Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

CONSOLIDATED ANNUAL REPORT

31 December 2015

CONTENT

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	**Attila Gombás**
Chief Executive Officer	Chief Financial Officer

KERESKEDELMI ÉS HITELBANK ZÁRTKÖRŰEN MŰKÖDŐ RÉSZVÉNYTÁRSASÁG

CONSOLIDATED ANNUAL FINANCIAL STATEMENTS
PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS
AS ADOPTED BY THE EUROPEAN UNION

FOR THE YEAR ENDED 31 DECEMBER 2015

WITH THE REPORT OF INDEPENDENT AUDITORS

EY
Building a better working world

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Independent Auditors' Report

To the Shareholder of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

Report on consolidated financial statements

1.) We have audited the accompanying 2015 consolidated annual financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság ("the Company"), which comprise the consolidated statement of financial position as at 31 December 2015 - showing a balance sheet total of HUF 2,582,956 million and a profit for the year of HUF 37,863 million -, the related consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

2.) Management is responsible for the preparation and presentation of consolidated financial statements that give a true and fair view in accordance with the International Financial Reporting Standards as adopted by EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

3.) Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International and the 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 consolidated financial statements are free from material misstatement.

4.) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments the auditor considers internal control relevant to the entity's preparation of consolidated 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 consolidated 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 consolidated 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 International Financial Reporting Standards as adopted by EU.

Other reporting requirement – Report on the consolidated business report

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

Budapest, 12 April 2016

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

Virágh Gabriella
Registered auditor
Chamber membership No.: 004245

CONTENTS OF THE CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

	Notes	2015 MHUF	Reclassified 2014 MHUF
Interest income		101 807	118 952
Interest expense		(27 924)	(36 994)
Net interest income	3;4	73 883	81 958
Fee and commission income		69 943	67 685
Fee and commission expense		(17 686)	(16 471)
Net fee and commission income	3;5	52 257	51 214
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	3;6	17 785	17 121
Net realised gains / (losses) from available-for-sale assets	3;7	665	3 982
Other net income / (expense)	3;9	18 130	(63 889)
Total income		162 720	90 386
Operating expenses	3	(102 095)	(103 604)
Staff expenses	13	(32 078)	(29 113)
General administrative expenses	11	(47 386)	(51 975)
Depreciation and amortisation of tangible and intangible assets	34;35	(6 876)	(6 676)
Bank tax	12	(15 755)	(15 840)
Impairment:	3;14	(13 090)	(15 105)
Loans and receivables	28	(12 288)	(14 677)
Other		(802)	(428)
Share in results of associated companies	3;15	-	41
Profit / (loss) before tax		47 535	(28 282)
Income tax expense	3;16	(9 672)	(8)
Profit / (loss) after tax		37 863	(28 290)
Earnings / (loss) per share in HUF (basic)	17	0.2685738	(0.2006696)

The figures of earnings / (loss) per share calculated for basic and diluted shares do not differ.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	2015 MHUF	2014 MHUF
Profit / (loss) after tax		37 863	(28 290)
Other comprehensive income			
Available-for-sale equity instruments			
Amounts to be reclassified subsequently to the income statement:			
Net gain / (loss) from fair value changes	18	4 349	-
Deferred tax impact on fair value changes	31	(897)	-
Transfer from available for sale reserve to net profit:			
(Losses)/ gains on disposal	7	-	-
Deferred income tax	31	-	-
Available for sale debt instruments			
Amounts to be reclassified subsequently to the income statement:			
Net gain / (loss) from fair value changes	18	869	13 864
Deferred tax impact on fair value changes	31	(179)	(2 859)
Transfer from available for sale reserve to net profit:			
(Losses)/ gains on disposal	7	(665)	(3 982)
Amortisation of reclassified assets		(82)	2 269
Deferred income tax	31	154	353
Cash flow hedge			
Amounts to be reclassified subsequently to the income statement:			
Net gain / (loss) from fair value changes		607	12 968
Deferred tax impact on fair value changes	31	(125)	(2 674)
Transfer from cash flow hedge reserve to net profit:			
Ineffective part	6;29	394	239
Gross amount	6;29	(675)	(5 575)
Deferred income tax	31	58	1 100
Total other comprehensive income		3 808	15 703
Total comprehensive income		41 671	(12 587)

Approved by the Board of Directors on 12 April 2016.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	2015	Reclassified 2014
		MHUF	MHUF
ASSETS			
Cash and cash balances with central banks		68 715	77 547
Financial assets	18	2 431 286	2 263 847
Held for trading	29	81 735	99 529
Designated at fair value through profit or loss	23	-	2 571
Available for sale	27	163 245	126 579
Loans and receivables	25	1 746 912	1 602 485
Held to maturity	18	428 371	421 915
Hedging derivatives	29	11 023	10 768
Tax assets		13 703	13 465
Current tax assets		7 803	1 691
Deferred tax assets	31	5 900	11 774
Investments in associated companies	32	542	542
Investment property	33	740	850
Property and equipment	34	37 457	39 324
Intangible assets	35	11 723	10 048
Other assets	30	18 790	37 213
Total assets		2 582 956	2 442 836
LIABILITIES AND EQUITY			
Financial liabilities	18	2 286 854	2 176 854
Held for trading	29	35 859	46 142
Designated at fair value through profit or loss	23	216 315	196 709
Measured at amortised cost	18	2 034 669	1 933 865
Hedging derivatives	29	11	138
Fair value changes of hedged item under portfolio hedge of interest rate risk	29	3 164	1 236
Tax liabilities		15	12
Current tax liabilities		15	12
Deferred tax liabilities	31	-	-
Provisions for risks and charges and credit commitments	28;36	7 765	53 249
Other liabilities	37	63 771	31 769
Total liabilities		2 361 569	2 263 120
Total equity	38;47	221 387	179 716
Total liabilities and equity		2 582 956	2 442 836

Approved by the Board of Directors on 12 April 2016.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

