustments to the value of tangible assets		
88.	11. TREASURY STOCK		
89.	12. OTHER ASSETS	11 891	21 884
90.	a) inventories	3 138	5 558
91.	b) other receivables	8 753	16 326
92.	of which: - amounts due from affiliated undertakings	37	14
93.	- amounts due from other associated undertakings		
94.	12/A. VALUATION DIFFERENCE OF OTHER RECEIVABLES		
95.	12/B. POSITIVE VALUATION DIFFERENCE OF DERIVATIVE TRANSACTIONS	36 292	34 309
96.	13. PREPAYMENTS AND ACCRUED INCOME	46 172	44 893
97.	a) accrued income	44 369	43 122
98.	b) prepayments	1 803	1 771
99.	c) deferred expense		
100.	TOTAL ASSETS	2 493 142	2 607 217
101.	of which: - CURRENT ASSETS [1+2.a)+3.a)+3.ba)+3.c)+4.aa)+4.b)+5.aa)+5.ba)+6.a)+6.ba)+11+12+ the values of Lines 2/A,+3/A,4/A,5/A,6/A,12/A and 12/B related to the items above]	1 078 416	1 227 616
102.	- FIXED ASSETS [2.b)+3.bb)+4.ab)+5.ab)+5.bb)+6.bb)+7+8+9+10 + the values of Lines 2/A,3/A,4/A,5/A,6/A,7/A,12/A and 12/B related to the items above]	1 368 554	1 334 708

Budapest, 12nd April 2016

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

10195664-6419-114-01

statistical number

**Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság
Balance Sheet (Credit Institutions) – Liabilities & Equity**

HUF millions

No.	Description	Previous year 31.12.2014.	Reporting year 31.12.2015.
a	b	c	d
103.	1. AMOUNTS DUE TO CREDIT INSTITUTIONS	462 764	362 155
104.	a) on demand	8 295	22 442
105.	b) fixed-term liabilities from financial services	454 469	339 713
106.	ba) short-term	248 468	124 241
107.	of which: - from affiliated undertakings	146 613	31 312
108.	- from other associated undertakings		
109.	- from the NBH	13 173	8 269
110.	- from the clearing house		
111.	bb) long-term	206 001	215 472
112.	of which: - from affiliated undertakings		
113.	- from other associated undertakings		
114.	- from the NBH	151 369	192 307
115.	- from the clearing house		
116.	c) from investment services		
117.	of which: - from affiliated undertakings		
118.	- from other associated undertakings		
119.	- from the clearing house		
120.	1/A. VALUATION DIFFERENCE OF AMOUNTS DUE TO CREDIT INSTITUTIONS		
121.	2. AMOUNTS DUE TO CLIENTS	1 684 007	1 895 672
122.	a) savings deposits		
123.	aa) on demand		
124.	ab) short-term		
125.	ac) long-term		
126.	b) other liabilities from financial services	1 670 701	1 874 460
127.	ba) on demand	993 018	1 302 199
128.	of which: - from affiliated undertakings	18 252	3 767
129.	- from other associated undertakings		
130.	bb) short-term	472 798	339 801
131.	of which: - from affiliated undertakings	3 153	720
132.	- from other associated undertakings		
133.	bc) long-term	204 885	232 460
134.	of which: - from affiliated undertakings	23 870	23 849
135.	- from other associated undertakings		
136.	c) from investment services	13 306	21 212
137.	of which: - from affiliated undertakings		
138.	- from other associated undertakings		
139.	ca) liabilities from stock exchange investment services		
140.	cb) liabilities from over-the-counter investment services		
141.	cc) amounts due to clients from investment services	13 306	21 212
142.	cd) amounts due to the organization performing clearing house activities		
143.	ce) other liabilities from investment services		
144.	2/A. VALUATION DIFFERENCE OF AMOUNTS DUE TO CLIENTS		
145.	3. LIABILITIES FROM SECURITIES ISSUED	7 530	5 723
146.	a) bonds issued	7 286	5 482
147.	aa) short-term	3 194	1 705
148.	of which: - from affiliated undertakings		
149.	- from other associated undertakings		
150.	ab) long-term	4 092	3 777
151.	of which: - from affiliated undertakings		
152.	- from other associated undertakings		

No.	Description	Previous year 31.12.2014.	Reporting year 31.12.2015.
a	b	c	d
153.	b) other debt securities issued		
154.	ba) short-term		
155.	of which: - from affiliated undertakings		
156.	- from other associated undertakings		
157.	bb) long-term		
158.	of which: - from affiliated undertakings		
159.	- from other associated undertakings		
160.	c) debt instruments treated as securities for accounting purposes but not deemed securities under the Securities Act	244	241
161.	ca) short-term	244	241
162.	of which: - from affiliated undertakings		
163.	- from other associated undertakings		
164.	cb) long-term		
165.	of which: - from affiliated undertakings		
166.	- from other associated undertakings		
167.	4. OTHER LIABILITIES	30 353	48 166
168.	a) short-term	30 353	48 166
169.	of which: - from affiliated undertakings	22	95
170.	- from other associated undertakings		
171.	- other financial contributions made by members of co-operative credit institutions		
172.	b) long-term		
173.	of which: - from affiliated undertakings		
174.	- from other associated undertakings		
175.	4/A. NEGATIVE VALUATION DIFFERENCE OF DERIVATIVE TRANSACTIONS	22 045	20 318
176.	5. ACCRUALS AND DEFERRED INCOME	23 941	27 192
177.	a) accrued income	107	74
178.	b) accrued cost and expense	23 535	26 860
179.	c) deferred income	299	258
180.	6. PROVISIONS	64 195	8 315
181.	a) provisions for retirement benefits and severance pay	55	24
182.	b) risk provisions for contingent and future liabilities	5 360	6 438
183.	c) general risk provisions		
184.	d) other provisions	58 780	1 853
185.	7. SUBORDINATED LIABILITIES	18 893	28 181
186.	a) subordinated debt	18 893	28 181
187.	of which: - from affiliated undertakings	18 893	28 181
188.	- from other associated undertakings		
189.	b) other financial contributions made by members of co-operative credit institutions		
190.	c) other subordinated liabilities		
191.	of which: - from affiliated undertakings		
192.	- from other associated undertakings		
193.	8. SUBSCRIBED CAPITAL	140 978	140 978
194.	- repurchased ownership interest at par value		
195.	9. SUBSCRIBED CAPITAL UNPAID (-)		
196.	10. CAPITAL RESERVE	23 179	23 179
197.	a) differences between the par value and offering price of shares and participations (premium)	14 393	14 393
198.	b) other	8 786	8 786
199.	11. GENERAL RESERVE	5 542	8 750
200.	12. PROFIT RESERVE (+/-)	9 715	9 715
201.	13. EARMARKED RESERVE		
202.	14. VALUATION RESERVE		
203.	a) valuation reserve for value adjustments		
204.	b) valuation reserve for fair market valuation		
205.	15. RETAINED EARNINGS (+/-)	-	28 873
206.	TOTAL LIABILITIES & EQUITY	2 493 142	2 607 217
207.	of which: - SHORT-TERM LIABILITIES [1.a)+1.ba)+1.c)+1/A+2.aa)+2.ab)+2.ba)+2.bb)+2.c)+2/A+3.aa)+3.ba)+3.ca)+4.a)+4/A]	1 791 721	1 880 325
208.	- LONG-TERM LIABILITIES [1.bb)+2.ac)+2.bc)+3.ab)+3.bb)+3.cb)+4.b)+7]	433 871	479 890
209.	- EQUITY (8-9+10+11+12+13+14+15)	179 414	211 495

Budapest, 12nd April 2016

Hendrik Scheerlinck
Chief Executive OfficerAttila Gombás
Chief Financial Officer

10195664-6419-114-01

statistical number

**Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság
Profit & Loss Account (Credit Institutions)**

HUF millions

No.	Description	Previous year 31.12.2014.	Reporting year 31.12.2015.
a	b	c	d
01.	1. Interest received and similar income	116 015	95 442
02.	a) interest received (receivable) on fixed-interest debt securities	41 490	33 093
03.	of which: - from affiliated undertakings		
04.	- from other associated undertakings		
05.	b) other interest received and similar income	74 525	62 349
06.	of which: - from affiliated undertakings	1 376	1 232
07.	- from other associated undertakings		
08.	2. Interest paid and similar expense	34 240	24 070
09.	of which: - from affiliated undertakings	2 021	1 661
10.	- from other associated undertakings		
11.	NET INTEREST INCOME (1-2)	81 775	71 372
12.	3. Income from securities	2 154	2 438
13.	a) income from shares and participations held for trading (dividend, minority interest)		
14.	b) income from participations in affiliated undertakings (dividend, minority interest)	2 154	2 438
15.	c) income from other participations (dividend, minority interest)		
16.	4. Fees and commissions received (receivable)	62 530	63 601
17.	a) income from other financial services	52 736	54 023
18.	of which: - from affiliated undertakings	50	283
19.	- from other associated undertakings		
20.	b) income from investment services (excluding income from trading operations)	9 794	9 578
21.	of which: - from affiliated undertakings	31	3
22.	- from other associated undertakings		
23.	5. Fees and commissions paid (payable)	16 528	17 837
24.	a) expense on other financial services	15 781	17 328
25.	of which: - from affiliated undertakings	896	805
26.	- from other associated undertakings		
27.	b) expense on investment services (excluding expense on trading operations)	747	509
28.	of which: - from affiliated undertakings	194	174
29.	- from other associated undertakings		
30.	6. Profit/loss on financial transactions [6.a)-6.b)+6.c)-6.d)]	40 449	20 520
31.	a) income from other financial services	21 253	14 525
32.	of which: - from affiliated undertakings		
33.	- from other associated undertakings		
34.	- valuation difference		
35.	b) expense on other financial services	2 173	4 467
36.	of which: - from affiliated undertakings		
37.	- from other associated undertakings		
38.	- valuation difference		
39.	c) income from investment services (income from trading operations)	69 677	45 486
40.	of which: - from affiliated undertakings		
41.	- from other associated undertakings		
42.	- reversal of impairment on securities held for trading		
43.	- valuation difference	18 774	6 193
44.	d) expense on investment services (expense on trading operations)	48 308	35 024
45.	of which: - to affiliated undertakings		
46.	- to other associated undertakings		
47.	- impairment on securities held for trading		
48.	- valuation difference	15 128	4 681

HUF millions

No.	Description	Previous year 31.12.2014.	Reporting year 31.12.2015.
a	b	c	d
49.	7. Other income from business activities	23 154	44 808
50.	a) income from non-financial and investment services	17 349	29 904
51.	of which: - from affiliated undertakings	447	484
52.	- from other associated undertakings		
53.	b) other income	5 805	14 904
54.	of which: - from affiliated undertakings	302	332
55.	- from other associated undertakings		
56.	- reversal of impairment on inventories	15	17
57.	8. General and administrative expenses	50 594	51 921
58.	a) personnel expense	27 676	31 099
59.	aa) salaries and wages	18 987	21 482
60.	ab) other personnel expense	2 771	2 866
61.	of which: - social security expense	355	335
62.	- retirement expense	200	178
63.	ac) contributions payable on salaries and wages	5 918	6 751
64.	of which: - social security expense	399	484
65.	- retirement expense		
66.	b) other administrative expenses (material-type expenses)	22 918	20 822
67.	9. Depreciation	7 673	8 214
68.	10. Other expenses on business activities	137 783	93 856
69.	a) expense on non-financial and investment services	14 172	27 004
70.	of which: - to affiliated undertakings		
71.	- to other associated undertakings		
72.	b) other expense	123 611	66 852
73.	of which: - to affiliated undertakings	19	5
74.	- to other associated undertakings		
75.	- impairment on inventories	67	11
76.	11. Impairment on receivables and risk provisioning for contingent and future liabilities	37 307	69 148
77.	a) impairment on receivables	35 619	66 587
78.	b) risk provisioning for contingent and future liabilities	1 688	2 561
79.	12. Reversal of impairment on receivables and risk provisions used for contingent and future liabilities	35 542	86 675
80.	a) reversal of impairment on receivables	34 783	85 220
81.	b) risk provisions used for contingent and future liabilities	759	1 455
82.	12/A. Difference between general risk provisions made and used	-	-
83.	13. Impairment on debt securities held for investment and shares and participations in affiliated and other associated undertakings	119	-
84.	14. Reversal of impairment on debt securities held for investment and shares and participations in affiliated and other associated undertakings	277	2 778
85.	15. Profit/loss on ordinary activities	- 4 123	51 216
86.	of which: - profit/loss on financial and investment services [1-2+3+4-5+6+7.b)-8-9-10.b)-11+12-13+14]	- 7 300	48 316
87.	- profit/loss on non-financial and investment services [7.a)-10.a)]	3 177	2 900
88.	16. Extraordinary income	179	68 067
89.	17. Extraordinary expense	8	72 602
90.	18. Extraordinary profit/loss (16-17)	171	- 4 535
91.	19. Pretax profit/loss (+15+18)	- 3 952	46 681
92.	20. Taxation	10 929	14 600
93.	21. Net profit/loss (+19-20)	- 14 881	32 081
94.	22. General provisions made/used (+)	14 881	- 3 208
95.	23. Profit reserve used for dividend and minority interest		
96.	24. Dividend and minority interest approved		
97.	of which: - to affiliated undertakings		
98.	- to other associated undertakings		
99.	25. Retained earnings (+21-/ +22+23-24)	-	28 873

Budapest, 12th April 2016

Hendrik Scheerlinck
Chief Executive OfficerAttila Gombás
Chief Financial Officer

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

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31 December 2015

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I. OVERVIEW

I/1. Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság – key facts

type of company: company limited by shares

method of operation: private

date of establishment: 20 February 1987

shareholders:

Shareholder	31 December 2014		31 December 2015	
	Subscribed capital (HUF m)	Stake (%)	Subscribed capital (HUF m)	Stake (%)
KBC Bank N.V. Havenlaan 2, 1080 Brussels, Belgium	140 978	100	140 978	100
Total subscribed capital	140 978	100	140 978	100

Activities:

Financial leasing

Other monetary intermediation

Insurance agent and broker activities

Financial mediation n.e.c.