For breakdown of assets and liabilities by remaining maturity see Note 26.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital MHUF	Share premium MHUF	Statutory risk reserve MHUF	Available for sale reserve MHUF	Cash flow hedge reserve MHUF	Retained earnings MHUF	Total equity MHUF
2014							
Balance at the beginning of the period	140 978	48 775	20 422	(983)	(2 051)	2 309	209 450
Net profit for the year	-	-	-	-	-	(28 290)	(28 290)
Other comprehensive income for the period (Note 6;7)	-	-	-	9 645	6 058	-	15 703
Total comprehensive income	-	-	-	9 645	6 058	(28 290)	(12 587)
Dividend	-	-	-	-	-	(17 147)	(17 147)
Transfer from retained earnings to statutory risk reserve (Note 47)	-	-	(14 881)	-	-	14 881	-
Total change	-	-	(14 881)	9 645	6 058	(30 556)	(29 734)
Balance at the end of the period	140 978	48 775	5 541	8 662	4 007	(28 247)	179 716
of which revaluation reserve for bonds (Note 18)	-	-	-	8 662	-	-	
2015							
Balance at the beginning of the period	140 978	48 775	5 541	8 662	4 007	(28 247)	179 716
Net profit for the year	-	-	-	-	-	37 863	37 863
Other comprehensive income for the period (Note 6;7)	-	-	-	3 549	259	-	3 808
Total comprehensive income	-	-	-	3 549	259	37 863	41 671
Transfer from statutory risk reserve to retained earnings (Note 47)	-	-	3 208	-	-	(3 208)	-
Total change	-	-	3 208	3 549	259	34 655	41 671
Balance at the end of the period	140 978	48 775	8 749	12 211	4 266	6 408	221 387
of which revaluation reserve for shares (Note 18)	-	-	-	3 452	-	-	
of which revaluation reserve for bonds (Note 18)	-	-	-	8 759	-	-	

No dividend was paid in 2015. (The dividend paid on ordinary shares was HUF 17 147 million – 0.121629 HUF/share in 2014). There is no dividend proposed on ordinary shares in 2016.

Approved by the Board of Directors on 12 April 2016.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2015	Reclassified 2014
		MHUF	MHUF
OPERATING ACTIVITIES			
Profit / (loss) before tax		47 535	(28 282)
Adjustments for:			
Net transfer from available for sale reserve	7	(747)	(1 713)
Net transfer from cash flow hedge reserve	6	(281)	(5 336)
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	34;35	7 691	7 108
(Profit)/Loss on the disposal of property and equipment	9	(260)	15
(Profit)/Loss on the disposal of investment property	9	(57)	(10)
(Profit)/Loss on the disposal of subsidiaries	9	-	(644)
Change in impairment on loans and advances*	14;28	12 288	14 677
Change in other provisions	36	(9 109)	16 448
Unrealised valuation differences	6	(17 694)	(30 038)
Income from associated companies	15	-	(41)
Cash flows from operating profit / (loss) before tax and before changes in operating assets and liabilities		39 366	(27 816)
Changes in financial assets held for trading		25 432	64 093
Changes in financial assets designated at fair value through profit or loss		2 513	(87)
Changes in financial assets held to maturity		1 829	(787)
Changes in financial assets available for sale		(31 447)	349 711
Changes in loans and receivables		(346 696)	(45 626)
Changes in other assets		12 319	(3 838)
Changes in operating assets		(336 050)	363 466
Changes in financial liabilities held for trading		(8 314)	17 446
Changes in financial liabilities designated at fair value through profit or loss		20 510	(22 106)
Changes in financial liabilities measured at amortised cost		203 812	(30 383)
Changes in other liabilities		(3 937)	(47 475)
Changes in operating liabilities		212 071	(82 518)
Income taxes paid		(4 788)	(13 153)
Net cash from/(used in) operating activities		(89 401)	239 979

* Including impairments on loans and receivables and loan commitments.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2015 MHUF	Reclassified 2014 MHUF
INVESTING ACTIVITIES			
Purchase of held-to-maturity securities		(80 762)	(25 672)
Proceeds from the disposal of held-to-maturity securities		20 000	25 000
Proceeds from the repayment of held-to-maturity securities at maturity		52 477	48 521
Dividends received from associated companies	8	-	-
Purchase of intangible fixed assets	35	(4 368)	(3 241)
Purchase of property, plant and equipment	34	(3 607)	(3 398)
Proceeds from the sale of shares in associated companies	9	-	2 173
Proceeds from the sale of property, plant and equipment	34	894	830
Net cash from/(used in) investing activities		(15 366)	44 213
FINANCING ACTIVITIES			
Dividends paid*		-	(17 147)
Net cash from/(used in) financing activities		-	(17 147)
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents		(104 767)	267 045
Net foreign exchange difference		7 439	2 986
Cash and cash equivalents at beginning of the period		299 541	29 510
Cash and cash equivalents at end of the period		202 213	299 541

*For dividends paid see consolidated statement of changes in equity.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2015 MHUF	Reclassified 2014 MHUF
OPERATING CASH FLOWS FROM INTEREST AND DIVIDENDS			
Interest received	4	104 284	121 232
Interest paid	4	(27 520)	(45 618)
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash and cash balances with central banks		68 715	77 547
Loans and advances to banks repayable on demand and term loans to banks < 3 months	18	190 927	382 432
Deposits from banks repayable on demand and redeemable at notice	18	(57 429)	(160 438)
Total cash and cash equivalents		202 213	299 541

The interest cash flow results from the Group's banking activity and is part of the operating cash flow. For further information see Note 4.

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

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

Approved by the Board of Directors on 12 April 2016.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – GENERAL

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság ("K&H Bank Zrt." or "the Bank") is a limited liability company incorporated in Hungary. K&H Bank Zrt. and its subsidiaries ("the Group") provide a full range of banking services through a nation-wide network of 209 branches. As at 31 December 2015 K&H Bank Zrt.'s registered office was at Lechner Ödön Fasor 9, Budapest.

The parent company of K&H Bank Zrt. is KBC Bank N.V. The ultimate parent is KBC Group N.V.

NOTE 2 – ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of these financial statements are summarised below.

2.1 Basis of presentation

The consolidated financial statements have been prepared on a historical cost basis, except for held-for trading financial instruments, financial instruments designated at fair value through profit or loss, available-for-sale financial assets and hedging derivatives, which have been measured at fair value. The carrying values of recognized assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortized cost, are adjusted to record changes in fair value attributable to the risk that are being hedged.

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

2.1.1 Statement of compliance

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

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

Certain accounting principles prescribed for statutory purposes are different from IFRS. In order to present the financial position and results of operations of the Group in accordance with IFRS certain adjustments have been made to the Group's Hungarian consolidated statutory accounts. Details on these adjustments are presented in note 44.