Stock and commodities market agent activities

Other auxiliary financial activities

Principal activity

I/2. Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság – Accounting Policy

The Bank has compiled its Accounting Policy in accordance with the provisions of Act C of 2000 on Accounting, Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises and Government Decree No. 250/2000 (XII.24.) on the special bookkeeping and annual reporting obligations of credit institutions and financial enterprises (hereinafter: “accounting legislation”).

The Bank keeps its business records in compliance with applicable accounting regulations. These business records (general ledger and subledger [“analytical”] systems) support the Bank’s internal and external reporting obligations, including reporting to the National Bank of Hungary.

The Bank’s Accounting Policy and related internal regulations set out the valuation methods, principles and processes used by management in preparing reports and other financial statements. Furthermore, the Accounting Policy also sets forth requirements concerning disclosures, announcements and auditing.

The Bank observes statutory accounting principles in its Accounting Policy in order to ensure that its books and annual reports give a fair and reliable view of its state of affairs.

The Bank’s – analytical and general ledger – records continuously capture any and all economic events arising in the course of its business activities that can have an impact on the Bank’s net worth, financial position and income. The books are closed at the end of each business year. The Bank uses double-entry bookkeeping, and its books are in Hungarian.

Accounting operations at the Bank’s head office and branch network units are supported primarily by product-focused IT systems, which are generally integrated systems. Automatic posting by these systems is occasionally complemented by manual bookkeeping, these being the inputs of the general ledger of the Bank.

The Bank’s chart of accounts is a listing of all general ledger accounts to be used for accounting and record-keeping purposes as well as the numbers of such accounts, broken down by account class.

The detailed system of accounts defines the content, nature and function of each general ledger account. The chart of accounts and the system of accounts are set out in the monthly closing directive. The account movements related to the various economic events are described on the so-called accounting schemes attached to the Bank’s product regulations.

Pursuant to applicable law and its own business decision, the Bank maintains contingent accounts in account class “0” linked to specific asset, liability and profit & loss items.

A statement presenting the balance of and activity on general ledger accounts is prepared on a monthly basis. In order to ensure the completeness of accounting records, the Bank performs the necessary additions, corrections, reconciliations and consolidations monthly, quarterly and annually. The Bank issues monthly account closing directives to regulate the closing process.

All economic events and transactions that change the balance of the Bank’s assets and liabilities or the balance or composition of its off-balance sheet items are posted on the basis of accounting vouchers; the Bank’s accounting records contain the data of all accounting vouchers that reflect the process of economic events.

An accounting voucher is an external or internal document having predefined features of form and content that truthfully registers all the data of the given economic event required for entry in the books.

The Bank uses the Hungarian language in its accounting vouchers.

The Bank registers the vouchers in the Bank’s accounting records at the time of the funds movement in case of cash transactions, on the T-day of economic events and transactions are not related to cash transactions, after the economic events occurred in case of other type of economic events and transactions but no later than the third workday following the reference month.

The Bank employs a closed system to provide the possibility for reconciliation and checks of general ledger accounts, sub-ledger records and vouchers.

The Bank's (annual consolidated) report – supported by accounting records – reflects the Bank's operations, net worth, financial position and income and is prepared in Hungarian upon the closing of the Bank's books for the business year.

Business year refers to the period covered by the Bank's annual report and business report. The business year is identical to the calendar year.

The balance sheet date is 31 December of the reporting year.

The date of preparing the balance sheet is the third workday of the year following the reporting year.

The annual report consists of the following parts:

- Balance Sheet,
- Profit & Loss Account,
- Notes to the Financial Statements, which include the Cash Flow Statement.

The vertically arranged Profit & Loss Account, prepared using the so-called turnover cost accounting method, calculates the Bank's retained earnings through various profit/loss categories.

The Bank's annual report shows figures in million forints (HUF).

The structure and content of the annual report and the consolidated annual report are governed by the Accounting Act, as amended, the Act on Credit Institutions and Financial Enterprises and the government decree on the special bookkeeping and annual reporting obligations of credit institutions and financial enterprises – in accordance with the accounting standards of the European Community. K&H Bank Zrt. as „parent company” shall prepare consolidated financial statements.

If an audit or self-audit finds significant error(s) in the reports for prior business year(s), then the Bank reports the adjustments arising from such findings, known as of the date of preparing the balance sheet, alongside the prior-year figures under every item in the balance sheet and the profit & loss account; these figures shall not be understood as relating to the reporting year in the profit & loss account. In such cases the balance sheet and the profit & loss account contain separate columns for prior-year data, adjustments to closed year(s) and reporting-year data, unless the legislation exempts the Bank from this regulation. Significant error impacts are reviewed once a year in their absolute sums, cumulatively.

An error is defined as being of significant sum if the cumulative total (absolute value) of errors or error consequences increasing/reducing profits or equity in the relevant business year (for each year separately) and identified by any kind of checks or audits during the year exceed 2 percent of the balance sheet total.

It follows from the above that if the findings are not significant, i.e. the errors remain below the above stated threshold of 2 percent of the balance sheet total, then the Bank includes these in its figures for the reporting year.

VALUATION PROCEDURES EMPLOYED IN THE REPORT

The valuation of assets and liabilities is regulated in detail by the Accounting Act and the government decree on the special bookkeeping and reporting obligations of credit institutions and financial enterprises.

Regulations applicable to the valuation of assets and liabilities are set forth in a separate internal policy, as part of the Bank's Accounting Policy, pursuant to the legislation mentioned above.

The key principles of valuation procedures:

I. Fair market valuation

In its accounting operations the Bank uses fair market valuation in respect of financial instruments. It made a transition to this method as of 1 January 2008.

In accordance with the provisions of the Accounting Act and Government Decree No. 250/2000 the financial instruments subject to fair market valuation are shown in the report at their fair market value or at their original cost in line with the general rules.

The Bank classifies financial instruments in the following categories.

- Financial assets
 - Financial assets held for trading: financial assets obtained in order to profit from short-term price and rate fluctuations. They are shown at fair market value in the report.
 - Available-for-sale financial assets: financial assets not classified under financial assets held for trading, financial assets held until maturity or loans and other receivables originating from the business entity. Pursuant to the Bank's decision, they are reported at original cost in accordance with general valuation requirements (original contract cost less repayments and impairment).
 - Financial assets held until maturity: financial assets that the Bank intends and is able to keep until they mature. They are reported at original cost in accordance with general valuation requirements.
 - Loans granted by and other receivables of the business entity: financial assets created or stated by, or involving definable payments arising from, the Bank's provision of financial assets, goods or services – delivered directly to the debtor –, except if created by the Bank for short-term sales purposes. They are reported at original cost in accordance with general valuation requirements.
- Financial obligations
 - Trading liabilities: liabilities due to borrowing of securities. They are reported at fair market value.
 - Other financial obligations: all financial obligations that fall outside the scope of trading liabilities. They are reported at original cost in accordance with general valuation requirements.
- Derivative transactions: commodities- or financial assets-based transactions for trading or hedging purposes, options or swaps, or their derivatives.
 - Derivative transactions for trading: derivative transactions not for hedging purposes.
 - Market value (fair value) hedging transactions: transactions serving the purpose of covering the risk of changes to the market value of the whole or certain part of an asset or liability in the balance sheet arising from a hedged transaction or transactions, or changes to the expected future profit or loss from (market value of) a derivative transaction. The hedged risk is a specific risk impacting the profit or loss reported.
 - Cash-flow hedging transaction: transaction to hedge the risk connected to potential changes in future cash-flows related to assets or liabilities in the balance sheet originating from a hedged transaction (including the related interest payments as well), or related to swaps, options or (delivery) forward transactions executed upon the delivery of goods or financial assets. The hedged risk is a risk in a specific cash-flow, impacting the profit or loss reported.
 - Net hedging transaction of net investment in foreign business entity: a transaction concluded to hedge the risks arising from changes in exchange rate related to investments representing ownership and held not for trading purposes (shares, participations, other interest) in foreign currency and in a foreign business entity classifying as an associated enterprise, and the long-term receivables from and liabilities to such a business entity.
- Regardless of their above categorization, all derivative transactions are reported at fair market value.

In the case of the financial assets and obligations reported at fair market value, the fair market value is the amount for which the asset can be exchanged or an obligation can be settled between properly informed partners expressing their intention to transact and to do so in the form of a transaction complying with standard market conditions.

The Bank relies on calculations in its Treasury system to determine the fair market value of its transactions reported at fair market value. This is essentially equivalent to the available market prices or the present value of the future cash-flows on the transactions.

Defining the yield curves used in present value calculation:

- The yield curve for government securities is defined on the basis of the yields on benchmark government securities published by the Government Debt Management Agency (ÁKK).
- The valuation of the derivatives is based on the yield curves including the market liquidity spread.

Fair market value is determined for the individual product groups as follows

- Trading debt securities
 - Government securities: determined on the basis of the average of the best buy and sell rate published by the ÁKK for the given date and the benchmark yields published by the ÁKK.
 - Debt securities: present value calculated on the basis of benchmark yields adjusted with risk premium.
 - Closed-end investment units: the net asset value per investment unit, as published officially by the fund manager.
- Investments representing an ownership interest held for trading
 - Shares: stock market price
 - Open-end investment units: the net asset value per investment unit, as published officially by the fund manager
- Derivative transactions
 - Forward transactions: the difference between the spot market price of the transaction and the discounted value of the deal price (trading price) from the date of maturity to the date of valuation.
 - Swap transactions: the Bank values the forward part in accordance with the requirements governing forward transactions and the spot part is accounted for in accordance with the general rules.
 - In valuing swap transactions concluded for interest arbitrage purposes, and composite transactions created by combining spot and forward FX transactions (equivalent in nature to swaps), the Bank employs, in addition to fair market valuation, the provisions in Article 22 (4), (7), (8) and (11) of Government Decree No. 250/2000. Accordingly,
 - the Bank reports the pro-rata difference between the spot and the forward prices of the transaction as an interest profit or loss against accruals
 - until closing the transaction, the Bank tracks under accruals the price difference of the spot part of swaps and composite transactions.
 - Options: the valuation model matching the type of option is used (e.g. Black Scholes model for simple European and European barrier options, Cox Rubinstein for simple American options)
 - Interest rate swaps: the difference between the present values, discounted to the valuation date, of interest cash-flows estimated based on market information for the remainder of the transaction term.
 - Other derivative transactions: the present value of the future cash-flows estimated on the basis of available market information.

The amount of the fair value which is calculated on transaction level is adjusted (MVA - Market Value Adjustment) by the Bank taking into account the elements listed below. The adjustment according to the following elements is calculated by instrument / transaction types or on customer level:

- close-out cost of the transactions,
- funding value adjustment,
- illiquidity of the markets,
- counterparty risk.