2.1.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and all entities it controlled as at 31 December 2015. The Bank and the entities which it controls are referred to collectively as "the Group". Control is presumed to exist if all of the following conditions are met:

- the Bank has power over the entity;
- the Bank has exposure, or rights, to variable returns from its involvement with the investee;
- the Bank has the ability to use its power over the investee to affect the amount of the investor's returns.

In case of the Bank's exclusive control the effects of all material intercompany balances and transactions are eliminated. Subsidiaries under liquidation are consolidated using the equity method.

NOTE 2 – ACCOUNTING POLICIES (continued)

An investment in an associate is one in which the Bank holds, directly or indirectly, more than 20% of the voting rights and over which the Group exercises significant influence but which it does not control. Associates are accounted for under the equity method of accounting, and the pro-rata share of their income (loss) is included in the consolidated income statement. The Group's interest in an associate is carried in the consolidated statement of financial position at an amount that reflects its share of the net assets of the associate.
Joint ventures are companies where the Bank and another party exercise joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. Joint ventures are accounted for using the proportionate consolidation method.

A list of subsidiary and associated companies is provided in Note 43.

2.2 Significant accounting judgements and estimates

In the process of applying the Group's accounting policies, Management has used its judgements and made estimates in determining the amounts recognized in the consolidated financial statements. The most significant use of judgements and estimates are as follows:

Going concern

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

Fair value of financial instruments

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

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

The Group regularly reviews its loans and receivables its commitments and contingent liabilities to assess impairment. The Group applies its judgement on the basis of experience to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and where there is little available historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables.

NOTE 2 – ACCOUNTING POLICIES (continued)

Provision for litigations and claims

The amount of provision required to meet losses incurred as a result of litigations and claims is another principal area of estimation uncertainty in these financial statements. Refer to note 36 for further details.

Allowance for impairment of available-for-sale investments

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

Deferred tax assets

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

2.3 Changes in accounting policies

Changes in IFRSs

The International Accounting Standards Board (IASB) has issued new accounting Standards and has introduced numerous changes to the Standards that became effective in 2015.

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

IAS 19 Employee Benefits (amendment)

The amendments of IAS 19 are intended to provide relief in that entities are allowed to deduct contributions from service cost in the period in which the service is rendered.

Annual Improvements 2010-2012 Cycle

With the exception of the improvement relating to IFRS 2 Share-based Payment applied to share-based payment transactions with a grant date on or after 1 July 2014, all other improvements are effective for accounting periods beginning on or after 1 July 2014. They include:

IFRS 2 Share-based Payment

This improvement is applied prospectively and clarifies various issues relating to the definitions of performance and service conditions which are vesting conditions.

IFRS *3 Business Combinations*

The amendment is applied prospectively and clarifies that all contingent consideration arrangements classified as liabilities (or assets) arising from a business combination should be subsequently measured at fair value through profit or loss whether or not they fall within the scope of IAS 39.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRS 8 Operating Segments

The amendments are applied retrospectively and clarify that:

- An entity must disclose the judgements made by management in applying the aggregation criteria in paragraph 12 of IFRS 8, including a brief description of operating segments that have been aggregated and the economic characteristics (e.g., sales and gross margins) used to assess whether the segments are 'similar';
- The reconciliation of segment assets to total assets is only required to be disclosed if the reconciliation is reported to the chief operating decision maker, similar to the required disclosure for segment liabilities.

IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets

The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data by either adjusting the gross carrying amount of the asset to market value or by determining the market value of the carrying value and adjusting the gross carrying amount proportionately so that the resulting carrying amount equals the market value. In addition, the accumulated depreciation or amortisation is the difference between the gross and carrying amounts of the asset.

IAS 24 Related Party Disclosures

The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services.

Annual Improvements 2011-2013 Cycle
These improvements are effective from 1 July 2014. They include:

IFRS 3 Business Combinations

The amendment is applied prospectively and clarifies for the scope exceptions within IFRS 3 that:

- Joint arrangements, not just joint ventures, are outside the scope of IFRS 3
- This scope exception applies only to the accounting in the financial statements of the joint arrangement itself

IFRS 13 Fair Value Measurement

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IAS 39.

IAS 40 Investment Property

The description of ancillary services in IAS 40 differentiates between investment property and owner-occupied property (i.e., property, plant and equipment). The amendment is applied prospectively and clarifies that IFRS 3, and not the description of ancillary services in IAS 40, is used to determine if the transaction is the purchase of an asset or a business combination.

The amendments have no major impact on the consolidated financial statement.

2.4 Summary of significant accounting policies

2.4.1 Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated into HUF at exchange rates quoted by the National Bank of Hungary as at the date of the consolidated statement of financial position. Income and expenses arising in foreign currencies are converted at the rate of exchange on the transaction date. Resulting foreign exchange gains or losses are recorded in the consolidated income statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2 Financial instruments

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

2.4.2.1 Trade and settlement date accounting

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

2.4.2.2 Financial instruments at fair value through profit or loss

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

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

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

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

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

2.4.2.3 Derivatives

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship.

Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed regularly. The frequency is defined in the hedging document. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%. For situations where that hedged item is a forecast transaction, the Group assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the consolidated income statement.

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

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized initially in the consolidated other comprehensive income in the cash flow hedge reserve and the ineffective portion is recognized in the consolidated income statement. The gains or losses on effective cash flow hedges recognized initially in the consolidated other comprehensive income are either transferred to the consolidated income statement in the period in which the hedged transaction impacts the consolidated income statement or included in the initial measurement of the cost of the related non-financial asset or liability.

For hedges which do not qualify for hedge accounting and trading derivatives, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated income statement for the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, the cumulative gain or loss on a cash flow hedge recognized in the consolidated other comprehensive income remains in the consolidated other comprehensive income until the forecasted transaction occurs, when it is then transferred to the consolidated income statement for the period. Also at that time an item subject to a fair value hedge ceases to be revalued.

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

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

2.4.2.4 Financial assets and financial liabilities measured at amortized cost

2.4.2.4.1 Loans and receivables

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2.4.2 Financial liabilities at amortised cost

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

2.4.2.4.3 Held-to-maturity instruments

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

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

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

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

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

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

2.4.2.5 Available-for-sale financial instruments

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

2.4.2.6 Fair value hierarchy of financial instruments

The fair value measurements are classified into the levels of fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1	quoted prices (unadjusted) in active markets for identical assets or liabilities
Level 2	inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
Level 3	inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement.

The Group assesses the significance of fair value adjustments at portfolio level in function of the proportion of the fair value adjustment relative to the size of the underlying portfolio.

A fair value adjustment related to the unobservable input is considered to be material for the Group if this fair value adjustment makes up at least 5% of the nominal exposure of the underlying portfolio.

Changes to the fair value classification

The classification of a financial instrument into the fair value hierarchy is not static. Financial instruments can shift between different fair value levels for various reasons, for instance:

- Market changes: The market can become inactive. As a result, previously observable parameters can become unobservable (possible shift from level 1 to level 2 or 3);
- Model changes: The application of a new refined model that takes more observable input factors into account or reduces the fair value impact of unobservable inputs (possible shift from level 3 to level 2);
- Change in sensitivity: The sensitivity of a valuation input to the entire fair value may change over time. An unobservable input that used to be significant to the entire fair value measurement may become insignificant (or vice versa). The fair value classification in the hierarchy would consequently change from level 3 to level 2 (or vice versa).

The above examples illustrate that defining the fair value classification of a financial instrument can only be made taking into account changing market circumstances, upgraded models and the sensitivity of the valuation inputs. With this regard, the fair value classification per instrument/portfolio is reassessed by the Group on a regular basis.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.3 Day 1 profit

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

2.4.4 Repo and reverse repo agreements

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

2.4.5 Securities lending and borrowing

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

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

2.4.6 Allowances for impairment of financial assets

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

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

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.6.1 Financial assets measured at amortized cost

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

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

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

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

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

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

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

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

2.4.6.2 Available-for-sale financial assets

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.6.3 Renegotiated loans

Where possible, the Group seeks to renegotiate loans rather than to take possession of collateral.

The Group considers a loan (receivable) renegotiated if the loan or credit arrangements are renegotiated, rescheduled (prolonged) and renegotiated upon the debtor's or the financial institution's initiative, within the framework of the amendment of the underlying contract, where the underlying contract is amended with a view to avoiding default because of the considerable deterioration in the financial condition or solvency of the borrower, on account of which he is unable to meet the obligations of repayment as originally contracted.

Such amendments result in significant changes in the terms and conditions of the underlying contract, bringing considerably more favourable terms for the client - by way of derogation from the market conditions pertaining to contracts of the same type bearing similar terms and conditions.

The amendments are representing, among others, the deferral of repayments (interest and/or principal) temporarily for a specific period (grace period), payment by instalments, modification of interest rates (for example repricing in the form of discount rates), capitalization of interest, changing the type of currency of denomination, extending the term of the loan, rescheduling instalment payments, reducing the level of collateralization or the level of security requested, or allowing other form of collateral or security, waiving the collateral or security requirement (non-collateralization), introducing new contract terms and conditions or eliminating certain existing terms and conditions.

Furthermore a supplementary agreement or a new contract may be concluded between the debtor and the Group, or between the borrower and an affiliate of the original lender, for a new loan for refinancing the debts (interest and principal) outstanding on account of the existing contract, or for undertaking additional commitments with a view to avoiding any further increase in risk exposure or to cutting losses, upon which the claims of the Group (including the financial institution participating as the affiliate of the original lender) arising on account of the aforesaid supplementary agreement or new contract are also recognized as renegotiated loans (receivables).

Loans where the relevant contract had to be amended due to changes in market conditions are not considered as renegotiated loans (receivables), furthermore, where the parties agree in market conditions pertaining to similar agreements and where the solvency of the debtor is such as to ascertain his ability to comply with his ensuing contractual obligations.

Derecognition of renegotiated loans

For the derecognition of the renegotiated loans the Group applies the following criteria. An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial asset and the recognition of a new financial asset. A substantial modification of the terms of an existing financial asset or a part of it is accounted for as an extinguishment of the original financial asset and the recognition of a new financial asset.

The terms are considered as substantially different in any case if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial asset.

If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the asset and are amortised over the remaining term of the modified liability.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.7 Offsetting

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

2.4.8 Derecognition of financial assets

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

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

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

2.4.9 Derecognition of financial liabilities

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

2.4.10 Leases

Determination of whether an arrangement contains a lease

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

2.4.10.1 Where the Group is the lessee

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.10.2 Where the Group is the lessor

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

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

Assets subject to operating leases are included in bank premises and equipment in the consolidated statement of financial position and lease payments received are presented as income in the consolidated income statement.

In case of financing the purchase of a vehicle or other equipment, the main collateral is the vehicle or the other equipment, on which the Group has got the right to buy. When the contract is extraordinarily terminated the assets received in the debt settlement are measured at cost which is defined as the fair value of the vehicle or other the equipment. If the carrying amount of the received asset differs from the value defined at the subsequent valuation of the asset then impairment is accounted for or the formerly booked impairment is fully or partially released.

2.4.11 Revenue recognition

Interest income and fees related to financial instruments are recognized as part of the effective interest of the instrument, other fees (related to transactions and provided or rendered services) receivable or payable are recognized when earned, i.e. at completion of the transaction or after performing the service. Dividend income is recognized when the right to receive payment is established.

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

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

2.4.13 Cash and cash equivalents

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

2.4.14 Investment property

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.15 Bank premises and equipment

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

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

Replacements and improvements, which prolong the useful life or significantly improve the condition of the asset, are capitalized. Repairs and maintenance are charged to the consolidated income statement as incurred. The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

2.4.16 Intangible assets

An intangible asset shall be recognised if, and only if it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

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

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

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

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

Core systems are types of standard software, which are back-end data applications for processing the transactions and generating postings. Core systems typically include current account, deposit and credit processing applications, with interfaces to the general ledger and reporting tools.

NOTE 2 – ACCOUNTING POLICIES (continued)

According to the accounting policies of the Group
- licences and standard software are capitalized;
- customized and internally generated software are capitalized only if the development costs of that exceed a certain amount. In 2014 this threshold was HUF 140 million, in 2015 it is HUF 120 million. Below this threshold the development cost are expensed when they occur.

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

2.4.17 Commitments, contingent liabilities

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

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

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

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

2.4.18 Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Any compensation that arises in relation to provisions for operational losses from claims and legal disputes regarding commercial activity are presented in other net income / (expense) when they become virtually certain.