The Bank tracks the valuation differences arising from fair market valuation linked to the given financial instrument in its sub-ledger and general ledger accounts.

As regards the sale or reclassification of financial assets held until maturity, the Bank classifies as significant any sums exceeding 5 percent of the book value of the given asset.

II. Valuation of assets

Valuation of foreign currency and foreign exchange inventories, and receivables and liabilities denominated in a foreign currency

The Bank's foreign currency and foreign exchange inventories and its receivables and debts denominated in a foreign currency are stated at the daily foreign exchange rate of the National Bank of Hungary (NBH). Foreign exchange and foreign currency inventories and receivables and liabilities denominated in currencies not quoted by the NBH are stated at the middle rate published for the last day of the month or the last day of the year, respectively, in the exchange rates section of a national newspaper, or, in the absence thereof, at the average middle rate used by the credit institution in the last month preceding the valuation.

Valuation of debt securities held for investment or trading

Interest-bearing securities held for investment (debt securities with a maturity of over one year) are posted to the Bank's books at original cost less purchased interest; the Bank uses the FIFO (first in, first out) method in respect of such securities. In the case of interest-bearing securities held for investment, the difference between par value and purchase price is recognized *pro rata temporis* during the term of the securities.

Securities held for negotiation that are not classified under financial assets held for trading for the purposes of fair market valuation are posted to the Bank's books at original cost; the Bank uses the FIFO method in respect of such securities.

The Bank rates the securities not classified under financial assets held for trading for purposes of fair market valuation and, if necessary, it recognizes impairment or reversal of impairment on them.

The Bank does not recognize impairment on government securities.

Valuation of participations

As far as impairment is concerned, the Bank will regard a difference as permanent and significant if it is identified as such during the investment rating procedure conducted pursuant to the Long Term Capital Investment Policy.

Under the Accounting Act, if the market value of an asset that is held for investment and represents an ownership interest significantly exceeds the book value (original cost) of such asset following a reversal of impairment, the difference may be stated as a value adjustment and added to the valuation reserve. The Bank, however, does not use this possibility.

Valuation of amounts due from credit institutions and clients

The original cost of receivables arising from contracts concluded by the Bank equals the amount of principal not yet repaid; in the case of receivables purchased, the original cost equals the part of the purchase price not yet paid.

The Bank regularly rates its receivables.

It classifies its receivables into asset rating categories for individual rating or valuation groups for group rating.

The Bank established the asset rating categories in such a way that allows for classifying all items ranging from those not affected by impairment or provisioning to those 100% covered by impairment and provisions.

It assigns a weight band to each asset rating category by breaking down the total of 100% and it establishes the impairment to be charged in each weight band.

Any impairment on foreign currency receivables, and any reversal thereof, will be recognized and stated in foreign currency.

Valuation of intangible and tangible assets

The original (purchase and production) cost of assets is taken into consideration pursuant to Section 47 of the Accounting Act.

The Bank calculates ordinary depreciation on assets acquired before 1 January 2001 on the basis of original cost, using the straight-line depreciation method and the rates defined in the Corporation Tax Act.

In relation to assets purchased after 1 January 2001, ordinary depreciation is calculated on the basis of original cost less residual value, using the straight-line depreciation method.

For the purposes of extraordinary depreciation, the Bank treats as permanent any difference between book value and market value if that prevails for at least one year on the basis of historical events and future expectations. Furthermore, the difference is considered permanent - irrespective of its duration - if that appears final relying on the information available at the time of evaluation.

A significant difference between book value and market value is any amount that exceeds 15 percent of the original cost of the given asset.

With the exception of specific asset groups, tangible assets, rights, trademarks and patents purchased individually at an original cost of less than HUF 100,000 are depreciated in one sum at the time they are put into use.

Under the Accounting Act, if the market value of a right, trademark, patent or tangible asset – except for capital investments and advances for capital investments – significantly exceeds its book value (original cost) following a reversal of impairment, the difference may be stated as a value adjustment and added to the valuation reserve. The Bank, however, does not make such adjustments to value.

III. Valuation of liabilities & equity

The Bank states **equity, provisions and liabilities** in the Balance Sheet at original cost.

II. NOTES TO THE BALANCE SHEET

II/1. HUF equivalent of foreign currency assets in each asset class

HUF millions

Description	Balance Sheet	31 December 2014			31 December 2015		
		HUF	Foreign currency	Total	HUF	Foreign currency	Total
Cash and equivalents	Line 1	410 611	2 445	413 056	578 552	2 355	580 907
Government securities	Line 2	523 151	49 480	572 631	554 245	45 988	600 233
Valuation difference of government securities	Line 5	-160	-93	-253	-30	2	-28
Amounts due from credit institutions	Line 6	17 842	49 917	67 759	28 419	56 063	84 482
Valuation difference of amounts due from credit institutions	Line 23	0	0	0	0	0	0
Amounts due from clients	Line 24	584 170	698 885	1 283 055	905 386	258 048	1 163 434
Valuation difference of amounts due from clients	Line 40	0	0	0	0	0	0
Debt securities, including those with a fixed interest rate	Line 41	324	2 398	2 722	16 289	6	16 295
- of which foreign securities		0	0	0	0	0	0
Valuation difference of debt securities	Line 53	152	1	153	149	1	150
- of which foreign securities		0	0	0	0	0	0
Shares and other variable yield securities	Line 54	573	1 460	2 033	0	464	464
- of which foreign securities		0	0	0	0	0	0
Valuation difference of shares and other variable yield securities	Line 61	30	108	138	0	-3	-3
Shares and participations held for investment	Line 62	640	6	646	640	6	646
- of which foreign securities		0	0	0	0	0	0
Valuation difference of shares and participations	Line 67	0	0	0	0	0	0
Shares and participations in affiliated undertakings	Line 68	4 429	0	4 429	7 206	0	7 206
Intangible assets	Line 73	13 775	0	13 775	14 258	0	14 258
Tangible assets	Line 76	38 643	0	38 643	38 087	0	38 087
Treasury stock	Line 88	0	0	0	0	0	0
Other assets	Line 89	11 382	509	11 891	21 354	530	21 884
Valuation difference on other assets	Line 94	0	0	0	0	0	0
Positive valuation difference of derivative transactions	Line 95	36 292	0	36 292	34 309	0	34 309
Prepayments and accrued income	Line 96	42 365	3 807	46 172	42 274	2 619	44 893
Total assets		1 684 219	808 923	2 493 142	2 241 138	366 079	2 607 217

II/2. HUF equivalent of foreign currency liabilities & equity by category

HUF millions

Description	Balance Sheet	31 December 2014			31 December 2015		
		HUF	Foreign currency	Total	HUF	Foreign currency	Total
Amounts due to credit institutions	Line 103	210 087	252 677	462 764	239 216	122 939	362 155
Valuation difference of amounts due to credit institutions	Line 120	0	0	0	0	0	0
Amounts due to clients	Line 121	1 329 833	354 174	1 684 007	1 551 031	344 641	1 895 672
Valuation difference of amounts due to clients	Line 144	0	0	0	0	0	0
Liabilities from securities issued	Line 145	7 530	0	7 530	5 723	0	5 723
Other liabilities	Line 167	22 684	7 669	30 353	18 762	29 404	48 166
Negative valuation difference of derivative transactions	Line 175	22 045	0	22 045	20 318	0	20 318
Accruals and deferred income	Line 176	21 805	2 136	23 941	26 019	1 173	27 192
Provisions	Line 180	-10 538	74 733	64 195	2 657	5 658	8 315
Subordinated liabilities	Line 185	0	18 893	18 893	0	28 181	28 181
Subscribed capital	Line 193	140 978	0	140 978	140 978	0	140 978
Subscribed capital unpaid (-)	Line 195	0	0	0	0	0	0
Capital reserve	Line 196	23 179	0	23 179	23 179	0	23 179
General reserve	Line 199	5 542	0	5 542	8 750	0	8 750
Profit reserve (+/-)	Line 200	9 715	0	9 715	9 715	0	9 715
Earmarked reserve	Line 201	0	0	0	0	0	0
Valuation reserve	Line 202	0	0	0	0	0	0
Retained earnings	Line 205	0	0	0	28 873	0	28 873
Total liabilities & equity		1 782 860	710 282	2 493 142	2 075 221	531 996	2 607 217

II/3. Amounts due from credit institutions and clients, by maturity**31 December 2015**

HUF millions

Description	31 December 2014				
	0-3 months	3 months – 1year	1-5 years	5+ years	Total
Amounts due from credit institutions, arising from financial services (Balance Sheet line 08)	7 446	5 274	13 334	1 121	27 175
Amounts due from clients, arising from financial services (Balance Sheet line 25)	230 969	222 604	422 009	406 959	1 282 541
Total	238 415	227 878	435 343	408 080	1 309 716

HUF millions

Description	31 December 2015				
	0-3 months	3 months – 1year	1-5 years	5+ years	Total
Amounts due from credit institutions, arising from financial services (Balance Sheet line 08)	36 331	18 701	3 001	0	58 033
Amounts due from clients, arising from financial services (Balance Sheet line 25)	214 444	178 785	408 791	360 889	1 162 909
Total	250 775	197 486	411 792	360 889	1 220 942

II/4. Amounts due to credit institutions and clients, by maturity**31 December 2015**

HUF millions

Description	31 December 2014				
	0-3 months	3 months – 1year	1-5 years	5+ years	Total
Amounts due to credit institutions – fixed-term liabilities from financial services (Balance Sheet line 105)	180 098	68 371	171 359	34 641	454 469
Amounts due to clients – other short-term liabilities from financial services (Balance Sheet line 130)	370 159	102 639	0	0	472 798
Amounts due to clients – other long-term liabilities from financial services (Balance Sheet line 133)	0	0	153 774	51 111	204 885
Subordinated liabilities (Balance Sheet line 185)	0	0	18 893	0	18 893
Total	550 257	171 010	344 026	85 752	1 151 045

HUF millions

Description	31 December 2015				
	0-3 months	3 months – 1year	1-5 years	5+ years	Total
Amounts due to credit institutions – fixed-term liabilities from financial services (Balance Sheet line 105)	55 662	68 579	188 621	26 851	339 713
Amounts due to clients – other short-term liabilities from financial services (Balance Sheet line 130)	254 920	84 881	0	0	339 801
Amounts due to clients – other long-term liabilities from financial services (Balance Sheet line 133)	0	0	173 908	58 552	232 460
Subordinated liabilities (Balance Sheet line 185)	0	0	0	28 181	28 181
Total	310 582	153 460	362 529	113 584	940 155

II/5. Gross value of intangible and tangible assets**2015**

HUF millions

Description	Balance Sheet	Change in gross value				
		Opening value	Reclassification (+/-)	Increase (+)	Decrease (-)	Closing value
Intangible assets	Line 73	45 875	-7	4 747	-1 309	49 306
- rights		12 199	0	212	-237	12 174
- trademarks and patents		33 676	-7	4 535	-1 072	37 132
Tangible assets used in financial services	Line 77	71 613	7	4 141	-6 006	69 755
- land and buildings	Line 78	47 356	7	1 168	-2 739	45 792
- technical equipment, machinery	Line 79	22 910	0	2 456	-3 267	22 099
- capital expenditure	Line 80	1 347	0	517	0	1 864
- advances for capital investments	Line 81	0	0	0	0	0
Tangible assets not directly used in financial services	Line 82	82	0	0	-12	70
- land and buildings	Line 83	0	0	0	0	0
- technical equipment, machinery and vehicles	Line 84	82	0	0	-12	70
- capital expenditure	Line 85	0	0	0	0	0
- advances for capital investments	Line 86	0	0	0	0	0

The amount stated for technical equipment, machinery and vehicles includes the value of so-called small-value assets.

II/6. Accumulated depreciation of intangible and tangible assets**2015**

HUF millions

Description	Balance Sheet	Accumulated depreciation				
		Opening value	Reclassification (+/-)	Increase (+)	Decrease (-)	Closing value
<u>Intangible assets</u>	Line 73	32 100	-3	4 251	-1 300	35 048
- rights		7 906	0	1 540	-236	9 210
- trademarks and patents		24 194	-3	2 711	-1 064	25 838
<u>Tangible assets used in financial services</u>	Line 77	33 034	3	3 963	-5 268	31 732
- land and buildings	Line 78	14 787	3	2 133	-2 048	14 875
- technical equipment, machinery and vehicles	Line 79	18 247	0	1 830	-3 220	16 857
<u>Tangible assets not directly used in financial services</u>	Line 82	18	0	0	-12	6
- land and buildings	Line 83	0	0	0	0	0
- technical equipment, machinery and vehicles	Line 84	18	0	0	-12	6

The amount stated for technical equipment, machinery and vehicles includes the depreciation of so-called small-value assets.

II/7. Net value of intangible and tangible assets

HUF millions

Description	Balance sheet	31.12.2014.	31.12.2015.
		Closing value	Closing value
<u>Intangible assets</u>	Line 73	13 775	14 258
- rights		4 293	2 964
- trademarks and patents		9 482	11 294
<u>Tangible assets used in financial services</u>	Line 77	38 579	38 023
- land and buildings	Line 78	32 569	30 917
- technical equipment, machinery and vehicles	Line 79	4 663	5 242
- capital expenditure	Line 80	1 347	1 864
- advances for capital investments	Line 81	0	0
<u>Tangible assets not directly used in financial services</u>	Line 82	64	64
- land and buildings	Line 83	0	0
- technical equipment, machinery and vehicles	Line 84	64	64
- capital expenditure	Line 85	0	0
- advances for capital investments	Line 86	0	0

II/8. Annual depreciation of intangible and tangible assets**2015**

HUF millions

Description	Ordinary	Extraordinary	Total
<u>Intangible assets</u>	4 239	0	4 239
<u>Tangible assets used in financial services</u>	3 908	0	3 908
- land and buildings	2 133	0	2 133
- technical equipment, machinery and vehicles	1 775	0	1 775
<u>Tangible assets not directly used in financial services</u>	0	0	0
- land and buildings	0	0	0
- technical equipment, machinery and vehicles	0	0	0
<u>Depreciation of tangible assets with a value of less than HUF 100,000</u>	38	0	38
<u>Adjustment due to self-audit</u>	29	0	29
Total	8 214	0	8 214

Linear method is in use for calculation the depreciation in the Bank. There was not extraordinary depreciation written back.

II/9. Profit impact of the change in the depreciation method used with intangible and tangible assets

In 2015 the Bank did not change the depreciation method used with intangible and tangible assets.

II/10. Contingent-, future liabilities and receivables

a., Liabilities

Description	HUF millions	
	31.12.2014.	31.12.2015.
Guarantees and warranties issued	115 911	112 056
Loans, guarantees and letters of credit	370 396	433 477
Export letters of credit	0	121
Import letters of credit	2 551	3 156
Liabilities from lawsuits	6 576	5 660
Liabilities from options	321 559	392 466
Other contingent liabilities	866	807
Total contingent liabilities	817 859	947 743

Description	HUF millions	
	31.12.2014.	31.12.2015.
Swaps (foreign currency and other)	828 276	736 665
Foreign currency forwards	113 501	106 964
Liabilities from the sale/purchase of securities	8 582	13 904
Future liabilities on payments	757	519
Other future liabilities	4 619	3 257
Interbank deposits	4 881	0
Total future liabilities	960 616	861 309

The Bank had contingent-, future liabilities of HUF 476 882 million to its affiliates.

b., Receivables

Description	HUF millions	
	31.12.2014.	31.12.2015.
Received guarantees and coverages	1 812 182	1 726 741
Interests, extra interests receivables	34 292	25 736
Receivables from lawsuits	2 495	3 276
Receivables from options	321 559	391 671
Other contingent receivables	2 113	2 132
Total contingent receivables	2 172 641	2 149 556

Description	HUF millions	
	31.12.2014.	31.12.2015.
Swaps (foreign currency and other)	816 758	736 682
Foreign currency forwards	113 099	105 698
Liabilities from the sale/purchase of securities	14 914	22 369
Future receivables on payments	764	525
Other future receivables	404	350
Total future receivables	945 939	865 624

The Bank had contingent-, future receivables of HUF 454 752 million to its affiliates.

**II/11. Impairment and risk provisioning
2015**

HUF millions

Description	Opening balance	Impairment recognized and provisions made in the reporting year (+)	Reversal of impairment recognized, and use/release of provisions made, in the previous year (-)	Other changes	Closing balance
Impairment recognized on receivables (amounts due from credit institutions, clients)	117 965	66 152	93 403	7 354	98 068
Impairment recognized on financial leasing receivables	3 667	435	1 529	26	2 599
Impairment recognized on financial fixed assets	2 778	0	2 778	0	0
Impairment recognized on administrative risks	209	0	0	0	209
Impairment recognized on other receivables (operating)	274	1	18	0	257
Impairment recognized on received in debt settlement	19	11	17	0	13
Total impairment recognized on assets	124 912	66 599	97 745	7 380	101 146
Risk provisions for contingent and future liabilities	5 360	2 561	1 455	-28	6 438
Provisions of retail loan and financial lease receivables (based on 2014. XXXVIII. act.)	58 008	0	59 528	1 670	150
Provisions for anticipated liabilities	772	611	141	0	1 242
Provisions for administrative risks	0	545	84	0	461
Provisions for payment obligations due to early retirement and severance pay	55	0	31	0	24
Total provisions	64 195	3 717	61 239	1 642	8 315

The "Other changes" column shows the change resulting from revaluation in 2015, except for the change in general risk provision. Provision was not created for liabilities to affiliates.

II/12. Other notes to the Balance Sheet

a., Listed securities held by the Bank

- Under financial fixed assets:

HUF millions

Description	31 December 2014		31 December 2015	
	Par value	Book value	Par value	Book value
Government bonds	433 813	428 014	448 978	460 669
Total:	433 813	428 014	448 978	460 669

- Under current assets:

HUF millions

Description	31 December 2014		31 December 2015	
	Par value	Book value	Par value	Book value
Government bonds	21 931	23 224	36 506	38 032
Discounted Treasury bills	10 509	10 442	226	225
Investment units	86	89	163	157
Total:	32 526	33 755	36 895	38 414

- b., There was no legal lending limit breach in the Bank in accordance with the Regulation (EU) No 575/2013 as at the balance sheet date. The total amount of loans, securities, participations and liabilities classified as legal lending limits was HUF 40 892 million as at the balance sheet date after the application of the waivers and credit risk mitigation.
- c., As at 31 December 2015 the Bank's liabilities included subordinated debt of HUF 28 181 million (EUR 60 million, maturity date 30.06.2026., interest rate: 3-month EURIBOR +2.7%, that is, 2.568% and EUR 30 million, maturity date 28.09.2025., interest rate: 3-month EURIBOR +3.05%, that is, 2.919%), stated under subordinated liabilities.
- d., The Bank's own real estate properties are free of mortgages; in the case of partially owned properties, the Bank's ownership interests are also free of mortgages.
- e., The amount of accrued interest (including transaction interest and late interest), interest-type commission and fees receivable totaled HUF 14 571 million on 31 December 2015, versus HUF 17 831 million on 31 December 2014.
- f., The HUF equivalent of receivables and liabilities arising from spot foreign exchange trades totaled HUF 13 847 million and HUF 13 841 million, respectively, at the balance sheet date, 31 December 2015.
- g., On 31 December 2015, the balances of currency swap buy and sell trades made in the interbank market stood at HUF 623 023 million and HUF 623 269 million, respectively, while the balances of currency swap buy and sell trades made with clients were HUF 105 840 million and HUF 105 611 million, respectively. The balances of forward sell and buy trades made in the interbank market stood at HUF 2 070 million and

HUF 2 117 million, respectively, while the balances of FX forward sell and buy trades made with clients were HUF 89 733 million and HUF 90 960 million, respectively. The transactions served (exchange rate) hedging as well as trading purposes.

h., Actual sale and repurchase transactions and the underlying assets

HUF millions

Start date	Maturity date	Security	Par value	Transaction value
30DEC2015	06JAN2016	2018/A	1 500	1 657
30DEC2015	06JAN2016	2018/A	1 500	1 657
30DEC2015	06JAN2016	2018/A	230	251
28DEC2015	04JAN2016	2019/A	180	213
28DEC2015	04JAN2016	2020/B	3 000	3 222
30DEC2015	06JAN2016	2022/A	500	642
28DEC2015	04JAN2016	2024/B	300	305
30DEC2015	06JAN2016	2024/B	1 100	1 122
28DEC2015	04JAN2016	2028/A	1 000	1 362
29DEC2015	05JAN2016	D160928	1 500	1 490
30DEC2015	06JAN2016	D160928	1 500	1 490
Total active special delivery repos			12 310	13 411

HUF millions

Start date	Maturity date	Security	Par value	Transaction value
30DEC2015	06JAN2016	2015/A_X	1 500	1 496
28DEC2015	04JAN2016	2023/A	3 000	3 222
21DEC2015	21JAN2016	2025/B	700	737
Total passive special delivery repos			5 200	5 455

- i., K&H Bank Zrt. participates, for a commission, in the distribution of investment units issued by various open-end investment funds. The Bank had no debts to these funds on 31 December 2015. The par value of investment units posted as off-balance sheet items (held on securities accounts) – expressed in Hungarian forints – totaled HUF 883 449 million at the end of the year.
- j., The Bank did not have any earmarked reserves on 31 December 2015.
- k., On 31 December 2015 the total risk weighted assets of the Bank was HUF 1 594 831 million.
- l., The Bank did not have any retirement benefit payment obligations to its former Board of Directors or Supervisory Board members.
- m., The Bank manages securities with a total par value of HUF 1 657 842 million for its clients on custody and securities accounts. As part of its investment services, the Bank also maintains restricted cash accounts (client accounts) for its clients, the aggregate balance of which – expressed in Hungarian forints – was HUF 20 291 million as at 31 December 2015. Clients had receivables of HUF 20 906 million and payables of HUF 615 million on their client accounts at the end of the year.
- n., The Bank did not provide any asset management services for pension or health funds in 2015.

o., On 31 December 2015 the Bank had a total amount of HUF 47 392 million due from its parent company; at the same time, the Bank had liabilities of HUF 74 443 million to its parent of which short-term liabilities of HUF 46 262 million.

On 31 December 2015, amounts due from subsidiaries totaled HUF 29 442 million, while short-term liabilities amounted to HUF 4 582 million, and long-term liabilities to HUF 23 849 million come from open-end financial leasing.

The Bank had no subordinated liabilities to its subsidiaries.

p., K&H Bank Zrt. did not have any significant transactions with associated parties executed under conditions deviating from standard market practice.

II/13. Third-party securities

HUF millions*

Description	Par value		Comments
	31.12.2014.	31.12.2015.	
Dematerialized	1 182 876	1 629 712	
In safekeeping at the Bank's depository	35 598	28 130	
Total physical	35 598	28 130	
Total	1 218 474	1 657 842	

* converted into HUF at the NBH exchange rate for 31.12.2015.

II/14. Securities portfolio held by the Bank

- Stated in fixed assets

HUF millions

Description	Par value		Book value	
	31.12.2014.	31.12.2015.	31.12.2014.	31.12.2015.
Dematerialized	474 639	486 506	469 557	503 820
In safekeeping at the Bank's depository	761	761	2 689	5 363
Total physical	761	761	2 689	5 363
Total	475 400	487 267	472 246	509 183

- Stated in current assets

HUF millions *

Description	Par value		Book value	
	31.12.2014.	31.12.2015.	31.12.2014.	31.12.2015.
Dematerialized	105 169	116 806	109 748	115 162
Total physical	0	0	0	0
Total	105 169	116 806	109 748	115 162

* converted into HUF at the NBH exchange rate for 31.12.2015.