2.4.19 Taxation

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

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

2.4.20 Fiduciary assets

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.21 Dividend on ordinary shares

Dividends on ordinary shares are recognized as a liability and deducted from equity when they are approved by the shareholders. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Group.

2.4.22 Equity reserves

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

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

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

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

2.4.23 Share based payment transactions

A number of employees of the Group receive remuneration in the form of share-based payment transactions. They are granted share appreciation rights, which can only be settled in cash ("cash-settled transactions"). The cost of cash-settled transactions is measured at fair value at the grant date, using the KBC share price determining the fair value. The value of the share-based payment is expensed in the year of the remunerated performance with recognition of a corresponding liability. The liability is valued at the closing price of the underlying share at the end of the period. The liability is released at the date of pay-out.

2.5 Future changes in accounting policies

IASs, IFRSs and IFRIC interpretations not yet effective

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

IAS1 Disclosure Initiative (amendment)

The amendments clarify that information should not be obscured by aggregating or by providing immaterial information. Materiality considerations apply to all parts of the financial statements.

The amendment is applicable to annual reporting periods beginning on or after 1 January 2016.

Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)

The amendments confirm that the exemption from preparing consolidated financial statements for an intermediate parent entity is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all of its subsidiaries at fair value.

Entities shall apply these amendments for annual periods beginning on or after 1 January 2016.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Assets (or disposal companies) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This amendment must be applied prospectively.

Entities shall apply these amendments for annual periods beginning on or after 1 January 2016.

IFRS 7 Financial Instruments: Disclosures (amendment)

The amendments of the IFRS 7 is implementing additional disclosures (and consequential amendments) resulting from the introduction of the IFRS 9 Financial Instruments.

The amendments are effective for the same period as the IFRS 9 Financial Instruments principle.

IAS 7: Statement of Cash Flows: Disclosure initiative (amendment)

The amendments come with the objective that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments state the way to fulfil the new disclosure requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. The amendments state that changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2017. Early application is permitted.

IFRS 9 Financial Instruments (new)

IFRS 9 is a new standard dealing with the accounting for financial instruments. IFRS 9 reflects the IASB’s work on the replacement of IAS 39. The first phase of the standard applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The second phase establishes new impairment methodology for financial assets. The third phase replaces the rule-based hedge accounting requirements in IAS 39 to more closely align the accounting with risk management activities.

The effective date of IFRS 9 is 1 January 2018. Early application is permitted.

IFRS 11 Accounting for Acquisitions of Interests in Joint Operations (amendment)

The amendments of IFRS 11 such that the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3, is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2016. Early application is permitted.

IAS 12: Income Taxes: Recognition of Deferred Tax Assets for unrealised losses (amendment)

The amendments clarify the recognition of Deferred Tax Assets for unrealised losses. Unrealised losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use. The carrying amount of an asset does not limit the estimation of probable future taxable profits.

NOTE 2 – ACCOUNTING POLICIES (continued)

The amendment is applicable to an annual reporting period beginning on or after 1 January 2017. Early application is permitted.

IFRS 14 Regulatory Deferral Accounts (new)

IFRS 14 Regulatory Deferral Accounts permits an entity which is a first-time adopter of International Financial Reporting Standards to continue to account, with some limited changes, for 'regulatory deferral account balances' in accordance with its previous GAAP, both on initial adoption of IFRS and in subsequent financial statements. Regulatory deferral account balances, and movements in them, are presented separately in the statement of financial position and statement of profit or loss and other comprehensive income, and specific disclosures are required.

IFRS 14 applies to an entity's first annual IFRS financial statements for a period beginning on or after 1 January 2016. Early application is permitted.

IFRS 15 Revenue from Contracts with Customers (new)

IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures.

IFRS 15 applies to an annual reporting period beginning on or after 1 January 2018. Early application is permitted.

IFRS 16 Leases

IFRS 16 is a new standard dealing with the accounting for leases. IFRS 16 reflects the IASB's work on the replacement of IAS 17.

Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. This will typically produce a front-loaded expense profile as an assumed linear depreciation of the right-of-use asset and the decreasing interest on the liability will lead to an overall decrease of expense over the reporting period.

The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease.

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

IFRS 16 applies to an annual reporting period beginning on or after 1 January 2019. Early application is permitted if IFRS 15 has also been applied.

IAS 16 Property, Plant and Equipment (amendment)

The requirements of IAS 16 are amended to clarify that a depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. This is because such method reflects of economic benefits that arise from the operation of the business of which an asset is part, rather than the pattern of consumption of an asset's expected future economic benefits.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2016. Early application is permitted.

NOTE 2 – ACCOUNTING POLICIES (continued)

IAS 27 Equity Method in Separate Financial Statements (amendment)

The amendments allow an entity to account for investments in subsidiaries, joint ventures and associates in its separate financial statements at cost in accordance with the IAS 39 Financial Instruments: Recognition and Measurement for entities or using the equity method as described in IAS 28 Investments in Associates and Joint Ventures.

The amendments also clarify that when a parent ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2016. Early application is permitted.

IAS 34 Interim Financial Reporting

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. This amendment must be applied retrospectively.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2016.

IAS 38 Intangible Assets (amendment)

The requirements of IAS 38 are amended to introduce a rebuttable presumption that a revenue-based amortisation method for intangible assets is inappropriate for the same reasons as in IAS 16. However, the amendments states that there are limited circumstances when the presumption can be overcome: that the intangible asset is expressed as a measure of revenue and it can be demonstrated that revenue and the consumption of economic benefits of the intangible asset are highly correlated.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2016. Early application is permitted.

IAS 16 and IAS 41 Agriculture: Bearer Plants (amendment)

For the purpose of bringing bearer plants from the scope of IAS 41 into the scope of IAS 16 and therefore enabling entities to measure them at cost subsequent to initial recognition or at revaluation, a definition of a 'bearer plant' is introduced into both standards. A bearer plant is defined as "a living plant that: is used in the production or supply of agricultural produce; is expected to bear produce for more than one period; and has a remote likelihood of being sold as agricultural product, except for incidental scrap sales". The scope sections of both standards are then amended to clarify that biological assets except for bearer plants are accounted for under IAS 41 while bearer plants are accounted for under IAS 16.

The amendment is applicable to an annual reporting period beginning on or after 1 January 2016. Early application is permitted.

The Group does not use early application for the standards and interpretations mentioned above.

The Group expects that the adoption of the pronouncements described above have no significant impact on the Group's consolidated financial statements in the period of initial application with the exception of IFRS 9, where the impact of the adoption cannot be estimated, yet.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.6 Taxes and levies payable by financial institutions

Credit institutions and financial institutions are exposed to pay the so called “bank tax” introduced in 2010 in Hungary (see Note 12).

The actual bank tax and its reversal (if any) are recorded as expense in the financial period in which it is legally payable.

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

The IFRIC 21 Levies interpretation identifies the obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation. Based on the interpretation of IFRIC 21 the “bank tax” amount is recognized at the beginning of the year in a lump sum in the Group’s Consolidated Financial Statements.

In 2013 a tax called financial transaction levy (FTL) has been introduced. The FTL is payable based on specified type of transactions (including cash movements and money transfers). Subject of the levy are financial service providers (with seat or branch in Hungary). The FTL is recorded as part of general administrative expenses when the underlying business transaction occurs.

The Resolution Fund was established in 2014 to shift the costs of crisis management in the financial sector to the members of the sector. The Fund is financed by credit institutions and investment firms from the annual fees paid by the members. According to IFRIC 21 the Group records the total annual fee at the beginning of the period.

2.7 Reclassification and restatement

Cash and cash balances with central banks

2-week deposits with the National Bank of Hungary were reclassified from Cash and cash balances with central banks to Loans and receivables in the consolidated statement of financial position due to their non-cash equivalent feature. The table below presents the effect of the reclassification for previous years’ consolidated statement of financial position.

The Group had no 2-week deposits at 1 January 2014 therefore no third period (beginning of the comparative period) has been presented in the consolidated statements of financial position.

	Previously reported as at 31 December 2014	**Reclassification**	**Reclassified as at 31 December 2014**
	MHUF	**MHUF**	**MHUF**
Consolidated statement of financial position			
Assets			
Cash and cash balances with central banks	423 651	(346 104)	77 547
Loans and receivables	1 256 381	346 104	1 602 485

NOTE 2 – ACCOUNTING POLICIES (continued)

Loans and advances with central banks are reported on a separate line in Note 18 in this consolidated financial statement. Comparative figures were reclassified.

Adjustment of carrying amount of loans and advances due to reestimation of future cash flows

The loss resulting from the Curia Act presented as Adjustment of carrying amount of loans and advances due to reestimation of future cash flows in the consolidated financial statements for 2014 was reclassified to Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange and Other net income / (expense) in order the total impact of legislatory changes related to consumer loan contracts to be presented under a common heading.

For more details on the Curia loss in 2015 see Note 10.

	As previously reported 2014	Reclassification	Reclassified 2014
	MHUF	MHUF	MHUF
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	22 874	(5 753)	17 121
Adjustment of carrying amount of loans and advances due to reestimation of future cash flows	(55 742)	55 742	-
Other net income / (expense)	(13 900)	(49 989)	(63 889)

Some of the notes in the Consolidated Financial Statements were changed in comparison with the previous year's presentation. The reclassified categories are marked in the concerned notes.

The reclassified notes are the following:

- Consolidated statement of financial position
- Consolidated statement of cash flows
- Note 6 Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange
- Note 9 Other net income / (expense)
- Note 18 Financial assets and liabilities, breakdown by portfolio and product
- Note 22 Fair value of financial assets and liabilities
- Note 24 Financial assets and liabilities, breakdown by portfolio and geographical location
- Note 25 Financial assets and liabilities, breakdown by portfolio and quality
- Note 26 Remaining maturity of assets and liabilities
- Note 46 Risk management

Renegotiated and forborne loans

For reporting purposes in this consolidated financial statements the Group replaced the terminology "renegotiated" with the definition of "forborne" in Note 46 Risk management. The "forborne" definition determined by the European Banking Authority in its final draft technical standards nr. EBA/ITS/2013/03 was applied by the Group first in the local consolidated supervisory reports (Finrep reports) of the third quarter in 2014.

NOTE 2 – ACCOUNTING POLICIES (continued)

Management believes the above reclassifications relating to 2014 are immaterial to the consolidated financial statements taken as a whole.

2.8 Change in estimate

The Group has started to record funding valuation adjustment for derivatives in 2015 (adjustment to the risk-free market value for taking into account the funding cost inherent to the transaction). The change in the valuation resulted in a loss of HUF 621 million in 2015.

NOTE 3 – SEGMENT INFORMATION

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

Definitions of customer segments:

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

Corporate: companies with an annual turnover of higher than HUF 2 000 million, municipalities and related companies, structured and project financing, and institutions in the financial sector. Services: loans and other credit facilities, deposits and transactional services, lease services, etc.

Markets: market making.

Leasing: retail car loans.

General Management: consists of items which are not directly attributable to the business activity of the above defined segments. These include e.g. the result of tax and commercial litigations (see Note 36), impact of government measures related to consumer loan contracts (Curia Act, see Note 9 and Note 10), bank tax, result of strategic investments and fair value changes recognised under IFRS on derivatives used for hedging purposes that do not qualify for hedge accounting.

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

The Group only operates in Hungary (therefore the geographical breakdown of revenues from external customers is less relevant).

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

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2015:

	Retail	Corporate	Markets	Leasing	General management	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net interest income / (expense)	47 585	17 955	2 134	722	5 487	73 883
Net fee and commission income / (expense)	40 207	12 326	231	(116)	(391)	52 257
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	5 599	6 466	1 864	(53)	3 909	17 785
Net realised gains / (losses) from available-for-sale assets	3	13	-	-	649	665
Dividend income	-	-	-	-	-	-
Other net income / (expense)	264	132	-	118	17 616	18 130
Total income / (expense)	93 658	36 892	4 229	671	27 270	162 720
of which:						
external income / (expense)	92 697	37 853	4 229	671	27 270	162 720
internal income / (expense)	961	(961)	-	-	-	-
Operating expenses	(66 757)	(16 980)	(1 251)	(570)	(16 537)	(102 095)
Impairment	(728)	(1 455)	-	345	(11 252)	(13 090)
Share in results of associated companies	-	-	-	-	-	-
Profit / (loss) before tax	26 173	18 457	2 978	446	(519)	47 535
Income tax benefit / (expense)	(7 333)	(4 424)	(686)	(104)	2 875	(9 672)
Segment profit / (loss)	18 840	14 033	2 292	342	2 356	37 863
Total assets	703 301	539 011	191 681	16 920	1 132 043	2 582 956
Total liabilities and equity	1 477 714	858 379	11 221	1 354	234 288	2 582 956