II/15. Accruals

HUF millions

Prepayments and accrued income	31.12.2014.	31.12.2015.
Accrued interest and interest-type commissions	30 161	27 409
IR swaps fair market value interest accrual	11 772	13 422
IR arbitrage transactions interest accrual	812	617
Other accrued income	1 624	1 674
Accrued income	44 369	43 122
Prepaid costs and expenses	1 803	1 771
Deferred expense	0	0
Total (Balance Sheet line 96)	46 172	44 893

HUF millions

Accruals and deferred income	31.12.2014.	31.12.2015.
Accrued income	107	74
Accrued interest	14 503	15 815
IR swaps fair market value interest accrual	2 003	1 879
IR arbitrage transactions interest accrual	191	219
Other accrued expenses	0	0
Accrued costs	6 838	8 947
Accrued costs and expenses	23 535	26 860
Deferred income	299	258
Total (Balance Sheet line 176)	23 941	27 192

II/16. Changes in equity

HUF millions

Description	Subscribed capital	Capital reserve	Profit reserve	General reserve	Retained earnings for the year	Total
Balance 31.12.2014.	140 978	23 179	9 715	5 542	0	179 414
General reserves				3 208		3 208
Retained earnings for the year					28 873	28 873
Balance 31.12.2015.	140 978	23 179	9 715	8 750	28 873	211 495

II/17. Rights and concessions concerning properties stated in intangible and tangible assets by type

a) Intangible assets by type

Description	HUF millions	
	31.12.2014.	31.12.2015.
Licenses	4 274	2 952
Other	19	12
Rights	4 293	2 964
Basic software	49	25
User software	9 432	11 268
Trademarks	1	1
Patents	9 482	11 294
Total:	13 775	14 258

b) Rights and concessions concerning properties stated in tangible assets by type

Description	HUF millions	
	31.12.2014.	31.12.2015.
Lease rights	20	11
Acquired rights from payment contribution of public utility	39	45
Total:	59	56

II/18. Inventories purchased or received in debt settlement and intended for resale

Description	HUF millions	
	31.12.2014.	31.12.2015.
Materials	9	41
Goods	2 247	4 732
Inventories purchased	2 256	4 773
Land and buildings	882	785
Technical equipment, machinery and vehicles	0	0
Received in debt settlement	882	785
Total (Balance Sheet line 90)	3 138	5 558

II/19. Risk-free securities at par value

Issue currency	Description	HUF millions	
		2014	2015
HUF	Securities issued by the State of Hungary	527 102	540 405
HUF	Other		14 436
HUF Total		527 102	554 841
JPY	Bonds issued by the NBH	2 444	0
JPY Total		2 444	0
EUR	Securities issued by the State of Hungary	36 068	44 601
EUR Total		36 068	44 601
USD	Securities issued by the State of Hungary	9 896	0
USD Total		9 896	0

II/20. The impacts of fair market valuation

a., Derivative transactions

Derivative transaction	HUF millions					
	Positive fair market value		Negative fair market value		Future cash-flow	
	2014	2015	2014	2015	2014	2015
Asset swap	0	0	-104	0	-352	0
IRS	31 212	29 356	-16 967	-14 654	53 172	44 144
Forward	672	299	-654	-1 079	-407	-1 272
Option	4 132	3 628	-4 184	-3 623	0	0
Currency swap	268	1 014	-105	-926	75	-324
Other	8	12	-31	-36	-58	-23
Total	36 292	34 309	-22 045	-20 318	52 430	42 525

Accruals related to the fair market valuation of derivative transactions amounted to HUF 14 038 million in interest income and HUF 2 098 million in interest expense.

The HUF 638 million price difference of interest arbitrage-like swap transactions is stated under other liabilities.

b., Securities

HUF millions

Securities held for trading	Book value		Fair market value		Valuation difference	
	31.12.2014	31.12.2015	31.12.2014	31.12.2015	31.12.2014	31.12.2015
Government bonds	90 466	113 715	90 224	113 683	-242	-32
of which: reclassified from securities held for investment and maturing in 2016	56 011	74 246	56 011	74 246	0	0
Treasury bills	16 920	552	16 909	556	-11	4
Total government securities:	107 386	114 267	107 133	114 239	-253	-28
Closed-end investment units	329	401	482	551	153	150
Bonds	0	30	0	30	0	0
Total debt securities:	329	431	482	581	153	150
Open-end investment units	2 033	464	2 171	461	138	-3
Total shares and other variable-yield securities	2 033	464	2 171	461	138	-3

c., Fair market value of financial instruments stated at original cost

HUF millions

Description	Book value	Fair market value	Book value	Fair market value
	2014.12.31	2014.12.31	2015.12.31	2015.12.31
Securities held to maturity and securities included in available for sale	523 648	580 464	561 640	624 448
Receivables	1 350 813	1 337 470	1 247 916	1 239 857
Liabilities	2 173 194	2 162 526	2 291 731	2 292 448

II/21. Reclassification of financial instruments

The Bank did not reclassify any financial instruments into another category in 2015.

II/22. Data of restructured loan

HUF millions

Description	2014	2015
Conditional equity claim	268 957	162 315
Impairment	55 516	45 477
Book value of receivables	213 441	116 838

II. 23. Items managed in frame of special rating procedure

a., Net value of receivables

HUF millions

Description	2014				2015			
	Corporate loans	Retail loans	Credit institutions	Total	Corporate loans	Retail loans	Credit institutions	Total
Performing	692 925	400 223	67 759	1 160 907	625 879	393 334	84 482	1 103 695
Monitor	46 091	44 827	0	90 918	48 358	20 572	0	68 930
Substandard	17 904	5 331	0	23 235	1 536	3 581	0	5 117
Doubtful	17 164	9 646	0	26 810	7 939	5 338	0	13 277
Bad	1 491	44 849	0	46 340	1 947	42 604	0	44 551
Total	775 575	504 876	67 759	1 348 210	685 659	465 429	84 482	1 235 570

b., Net value of securities

HUF millions

Description	2014			2015		
	Investments	Debt securities	Total	Investments	Debt securities	Total
Performing	2 221	2 393	4 614	7 852	1 428	9 280
Monitor	378	0	378	0	0	0
Substandard	379	0	379	0	0	0
Doubtful	2 097	0	2 097	0	0	0
Bad	0	0	0	0	0	0
Total	5 075	2 393	7 468	7 852	1 428	9 280

c., Received in debt settlement

HUF millions

Description	2014			2015		
	Land and buildings	Technical equipment, machinery and vehicles	Total	Land and buildings	Technical equipment, machinery and vehicles	Total
Performing	801	0	801	721	0	721
Monitor	29	0	29	30	0	30
Substandard	45	0	45	26	0	26
Doubtful	7	0	7	8	0	8
Bad	0	0	0	0	0	0
Total	882	0	882	785	0	785

d., Net value of off balance sheet liabilities

HUF millions

Description	2014			2015		
	Corporate	Retail	Total	Corporate	Retail	Total
Performing	466 247	19 122	485 369	521 994	21 532	543 526
Monitor	790	5	795	724	3	727
Substandard	2 899	2	2 901	1 296	3	1 299
Doubtful	4 174	14	4 188	4 892	7	4 899
Bad	24	255	279	0	281	282
Total	474 134	19 399	493 532	528 906	21 826	550 732

II. 24 Financial leasing receivables

On 31 December 2015 the financial leasing receivables amounts was HUF 34 910 million.

III. NOTES TO THE PROFIT & LOSS ACCOUNT

III/1. Expenses on non-financial and investment services

HUF millions

No.	Description	31.12.2014.	31.12.2015.
1.	Re-invoiced value of third-party services	304	225
2.	Book value of inventories sold	13 868	26 779
Total (Profit & Loss Account line 69)		14 172	27 004

III/2. Income from and expense on investment services

HUF millions

Income from investment services	31.12.2014.	31.12.2015.
1. Income from custody services	599	762
2. Income from trading operations	69 677	45 486
3. Income from brokerage activities	8 320	7 969
4. Income from organizing activities on securities issue	0	0
5. Other income	875	847
Total (Profit & Loss Account lines 20 + 39)	79 471	55 064

HUF millions

Expense on investment services	31.12.2014.	31.12.2015.
1. Expense on custody services	47	7
2. Expense on trading operations	48 308	35 024
3. Expense on brokerage activities	700	502
4. Expense on organizing activities on securities issue	0	0
Total (Profit & Loss Account lines 27 + 44)	49 055	35 533

III/3. Provisions required but not made (in the breakdown set forth in Section II/11)

The Bank made all the provisions prescribed by applicable regulations to cover credit, interest, investment and other risks related to its activities in 2015.

III/4. Other notes to the Profit & Loss Account

a) Contributions to deposit insurance and institutional protection funds

HUF millions

Description	Amount	
	2014	2015
National Deposit Insurance Fund	1 207	1 414
Investor Protection Fund	158	348
Resolution Fund	292	985

b) Financial assistance received

The non-repayable grant given for extension of tools of cashless payment transactions was received by the Bank in amount of HUF 146 million in 2015, from which HUF 105 million was used in the reference year.

c) Geographic breakdown of income

In 2014

HUF millions

Profit & Loss Account lines	Geographical breakdown			Breakdown of non-EU countries			
	Domestic	EU member states	Non-EU countries	United States of America	Bissau-Guinea	Switzerland	Other
1. Interest received and similar income	113 655	2 310	50	3	0	47	0
3. Income from securities	2 154	0	0	0	0	0	0
4. Fees and commissions received (receivable)	62 471	52	7	0	3	1	3
6. Profit/loss from financial transactions							
a) income from other financial services	21 253	0	0	0	0	0	0
c) income from investment services	25 857	43 820	0	0	0	0	0
7. Other income from business activities	23 054	100	0	0	0	0	0

In 2015

HUF millions

Profit & Loss Account lines	Geographical breakdown			Breakdown of non-EU countries			
	Domestic	EU member states	Non-EU countries	United States of America	Bissau-Guinea	Switzerland	Other
1. Interest received and similar income	93 929	1 436	77	1	0	76	0
3. Income from securities	2 438	0	0	0	0	0	0
4. Fees and commissions received (receivable)	63 569	24	8	0	3	0	5
6. Profit/loss from financial transactions							
a) income from other financial services	12 589	1 936	0	0	0	0	0
c) income from investment services	20 366	25 120	0	0	0	0	0
7. Other income from business activities	44 596	212	0	0	0	0	0

**III/5. Extraordinary expense and extraordinary income
recognized in 2015**

Extraordinary expense	Amount		Extraordinary income	Amount	
	31.12.2014.	31.12.2015.		31.12.2014.	31.12.2015.
	HUF millions				
Amounts not deemed uncollectible but forgiven	7	15	Financial assistance received definitively for development purposes	53	62
Extraordinary expense related to donated assets	1	0	Lapsed liabilities	2	21
Extraordinary expenditures due to customers' receivables related to retail mortgage loans, personal loans and leasing activity		72 587	Extraordinary income due to customers' receivables related to retail mortgage loans, personal loans and leasing activity	0	8 451
			Use of provisions for customers' receivables related to retail mortgage loans, personal loans and leasing activity	0	59 528
			Extraordinary income related to associated businesses	15	0
			Extraordinary income related to businesses	96	0
			Extraordinary income related to assets taken over as refund	13	5
Total (Profit & Loss Account line 89)	8	72 602	Total (Profit & Loss Account line 88)	179	68 067

III/6. Profit/loss from closed forwards/futures, options and swaps

HUF millions

Description		31.12.2014.	31.12.2015.
Futures / forwards	Forward	-367	-2 106
	FRAs	246	1
	FX futures	-275	-220
Options	Options	333	989
Swaps	Asset swaps	-127	-129
	Currency swaps	1 547	-441
	Index swaps	-31	78
	Interest rate swaps	15 222	6 948
Total		16 548	5 120

III/7. Net profit/loss against parent company and affiliates

HUF millions

Profit/loss	2014		2015	
	Parent	Affiliate	Parent	Affiliate
Interest difference	-378	-267	-399	-31
Fees and commissions	-839	-170	-529	-163
Profit/loss from financial transactions	N/A	0	N/A	0
Other	-131	726	-96	771
Extraordinary	0	0	0	0

IV. ADDITIONAL INFORMATION

IV/1. Signatories to the Bank's annual report

- I. Name: Hendrik Scheerlinck
 Address: Budapest
- II. Name: Attila Gombás
 Address: Budapest

IV/2. Auditing

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

a., Auditor

Auditor's name: Ernst & Young Kft.
 Auditor's address: 1132 Budapest, Váci út 20.
 MKVK registration number: 001165
 Authorized signatory: Gabriella Virágh

b., Fees charged by the auditors in 2015

HUF millions

Description	Amount	
	Ernst & Young	Other auditors
Auditing	161	
Other certification services		
Tax consulting services	2	9
Other, non-auditor services	5	
Total	168	9

IV/3. Person in charge of accounting tasks

Name: Paula Ecsedi
 Registration number: 140573

IV/4. Registered office and website

Registered office: 1095 Budapest, Lechner Ödön fasor 9.
 Website: www.kh.hu

IV/5. Number and par value of the Bank's shares by type

Details of the K&H Bank Zrt. share (HU0000075304):

type: registered, dematerialized ordinary share

basic denomination: HUF 1

amount issued: 140 978 164 412 shares

par value: HUF 140 978 164 412

IV/6. Entities that have an ownership interest in the Bank

Company name	Registered office	Voting rights (%)
<u>Controlling interest:</u>		
<u>Qualified controlling interest:</u> KBC Bank N.V.	B-1080 Brussels, Havenlaan 2.	100

IV/7. Details of the company consolidating the Bank as its subsidiary

Consolidating unit	Company name	Registered office	Public	Available for inspection
Biggest	KBC Group N.V.	B-1080 Brussels, Havenlaan 2.	Yes	At its registered office.
Smallest	KBC Bank N.V.	B-1080 Brussels, Havenlaan 2.	Yes	At its registered office.

IV/8. The Bank's equity participations

a, Participations in subsidiaries

No.	Company name	Registered office	Stake (%)	Equity (HUF m)* 31.12.2014.	Subscribed capital (HUF m) * 31.12.2014.	Reserves (HUF m) * 31.12.2014.	Retained earnings for the last financial year (HUF m)* 31.12.2014.
1	K&H Befektetési Alapkezelő Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	3 397	850	151	2 396
2	K&H Autópark Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	452	11	217	225
3	K&H Alkusz Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	78	5	49	25
4	K&H Lízing Zrt. "v.a."	1095 Budapest, Lechner Ödön fasor 9.	100	124	50	74	0
5	K&H Csoportszolgáltató Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	562	60	461	40
6	K&H Equities Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	2 097	38	2 110	-52
7	K&H Eszközlízing Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	171	5	155	12
8	K&H Ingatlanlízing Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	167	50	66	51
9	K&H Faktor Pénzügyi Szolgáltató Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	379	51	261	67

* Corresponding to the annual report for previous year

No.	Company name	Registered office	Stake (%)	Equity (HUF m)* 31.12.2015.	Subscribed capital (HUF m) 31.12.2015.	Reserves (HUF m) 31.12.2015.	Retained earnings for the last financial year (HUF m)* 31.12.2015.
1	K&H Befektetési Alapkezelő Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	3 527	850	151	2 527
2	K&H Autópark Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	974	11	414	550
3	K&H Alkusz Kft. "v.a."	1095 Budapest, Lechner Ödön fasor 9.	100	77	5	73	-1
4	K&H Lízing Zrt. "v.a."	1095 Budapest, Lechner Ödön fasor 9.	100	124	50	74	0
5	K&H Csoportszolgáltató Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	561	60	460	42
6	K&H Equities Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	4 870	38	2 074	2 758
7	K&H Eszközlízing Kft.	1095 Budapest, Lechner Ödön fasor 9.	100	179	5	161	13
8	K&H Ingatlanlízing Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	234	50	117	68
9	K&H Faktor Pénzügyi Szolgáltató Zrt.	1095 Budapest, Lechner Ödön fasor 9.	100	508	51	328	129

* Unaudited

b, Participations in jointly managed undertakings

The Bank holds no ownership interest in any jointly managed undertaking either in this year or in the previous year.

c, Participations in affiliated undertakings

No.	Company name	Registered office	Stake (%)*	Equity (HUF m)* 31.12.2014.	Subscribed capital (HUF m) * 31.12.2014.	Reserves (HUF m) * 31.12.2014.	Retained earnings for the last financial year (HUF m)* 31.12.2014.
1	HAGE Zrt.	4181 Nádudvar, Kossuth u. 2.	25,00	7 188	2 689	4 008	491

* Corresponding to the annual report for previous year

No.	Company name	Registered office	Stake (%)	Equity (HUF m)* 31.12.2015.	Subscribed capital (HUF m) 31.12.2015.	Reserves (HUF m) 31.12.2015.	Retained earnings for the last financial year (HUF m)* 31.12.2015.
1	HAGE Zrt.	4181 Nádudvar, Kossuth u. 2.	25,00	7 465	2 689	4 640	136

* Unaudited

d, Participations in other associated undertakings

No.	Company name	Registered office	Stake (%)*	Equity (HUF m) * 31.12.2014.	Subscribed capital (HUF m) * 31.12.2014.	Reserves (HUF m) * 31.12.2014.	Retained earnings for the last financial year (HUF m) * 31.12.2014.
1	Garantiqa Hitelgarancia Zrt.	1082 Budapest, Kisfaludy u. 32.	8,16	25 852	7 840	12 596	5 417
2	Árpád Üzletház Egyesülés	1045 Budapest, Árpád út 112.	7,38	N/A	3	N/A	N/A
3	Swift SC	Belgium, B-1310 La Hulpe, Avenue Adele 1.	0,02	N/A	14	N/A	N/A
4	VISA Europe Limited	London, W2 6TT, Sheldon square 1.	1,27	N/A	N/A	N/A	N/A

* Corresponding to the annual report for previous year

No.	Company name	Registered office	Stake (%)	Equity* (HUF m) 31.12.2015.	Subscribed capital (HUF m) 31.12.2015.	Reserves (HUF m) 31.12.2015.	Retained earnings for the last financial year* (HUF m) 31.12.2015.
1	Garantiqa Hitelgarancia Zrt.	1082 Budapest, Kisfaludy u. 32.	8,16	28 204	7 840	16 962	3 402
2	Árpád Üzletház Egyesülés	1045 Budapest, Árpád út 112.	7,38	N/A	3	N/A	N/A
3	Swift SC	Belgium, B-1310 La Hulpe, Avenue Adele 1.	0,02	N/A	14	N/A	N/A
4	VISA Europe Limited	London, W2 6TT, Sheldon square 1.	1,28	N/A	N/A	N/A	N/A

* Unaudited

IV/9. Business associations in which the Bank has an ownership interest

Company name	Registered office	Subscribed capital (HUF m)	Voting rights
Controlling interest:			
-	-	-	-
Qualified controlling interest:			
K&H Befektetési Alapkezelő Zrt.	1095 Budapest, Lechner Ödön fasor 9.	850	100,00%
K&H Equities Zrt.	1095 Budapest, Lechner Ödön fasor 9.	38	100,00%
K&H Csoportszolgáltató Kft.	1095 Budapest, Lechner Ödön fasor 9.	60	100,00%
K&H Ingatlanlízing Zrt.	1095 Budapest, Lechner Ödön fasor 9.	50	100,00%
K&H Lízing Zrt. "v.a."	1095 Budapest, Lechner Ödön fasor 9.	50	100,00%
K&H Eszközlízing Kft.	1095 Budapest, Lechner Ödön fasor 9.	5	100,00%
K&H Autópark Kft.	1095 Budapest, Lechner Ödön fasor 9.	11	100,00%
K&H Alkusz Kft.	1095 Budapest, Lechner Ödön fasor 9.	5	100,00%
K&H Faktor Pénzügyi Szolgáltató Zrt.	1095 Budapest, Lechner Ödön fasor 9.	51	100,00%

IV/10. Other events with a significant impact on the company's financial position**a., Impairment recognized on the investment in K&H Equities Zrt.**

The Bank recognizes impairment on the investment in its subsidiary, K&H Equities Zrt. in previous years, due to the loss of capital resulting from the fraudulent practices that had occurred before 2003.

In 2015, the impairment previously recognized in the Bank has been derecognized as a consequence of the closed court proceedings in 2015.

b., Debtor relief programs*Overview on the government measures related to consumer loan contracts*

On 16 June 2014, the Hungarian Supreme Court rendered its decision regarding the legal assessment of foreign currency based loans („FX loans”) for consumers under Hungarian civil law.

Following the Supreme Court ruling several pieces of legislation have been adopted during the year 2014, which ones defined for the financial institutions the basic principles and detailed rules related to the settlement with consumers.

These legislations were completed by the act on the „Rules of the settlement of certain issues concerning the conversion into HUF of receivables related to consumer loan agreements (Act CXLV of 2015) proclaimed on 2 October 2015. The scope of the act includes all consumer loan agreements denominated in foreign currency, for which conversion have not been made based on the previous legislations of 2014. Conversion of these consumer loan agreements was made on exchange rate quoted by the NBH as of 19 August 2015 according to the act. Then a part of the total amount of loan calculated in proportion as a difference between the exchange rate used for conversion into HUF and exchange rate used for conversion of foreign currency mortgage loans was released by the financial institutions in favor of consumers. The burden arising from the debt allowance has been borne equally by the Hungarian State and by the financial institutions (50% of the debt allowance can be recuperated as tax allowance as from 2016). The conversion was not mandatory for the consumers.

Impact of government measures related to consumer loan contracts

The bank fulfilled its obligations related to settlement required by above mentioned legislations. The impact can be seen in Annual Statement as of 31.12.2015 as follows:

Balance Sheet impact:	
Open balance of provisions for customer's receivables related to retail mortgage loans, personal loans and leasing activity as of 1 January 2015	58 008 HUF millions
Change of provisions in 2015	1 670 HUF millions
Use of provisions for customer's receivables related to retail mortgage loans, personal loans and leasing activity in 2015	59 528 HUF millions
P&L impact:	
Extraordinary expenditures due to customer's receivables related to retail mortgage loans, personal loans and leasing activity	71 707 HUF millions
Extraordinary income due to customer's receivables related to retail mortgage loans, personal loans and leasing activity	8 451 HUF millions
Extraordinary expenditures due to release of customer's receivables related to consumer loans	880 HUF millions

In accordance with the §29/ZS of Act LXXXI of 1996 the corporate tax payable for the tax year 2015 and the subsequent years shall be decreased – instead in the form of self-revision, re-revision - with the amount the Bank would deduct from the total tax due to a related self-revision in consequence of settlement related to consumer loan contracts (if the deductible amount exceeds the corporate tax payable for 2015, the remaining amount shall be deducted from the corporate tax of the subsequent years). This option shall take effect when the deduction becomes possible due to enforcement of the Act XL of 2014 and the Act XXXVIII of 2014 regarding the corporate tax, special levy on collective enterprises, local business tax, innovation contribution and banking tax declared and paid for the tax years from 2008 to 2014.

Based on the Bank's financial plans the Bank will utilize the calculated tax allowance mentioned above until 2017.

IV/11. Average number of employees, wage costs by employee category, other personnel expenses and contributions payable on salaries and wages

Employees by category	Average statistical number of employees		Salaries and wages (HUF m)		Other personnel expenses (HUF m)		Contributions payable on salaries and wages (HUF m)	
	2014	2015	2014	2015	2014	2015	2014	2015
Full-time	3 078	3 259	18 627	21 001	2 703	2 793	5 805	6 599
Part-time	91	120	321	434	51	60	100	137
Retired	6	14	38	42	5	6	12	13
Not on payroll	0*	1	1	5	12	7	1	2
Total Profit & Loss Account line 59	3 175	3 394	18 987	21 482	2 771	2 866	5 918	6 751

* rounded figure

IV/12. Remuneration paid to members of the Board of Directors, Executive Management and the Supervisory Board for the business year

HUF millions

Description	Number of persons receiving remuneration		Remuneration	
	31.12.2014.	31.12.2015.	31.12.2014.	31.12.2015.
Board of Directors	3	2	228	230
Executive Management	35	31	1 304	1 029
Supervisory Board*	2	2	6	6
Total:	40	35	1 538	1 265

*Labor income

IV/13. Loans granted to members of the Board of Directors, Executive Management and the Supervisory Board

31 December 2015

Members of the Board of Directors, the Executive Management and the Supervisory Board have a total debt of HUF 214 million to the Bank in loans and interest/charges.

IV/14. Adjustments to the Bank's taxable income
31 December 2015

HUF millions

Items decreasing taxable income	Amount	Items increasing taxable income	Amount
Income from the use of provisions	257	Expense arising from provisioning	1 156
Depreciation according to the Corporation Tax Act	7 941	Depreciation according to the Accounting Act	8 185
Book value of tangible assets removed from the books	1 320	Book value of tangible assets removed from the books	749
Dividends received	2 438	Fines	13
Reversal of impairment	18	Depreciations	2
Use of provisions for customers' receivables related to retail mortgage loans, personal loans and leasing activity	59 528	Expenditures due to customers' receivables related to retail mortgage loans, personal loans and leasing activity	58 011
Income and expenses related to previous years	436	Expenses not incurred in the interest of the company	577
Donation	33		
Bank tax	14 384		
Total:	86 355	Total:	68 693

The customers' receivables related to retail mortgage loans, personal loans and leasing activity had an impact on the adjustments to the Bank's taxable income from the extraordinary expenditures and incomes.