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2014 after restatement:

	Retail	Corporate	Markets	Leasing	Reclassified General management	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net interest income / (expense)	55 141	21 054	4 966	1 339	(542)	81 958
Net fee and commission income / (expense)	39 943	11 203	388	(132)	(188)	51 214
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	6 059	5 123	(411)	262	6 088	17 121
Net realised gains / (losses) from available-for-sale assets	91	92	-	-	3 799	3 982
Dividend income	-	-	-	-	-	-
Other net income / (expense)	(115)	191	-	167	(64 132)	(63 889)
Total income / (expense)	101 119	37 663	4 943	1 636	(54 975)	90 386
of which:						
external income / (expense)	100 860	37 922	4 943	1 636	(54 975)	90 386
internal income / (expense)	259	(259)	-	-	-	-
Operating expenses	(65 911)	(19 139)	(1 974)	(800)	(15 780)	(103 604)
Impairment	(9 675)	(3 841)	-	(1 575)	(14)	(15 105)
Share in results of associated companies	-	-	-	-	41	41
Profit / (loss) before tax	25 533	14 683	2 969	(739)	(70 728)	(28 282)
Income tax benefit / (expense)	(6 021)	(3 228)	(621)	86	9 776	(8)
Segment profit / (loss)	19 512	11 455	2 348	(653)	(60 952)	(28 290)
Total assets	733 429	666 507	163 395	29 165	849 078	2 442 836
Total liabilities and equity	1 287 865	782 475	9 167	519	362 810	2 442 836

NOTE 4 – NET INTEREST INCOME

	2015	2014
	MHUF	MHUF
Loans and receivables	63 685	71 611
Held to maturity	24 855	29 466
Available-for-sale assets	5 969	10 378
Subtotal, interest income from financial assets not measured at fair value through profit or loss	94 509	111 455
Financial assets held for trading	2 002	3 112
Asset/liability management derivatives	1 312	831
Hedging derivatives	3 907	3 461
Other financial assets at fair value through profit or loss	77	93
Total interest income	101 807	118 952
Financial liabilities measured at amortised cost	(16 953)	(25 345)
Other liabilities not measured at fair value through profit or loss	(108)	(223)
Subtotal, interest income from financial assets not measured at fair value through profit or loss	(17 061)	(25 568)
Financial liabilities held for trading	(64)	(121)
Asset/liability management derivatives	(1 595)	(1 149)
Hedging derivatives	(1 532)	(611)
Other financial liabilities at fair value through profit or loss	(7 672)	(9 545)
Total interest expenses	(27 924)	(36 994)
Net interest income	73 883	81 958

The Group recorded HUF 376 million interest income (unwinding discount effect) on impaired assets in 2015 (HUF 726 million in 2014).

NOTE 5 – NET FEE AND COMMISSION INCOME

	2015 MHUF	2014 MHUF
Brokerage services	8 811	9 188
Trust and fiduciary activities	6 256	5 625
Credit and guarantee fee income	3 216	3 170
Structured finance	259	147
Payment services	39 897	38 348
Card services	9 790	9 447
Other	1 714	1 760
Fee and commission income	69 943	67 685
Brokerage services	(1 774)	(1 775)
Credit and guarantee fee expense	(2 030)	(1 886)
Commissions to agents	(112)	(59)
Structured finance	(107)	-
Payment transactions	(5 005)	(5 374)
Card services	(6 872)	(5 802)
Insurance services	(1 780)	(1 530)
Other	(6)	(45)
Fee and commission expense	(17 686)	(16 471)
Net fee and commission income	52 257	51 214

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

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

	2015 MHUF	Reclassified 2014 MHUF
Trading securities	151	965
Interest rate derivatives (including interest and fair value changes in trading derivatives)	2 169	8 742
Other financial instruments designated at fair value through profit or loss at initial recognition	856	(941)
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	14 328	3 019
Fair value adjustments in hedge accounting*	281	5 336
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	17 785	17 121

The comparative figures of Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives) has changed due to the reclassification of the loss resulting from the Curia Act in 2014. For more information see Note 2.7.

*Results of cash flow hedge derivatives transferred from Consolidated other comprehensive income to the Consolidated income statement amounted to HUF 675 million gain in 2015 (HUF 5 575 million gain in 2014) and HUF 394 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 239 million loss in 2014).

The changes in the fair value of financial liabilities designated at fair value through profit or loss attributable to credit risk amounted to HUF 113 million loss in 2015 (HUF 325 million loss in 2014) and HUF 25 million gain as at 31 December 2015 cumulatively (HUF 138 million gain as at 31 December 2014).

The change in the fair value of financial instruments at fair value through profit or loss, where the fair value calculation is based on non-observable parameters was HUF 5 million loss in 2015 (HUF 13 million loss in 2014).

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

	2015 MHUF	2014 MHUF
Fixed-income securities	665	3 982
Net realised gains from available for sale	665	3 982

NOTE 8 – DIVIDEND INCOME

No third-party dividend was recognised in the Group's consolidated financial statement in 2015 and 2014.

NOTE 9 – OTHER NET INCOME / (EXPENSE)

	2015	Reclassified 2014
	MHUF	MHUF
Gain on property, plant and equipment	317	(6)
Gain on the sale of associated companies	-	644
Sale of goods	680	763
Gain/(loss) on the disposal of held-to -maturity debt instruments	139	260
Revenue on other services	453	439
Gain / (loss) due to operational risks	2 208	1 786
Provision for expected loss in relation to the Curia Act	(279)	(15 584)
Adjustment of carrying amount of loans and advances due to reestimation of future cash flows	15 142	(49 989)
Other	(530)	(2 202)
Other net income / (expense)	18 130	(63 889)

For more details on the Provision for expected loss in relation to the Curia Act (Act XXXVIII of 2014) and on Adjustment of carrying amount of loans and advances due to reestimation of future cash flows see Note 10.

Gain on the sale of associated companies includes the result realised on the sale of Giro Elszámolásforgalmi Zrt. in 2014. The carrying amount of the investment derecognised amounted to HUF 1 625 million at the date of sale (see Note 32). The selling price of shares was HUF 2 173 million and it was settled in cash and cash equivalents.

The income of HUF 453 million reported as revenue on other services in 2015 (HUF 439 million 2014) results from finance and accounting, business management, technical, logistics and bank security services granted by the Group to other KBC Group entities operating in Hungary, but not included in the consolidation.

In 2015 gain / (loss) due to operational risks contains HUF 3 018 million gain from the reversal of the loss expected to be realized from operational risks in previous years (see Note 36).

NOTE 10 – ADJUSTMENT OF CARRYING AMOUNT OF LOANS AND ADVANCES DUE TO REESTIMATION OF FUTURE CASH FLOWS

The table below presents the loss recorded in the consolidated income statement in relation to the Curia Act in 2015 and 2014:

	Reference number	2015	2014
		MHUF	MHUF
Reversal of the expected loss / (expected loss) from the conversion and settlement regulated by the Curia, Settlement and Conversion Acts)	1	5 582	(49 989)
Loss realised on foreign exchange car loans and consumer loans due to Act CXLV of 2015	2	(880)	-
Subsequent adjustment of carrying amount of loans derecognised and recognised	3	10 440	-
Adjustment of carrying amount of loans and advances due to reestimation of future cash flows	4=1+2+3	15 142	(49 989)
Provision for expected loss in relation to the Curia Act	5	(279)	(15 584)
Other net income / (expense)	6=4+5	14 863	(65 573)

The Group recorded a loss of HUF 65 573 million (pre-tax) in the 2014 financial statements for both the settlement of bid-offer spreads and unilateral changes to interest rates as imposed by the Acts released in 2014 for the regulation of the HUF conversion of retail foreign exchange consumer loans (Curia Act: XXXVIII of 2014, Settlement Act: Act XL of 2014 and Conversion Act: Act LXXVII of 2014) (ref. 6).

From the above HUF 65 573 million total loss HUF 49 989 million losses (ref. 4) have been incurred in relation to customers with still existing exposure with the Group (at settlement date of 1 February 2015; see Note 9). In such instances, the Group adjusted the carrying amount of loans and advances to reflect changes in estimated future cash flows as a result of the settlement (reimbursement to customers that reduce exposures as of 1 February 2015).

Out of the total loss of HUF 65 573 million in 2014 HUF 15 584 million loss (ref. 5) was recognized in the consolidated income statement as “Provision for expected loss in relation to Curia Act” as it represents amounts due to clients without existing loan balances at 1 February 2015 (see Note 36).

The Group recorded a gain of HUF 5 582 million in 2015 partly reversing the expected loss recorded in 2014 (ref. 1). Due to Act CXLV of 2015 regulating the terms and conditions of the phasing out and conversion of FX car loans and consumer loans the Group recorded an additional loss of HUF 880 million (ref. 2) in 2015. HUF 10 440 million gain on the subsequent adjustment of carrying amount of loans derecognised and recognised under (ref. 3) results from the increase of the carrying amount of the converted loans representing quality improvement.

NOTE 10 – ADJUSTMENT OF CARRYING AMOUNT OF LOANS AND ADVANCES DUE TO REESTIMATION OF FUTURE CASH FLOWS (continued)

In 2015 HUF 279 million additional loss was recorded in relation to the Curia act on the expected loss arising from the reimbursement due to loans matured before 31 December 2014 (under the heading of "Provisions for expected loss in relation to the Curia Act" as part of "Other net income / (expense))".

In accordance with the Conversion Act the Group was required to convert foreign currency and foreign currency-based consumer mortgage loan contracts into Hungarian Forints with the effect date of 1 February 2015. Applicable conversion rates have been set at HUF 256.47 in case of the CHF, at HUF 308.97 in the case of the Euro and at HUF 2.163 in the case of the Japanese yen. As the conversion at 1 February 2015 represents a fundamental change in the agreement (contract) with the customer, impacted exposures were derecognized in 2015 according to IAS 39 with the same effective date when the conversion took place. The converted loans were recognised again at the fair value being the carrying amount including impairments at derecognition. The derecognition and recognition of loans impacted the gross carrying amounts and impairments presented in Note 25, 28, 36, 46.4, 46.5.

According to the above mentioned accounting treatment the Group derecognised an impairment of HUF 62 192 million as at the conversion date. This impairment would amount to HUF 52 148 million as at 31 December 2015 if no derecognition and recognition had been applied (the impact of the derecognition and recognition on the 2015 figures is presented in the table at the end of this Note).

In case of impaired loans and advances converted to HUF the subsequent increase in future cash-flow estimation due to credit quality improvement recorded as part of "Adjustment of carrying amount of loans and advances due to reestimation of future cash flows" within "Other net income / (expense)" resulted in a HUF 10 440 million gain in 2015 (ref. 3). The subsequent decrease in future cash-flow estimation due to credit quality worsening is recorded as part of impairments for all loans and receivables.

NOTE 10 – ADJUSTMENT OF CARRYING AMOUNT OF LOANS AND ADVANCES DUE TO REESTIMATION OF FUTURE CASH FLOWS (continued)

The following table presents the IAS 39 derecognition-recognition effect on the Loans and receivables portfolio due to the Curia Act described above:

	31 December 2015						31 December 2014		
	As presented in the notes, applying derecognition-recognition			As it would be presented in the notes if no derecognition-recognition had been applied			As presented in the notes		
	Impaired	Unimpaired	Total	Impaired	Unimpaired	Total	Impaired	Unimpaired	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Performing	-	1 676 155	1 676 155	-	1 676 155	1 676 155	-	1 514 353	1 514 353
Non-performing	85 211	35 773	120 984	173 132	-	173 132	208 761	-	-
Impairment	(46 666)	(3 561)	(50 227)	(98 814)	(3 561)	(102 375)	(115 440)	(5 189)	(120 629)
Loans and receivables total	38 545	1 708 367	1 746 912	74 318	1 672 594	1 746 912	93 321	1 509 164	1 602 485

NOTE 11 – GENERAL ADMINISTRATIVE EXPENSES

	2015 MHUF	2014 MHUF
IT expenses	(9 642)	(11 044)
Rental expenses	(2 707)	(2 707)
Repair and maintenance	(1 150)	(1 217)
Marketing expenses	(1 532)	(1 521)
Professional fees	(2 196)	(2 561)
Other facilities expenses	(4 351)	(4 264)
Communication expenses	(214)	(189)
Travel expenses	(92)	(72)
Training expenses	(307)	(475)
Personnel related expenses	(260)	(263)
Financial transaction levy	(21 403)