IV/15. Cash Flow Statement (presenting the sources and use of the Bank's funds)

		HUF millions	
No.	Description	Previous year	Reporting year
A.			
01.	+ Interest income	116 015	95 442
02.	+ Income from other financial services (excluding reversal of impairment on securities and positive valuation difference of receivables)	73 989	68 548
03.	+ Other income (excluding use of provisions, reversal of surplus provisions, reversal of impairment on inventories and reversal of extraordinary depreciation)	4 064	14 613
04.	+ Income from investment services (excluding reversal of impairment on securities and positive valuation difference)	60 538	48 777
05.	+ Income from non-financial and investment services	17 349	29 904
06.	+ Dividend income	2 154	2 438
07.	+ Extraordinary income	179	8 539
08.	- Interest expense	34 240	24 070
09.	- Expense on other financial services (excluding impairment on securities and negative valuation difference of receivables)	17 954	21 795
10.	- Other expense (excluding provisioning, impairment on inventories and extraordinary depreciation)	63 072	64 769
11.	- Expense on investment services (excluding impairment on securities and negative valuation difference)	33 927	30 852
12.	- Expense on non-financial and investment services	14 172	27 004
13.	- General and administrative expense	50 594	51 921
14.	- Extraordinary expense (excluding corporation tax liability for the year)	8	72 602
15.	- Corporation tax liability for the year	10 929	14 600
16.	- Dividend paid	0	0
17.	CASH FLOW FROM OPERATIONS (lines 01-16)	49 392	-39 352
18.	Change in liabilities (+ if increase, - if decrease)	-113 291	137 992
19.	Change in receivables (- if increase, + if decrease)	-98 010	113 975
20.	Change in inventories (- if increase, + if decrease)	-1 369	-2 414
21.	Change in securities stated under current assets (- if increase, + if decrease)	438 428	-5 407
22.	Change in securities stated under fixed assets (- if increase, + if decrease)	-1 596	-34 191
23.	Change in capital expenditure (including advances) (- if increase, + if decrease)	-131	-517
24.	Change in intangible assets (- if increase, + if decrease)	-4 314	-4 731
25.	Change in tangible assets (excluding capital expenditure and advances for capital investments) (- if increase, + if decrease)	-2 419	-3 640
26.	Change in prepayments and accrued income (- if increase, + if decrease)	3 881	2 929
27.	Change in accruals and deferred income (+ if increase, - if decrease)	-8 926	3 375
28.	Share offering at sale price	0	0
29.	Cash and equivalents received definitively under applicable law	0	0
30.	Cash and equivalents transferred definitively under applicable law	-1 611	-168
31.	Par value of Treasury stock and equity bonds retired	0	0
32.	NET CASH FLOW (lines 17-34)	260 034	167 851
33.	of which: - change in cash (HUF and foreign currency cash and checks)	-3 097	4 498
34.	- change in account balances (short-term, HUF and foreign currency technical and deposit accounts maintained with the NBH, and HUF transaction accounts maintained with other credit institutions under separate laws)	263 131	163 353

V. EVALUATION OF THE BANK'S NET WORTH, FINANCIAL POSITION AND INCOME

1. Key balance sheet and performance data

1.1. Balance sheet

HUF billion	31. Dec. 2014	31. Dec 2015	Change
Total assets	2 493	2 607	+4,6%
Amounts due from clients	1 283	1 163	-9,3%

K&H Bank's total assets amounted to HUF 2 607 billion on 31 December 2015. Main changes in the balance sheet:

- The significant growth in *cash and equivalents* (2015: HUF 581 billion, 2014: HUF 413 billion) was mainly related to the increase in customer deposits along with the overall moderate credit demand. The Bank kept the surplus HUF liquidity in MNB deposit.
- *Amounts due from clients* decreased by 9% during 2015 (2015: HUF 1 163 billion; 2014: HUF 1 283 billion). The loan volume of SME segment remained on a growing path (+6%) driven by the Hungarian National Bank's "Funding for growth" scheme, the decrease in corporate loan volume was mainly related to individual transactions (prepayments). Decrease in retail loans is related to the technical impact of consumer loan settlement and conversion mostly offset by the increased demand for loans (volume of newly disbursed mortgages of K&H increased by 71% compared to 2014 significantly exceeding the 49% growth in the banking sector) resulting in an improved market share of K&H in new mortgage lending (2014: 14,0%, 2015: 16,1%).

Market share	31 Dec 2014	31 Dec 2015 *
Corporate loans	10,0%	10,1%
Retail loans	9,1%	9,5%
Corporate deposits	11,6%	11,5%
Retail deposits+mutual funds	11,2%	12,6%
New production of mortgages	14,0%	16,1%

* preliminary figures
source: MNB, K&H

- *Amounts due to clients* increased by 13% during the year (2015: HUF 1 896 billion; 2014: HUF 1 684 billion), and within that deposits by all business segments (retail, SME, corporate) increased including deposits placed by mutual funds managed by the K&H Fund Management.

HUF billion	31. Dec. 2014	31. Dec 2015	Change
Amounts due to clients	1 684	1 896	+12,6%
Equity	179	211	+17,9%

- Shareholders' equity increased by HUF 32,1 billion related to the net result of the year. According to the shareholder's resolution there is no dividend payment from the result of 2015.

	31. Dec. 2014	31. Dec 2015	Difference
Guarantee capital (HUF bln)	170,3	207,1	+21,6%
Capital adequacy ratio (%)	12,2	13,0	+0,76

1.2. Profit

HUF billion	2014	2015
Profit after taxation	-14,9	+32,1

In 2015 the Bank's net result amounted to HUF 32,1 billion (2014: HUF -14,9 billion¹).

- In comparison with previous year *net interest and interest-type income* decreased by 12,7% (2015: HUF 71,4 billion; 2014: HUF 81,8 billion) primarily related to lower margins and volumes as a result of the consumer loan settlement and conversion.
- Net income from fees and commission* remained on the previous year's level (2015: HUF 45,8 billion; 2014: HUF 46,0 billion).
- Profit/loss on financial transactions* decreased by 49,3% in 2015 (2015: HUF 20,5 billion; 2014: HUF 40,5 billion). Description of the financial instruments' valuation is included in the Bank's financial statements (II/19, II/20, II/21, III/6).
- There was a HUF 1,9 billion growth in *operating expenses* (2015: HUF 60,1 billion; 2014: HUF 58,3 billion).

2. Risk Management

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

2.1 Risk management governance model

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

- Overarching company and risk committees are the Board of Directors (BoD), the Risk and Compliance Committee (RCC), the Audit Board (AB), the Supervisory Board (SB), the Executive Committee (ExCo), the Country Team (CT) and the Capital and Risk Oversight Committee (CROC). These committees concentrate on overarching risk management and on monitoring value creation.
- Specialised risk councils (Credit Risk Council (CRC), Trading Risk Councils (TRC), Operational Risk Councils (ORC)) concentrate on implementing a group-wide framework for one particular type of risk and monitoring the associated risk management process. The risk councils are composed of representatives from line management and Value and Risk Management Division.
- Line management and activity-specific committees have primary responsibility for value and risk management on the operational level. Value and Risk Management Division measures risks,

¹ The loss in 2014 caused by the HUF 65,6 billion (pre-tax) provision related to the legislative changes on consumer loan agreements concerning the application of bid-offer spread and unilateral contract modifications:

- The provision (considering also the related tax allowances) was reported under the heading of "other expenses on business activities" in the Bank's standalone report according to HAS in 2014
- The realised loss and the provision write-back were reported under the heading of „extraordinary result" in 2015 (the related tax allowance utilized in 2015 was reported as part of income tax).

- economic capital and value creation for all relevant business entities and reports its findings directly to line management and the relevant activity-specific committees.
- Within Risk Management Division the Integrated Value and Risk Department is dedicated to overarch the three existing risk centers of competence (Credit Risk, Market and Liquidity Risk and Non-financial Risks), enhance coordination and report to senior management.

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

2.2 Risk types

- **Credit risk** means the potential loss sustained by the Bank if a customer becomes insolvent or cannot perform their payment obligations in due time. Credit risks are managed by risk mitigating techniques approved by the management of the Bank. Regulations cover the entirety of the lending process. The Bank constantly monitors the credit portfolio and prepares reports on the findings to the senior management of the Bank.

In the framework of the Basel II program, late 2010 the Bank was granted the permission of the regulator to use the internal rating model (IRB Foundation) which has been applied for regulatory capital calculation for credit risk since 1 January 2011. During the program, the Bank reviewed all debtor rating models and upgraded them in line with the new uniform group-level methodology.

In the subsequent years, the Bank paid special attention to the enhancement of the applied risk management methodology, with special regard to the analyses of the various stress scenarios affecting the credit portfolio (macro-economic indicators, foreign exchange rate changes and the changes in real estate values). An additional instrumental component of the further development of the risk management methodology was the revision of the management reports to better highlight the various quantitative risk indicators in order to allow the continuous monitoring of the credit portfolio. Based on MNB permission, the Bank shifted to IRB Advanced methodology for regulatory capital calculation from 30 September 2015.

Management reports were further fine-tuned during 2015, and amended with additional information. More emphasis was given to monitoring retail deals affected by the Curia decision (settlement, FX conversion). The main conclusions for 2015 are:

- Corporate and SME portfolio remained stable with some improvements in risk indicators, both NPL and outstanding figures.
- The quality of the loan portfolio disbursed in the MNB's funding for growth program is stable, but it is too early to see any important long term trends.
- The settlement impacted the retail portfolio: after the one-off positive impact of settlement the evolution of default rates and cure rates are very similar to the pre-settlement period.

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

- **Market risk** means the potential loss suffered by the Bank-upon a change in the value of foreign currency and interest positions. Both the asset-liability management and market risk management are based on the methodology applied by the shareholder KBC Group. Accordingly, the Capital and Risk Oversight Committee continuously monitors banking and trading book risks and controls them by setting limits (in compliance with the limit policy of KBC). Interest risks are measured and controlled by the joint application of various methods and limits (gap analysis, interest sensitivity, duration, BPV, NII). There's also sovereign monitoring in place.

The banking book is characterized by stable/slightly decreasing interest rate risk taking at full sovereign limit utilization. At year end of 2015 the bank has introduced the new KBC level Internal

Capital Calculation Method that follows the accounting logic, and links available capital with the required one.

Trading risk also remained stable/moderate. During the whole second half of the year there was one limit breach in bpv/tenor and one sovereign limit overrun that diminished after the necessary actions. Number of VaR model outliers decreased to two.

- **Liquidity risk** means the risk of the inability of an institution to comply with net financing requirements. Liquidity risk may be caused by disturbances on the market, credit downgrading, which may result in the constant cessation of certain financing sources. To eliminate this risk, the management seeks to diversify the financing sources and manages assets with due regard to liquidity requirements, maintaining a healthy balance between cash, liquid funds and promptly marketable securities. Short term liquidity risk is measured by the operational liquidity limit which establishes whether there is sufficient coverage for the 30-day cumulative liquidity gap. From 2011 structural liquidity is determined by the application of the coverage ratio, the calculation of the new regulatory and Basel III liquidity ratios (LCR, NSFR) as well as by liquidity stress tests and liquidity early warning signals. The Risk Management Directorate prepares regular reports to the K&H Bank Capital and Risk Oversight Committee on the various liquidity indicators and limits.

	31. Dec. 2014	31. Dec 2015	Regulatory requirement
Deposit coverage ratio (%)	49,1	37,0	20,0
Balance sheet coverage ratio (%)	23,4	19,5	10,0
Foreign currency financing ratio (%)	73,5	127,8	100,0

- K&H Bank group manages **operational risks** (the potential loss that may arise as a result of inappropriately operating systems, processes or human errors or external events) based on uniform principles and methodology. The methodology includes various techniques of risk identification, risk analysis such as self-assessments (top-down and bottom-up), analysis of losses incurred and the assessment and implementation of key control principles defined by KBC group. The risk mitigation measures (or risk acceptance) are decided according to the uniform accountability rules (decision-making authority). The identified exposures and handling of the risk is monitored and followed up by the Capital and Risk Oversight Committee and analyzed by the Operational Risk Councils that are established throughout the organization. K&H Bank group applies the standardized method to calculate the Pillar I. capital requirement for operational risk according to the permission of the Hungarian Financial Supervisory Authority that was granted in December 2007 (from 1 January 2008).

3. Operating Conditions of the Bank

The number of Bank employees increased by 360 during the year and amounted to 3 510 at the end of 2015. The increase in headcount is mainly due to insourcing IT personnel from the Hungarian branch of KBC Group N.V.

Capital investments in branches:

- 6 branches was moved to new location;
- 8 branches were fully or partially reconstructed, the reconstruction of 6 branches was in progress;
- 2 branches were closed during 2015.

The number of branches at year-end 2015 was 209.

The Bank installed 35 cash-in ATM-s. Total number of ATMs was 457 at the end of 2015 of which 41 cash-in ATM's.

The most important IT development projects of 2015 were the following:

- Several project size developments were initiated or completed to align with legal regulations (e.g. the consumer loan settlement and conversion, report on clients having foreign tax obligation, MIFID2 - MNB report development preparation).
- In order to connect to KELER's new back office system (BaNCS) a new project was launched.
- New functional development supporting Deposit module is done as a next step towards an integrated branch front-end application. Safe, Teller and Account developments are ongoing.
- Corporate customer terminal application (Electra) was upgraded. VISA PayWave and DCC (Dynamic Currency Conversion) products were implemented.
- Within the Digitalization programme the reshaping of K&H website has been done, mobile bank functionalities have been developed and in order to enhance client's experience further e-bank functions have been launched.

Budapest, 12 April 2016

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer



K&H Bank Zrt.

Management Report

31 December 2015

Below we summarise the business operations, the operating conditions and the financial results of K&H Bank Zrt. (hereunder "Bank") in 2015.

1. Economic environment

Following the GDP growth of 3.7% in 2014, the pace of the economic growth slowed down to 2.9% in 2015. The contribution of household consumption to the economic growth increased, while the investment activity performed in a low key during the year predicting further deceleration of economic growth for 2016. The internal and external balance positions of the Hungarian economy remained favorable. The state debt was decreasing slightly further and its currency composition improved, contributing to the more positive risk assessment/perception of the country. Two rating agencies gave positive outlook for the current rating level of the Hungarian sovereign debt indicating a potential upgrade to regain investment grade in 2016.

	2014 actual	2015 preliminary
GDP growth	+3.7%	+2.9%
CPI (average)	-0.2%	-0.1%
Households' consumption	+1.5%	+2.6%
Investments	+11.3%	+0.5%
Unemployment rate	7.1%	6.2%
Budget deficit (ESA) (in % of GDP)	-2.6%	-2.0%
Debt/GDP rate	76,2%	75.8%
Balance of payments (in % of GDP)	+2.3%	+4.7%

Source: MNB, KSH, K&H

While the European Central Bank has started a more vigorous monetary easing with launching a bond purchasing programme and moderated the deposit rate, the FED has stopped its quantitative easing programme, moreover it hiked the base rate for the first time after 10 years thanks to the improving economic outlook in the US. The National Bank of Hungary restarted the rate cut cycle in March and decreased the base rate by 15bps on a monthly basis from 2.1% to 1.35% till end of July and this level stayed until the end of the year. The central bank's self-financing program has also continued in 2015, and further limitations were implemented in connection with the two-week deposit tool to push the banking sector towards the government securities market.

2. Key balance sheet and performance data

2.1. Balance sheet

HUF billion	31 Dec 2014	31 Dec 2015	Change
Total assets	2,493	2,607	+4.6%
Amounts due from clients	1,283	1,163	-9.3%

K&H Bank's total assets amounted to HUF 2,607 billion on 31 December 2015. Main changes in the balance sheet:

- The significant growth in *cash and equivalents* (2015: HUF 581 billion, 2014: HUF 413 billion) was mainly related to the increase in customer deposits along with the overall moderate credit demand. The Bank kept the surplus HUF liquidity in MNB deposit.
- *Amounts due from clients* decreased by 9% during 2015 (2015: HUF 1,163 billion; 2014: HUF 1,283 billion). The loan volume of SME segment remained on a growing path (+6%) driven by the Hungarian National Bank's "Funding for growth" scheme, the decrease in corporate loan volume was mainly related to individual transactions (prepayments).
Decrease in retail loans is related to the technical impact of consumer loan settlement and conversion mostly offset by the increased demand for loans (volume of newly disbursed mortgages of K&H increased by 71% compared to 2014 significantly exceeding the 49% growth in the banking

sector) resulting in an improved market share of K&H in new mortgage lending (2014: 14.0%, 2015: 16.1%).

Market share	31 Dec 2014	31 Dec 2015 *
Corporate loans	10.0%	10.1%
Retail loans	9.1%	9.5%
Corporate deposits	11.6%	11.5%
Retail deposits+mutual funds	11.2%	12.6%
New production of mortgages	14.0%	16.1%

* preliminary figures
source: MNB, K&H

- *Amounts due to clients* increased by 13% during the year (2015: HUF 1,896 billion; 2014: HUF 1,684 billion), and within that deposits by all business segments (retail, SME, corporate) increased including deposits placed by mutual funds managed by the K&H Fund Management.

HUF billion	31 Dec 2014	31 Dec 2015	Change
Amounts due to clients	1,684	1,896	+12.6%
Equity	179	211	+17.9%

- Shareholders' equity increased by HUF 32.1 billion related to the net result of the year. According to the shareholder's resolution there is no dividend payment from the result of 2015.

	31 Dec 2014	31 Dec 2015	Difference
Guarantee capital (HUF bln)	170.3	207.1	+21.6%
Capital adequacy ratio (%)	12.2	13.0	+0.76

2.2. Profit

HUF billion	2014	2015
Profit after taxation	-14.9	+32.1

In 2015 the Bank's net result amounted to HUF 32.1 billion (2014: HUF -14.9 billion¹).

- In comparison with previous year *net interest and interest-type income* decreased by 12.7% (2015: HUF 71.4 billion; 2014: HUF 81.8 billion) primarily related to lower margins and volumes as a result of the consumer loan settlement and conversion.
- *Net income from fees and commission* remained on the previous year's level (2015: HUF 45.8 billion; 2014: HUF 46.0 billion).
- *Profit/loss on financial transactions* decreased by 49.3% in 2015 (2015: HUF 20.5 billion; 2014: HUF 40.5 billion). Description of the financial instruments' valuation is included in the Bank's financial statements (II/19, II/20, II/21, III/6).
- There was a HUF 1.9 billion growth in *operating expenses* (2015: HUF 60.1 billion; 2014: HUF 58.3 billion).

¹ The loss in 2014 caused by the HUF 65.6 billion (pre-tax) provision related to the legislative changes on consumer loan agreements concerning the application of bid-offer spread and unilateral contract modifications:

- The provision (considering also the related tax allowances) was reported under the heading of "other expenses on business activities" in the Bank's standalone report according to HAS in 2014
- The realised loss and the provision write-back were reported under the heading of „extraordinary result" in 2015 (the related tax allowance utilized in 2015 was reported as part of income tax).

3. Risk Management

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

3.1 Risk management governance model

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

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

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

3.2 Risk types

- **Credit risk** means the potential loss sustained by the Bank if a customer becomes insolvent or cannot perform their payment obligations in due time. Credit risks are managed by risk mitigating techniques approved by the management of the Bank. Regulations cover the entirety of the lending process. The Bank constantly monitors the credit portfolio and prepares reports on the findings to the senior management of the Bank.

In the framework of the Basel II program, late 2010 the Bank was granted the permission of the regulator to use the internal rating model (IRB Foundation) which has been applied for regulatory capital calculation for credit risk since 1 January 2011. During the program, the Bank reviewed all debtor rating models and upgraded them in line with the new uniform group-level methodology.

In the subsequent years, the Bank paid special attention to the enhancement of the applied risk management methodology, with special regard to the analyses of the various stress scenarios affecting the credit portfolio (macro-economic indicators, foreign exchange rate changes and the changes in real estate values). An additional instrumental component of the further development of the risk management methodology was the revision of the management reports to better highlight the various quantitative risk indicators in order to allow the continuous monitoring of the credit portfolio. Based on MNB permission, the Bank shifted to IRB Advanced methodology for regulatory capital calculation from 30 September 2015.

Management reports were further fine-tuned during 2015, and amended with additional information. More emphasis was given to monitoring retail deals affected by the Curia decision (settlement, FX conversion). The main conclusions for 2015 are:

- Corporate and SME portfolio remained stable with some improvements in risk indicators, both NPL and outstanding figures.
- The quality of the loan portfolio disbursed in the MNB's funding for growth program is stable, but it is too early to see any important long term trends.
- The settlement impacted the retail portfolio: after the one-off positive impact of settlement the evolution of default rates and cure rates are very similar to the pre-settlement period.

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

- **Market risk** means the potential loss suffered by the Bank-upon a change in the value of foreign currency and interest positions. Both the asset-liability management and market risk management are based on the methodology applied by the shareholder KBC Group. Accordingly, the Capital and Risk Oversight Committee continuously monitors banking and trading book risks and controls them by setting limits (in compliance with the limit policy of KBC). Interest risks are measured and controlled by the joint application of various methods and limits (gap analysis, interest sensitivity, duration, BPV, NII). There's also sovereign monitoring in place.

The banking book is characterized by stable/slightly decreasing interest rate risk taking at full sovereign limit utilization. At year end of 2015 the bank has introduced the new KBC level Internal Capital Calculation Method that follows the accounting logic, and links available capital with the required one.

Trading risk also remained stable/moderate. During the whole second half of the year there was one limit breach in bpv/tenor and one sovereign limit overrun that diminished after the necessary actions. Number of VaR model outliers decreased to two.

- **Liquidity risk** means the risk of the inability of an institution to comply with net financing requirements. Liquidity risk may be caused by disturbances on the market, credit downgrading, which may result in the constant cessation of certain financing sources. To eliminate this risk, the management seeks to diversify the financing sources and manages assets with due regard to liquidity requirements, maintaining a healthy balance between cash, liquid funds and promptly marketable securities. Short term liquidity risk is measured by the operational liquidity limit which establishes whether there is sufficient coverage for the 30-day cumulative liquidity gap. From 2011 structural liquidity is determined by the application of the coverage ratio, the calculation of the new regulatory and Basel III liquidity ratios (LCR, NSFR) as well as by liquidity stress tests and liquidity early warning signals. The Risk Management Directorate prepares regular reports to the K&H Bank Capital and Risk Oversight Committee on the various liquidity indicators and limits.

	31 Dec 2014	31 Dec 2015	Regulatory requirement
Deposit coverage ratio (%)	49.1	37.0	20.0
Balance sheet coverage ratio (%)	23.4	19.5	10.0
Foreign currency financing ratio (%)	73.5	127.8	100.0

- K&H Bank group manages **operational risks** (the potential loss that may arise as a result of inappropriately operating systems, processes or human errors or external events) based on uniform principles and methodology. The methodology includes various techniques of risk identification, risk analysis such as self-assessments (top-down and bottom-up), analysis of losses incurred and the assessment and implementation of key control principles defined by KBC group. The risk mitigation measures (or risk acceptance) are decided according to the uniform accountability rules (decision-making authority). The identified exposures and handling of the risk is monitored and followed up by the Capital and Risk Oversight Committee and analyzed by the Operational Risk Councils that are established throughout the organization. K&H Bank group applies the standardized method to calculate the Pillar I. capital requirement for operational risk

according to the permission of the Hungarian Financial Supervisory Authority that was granted in December 2007 (from 1 January 2008).

4. Operating Conditions of the Bank

The number of Bank employees increased by 360 during the year and amounted to 3,510 at the end of 2015. The increase in headcount is mainly due to insourcing IT personnel from the Hungarian branch of KBC Group N.V.

Capital investments in branches:

- 6 branches was moved to new location;
- 8 branches were fully or partially reconstructed, the reconstruction of 6 branches was in progress;
- 2 branches were closed during 2015.

The number of branches at year-end 2015 was 209.

The Bank installed 35 cash-in ATM's. Total number of ATMs was 457 at the end of 2015 of which 41 cash-in ATM's.

The most important IT development projects of 2015 were the following:

- Several project size developments were initiated or completed to align with legal regulations (e.g. the consumer loan settlement and conversion, report on clients having foreign tax obligation, MIFID2 - MNB report development preparation).
- In order to connect to KEELER's new back office system (BaNCS) a new project was launched.
- New functional development supporting Deposit module is done as a next step towards an integrated branch front-end application. Safe, Teller and Account developments are ongoing.
- Corporate customer terminal application (Electra) was upgraded. VISA PayWave and DCC (Dynamic Currency Conversion) products were implemented.
- Within the Digitalization programme the reshaping of K&H website has been done, mobile bank functionalities have been developed and in order to enhance client's experience further e-bank functions have been launched.

Dated: Budapest, 29 April 2016

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer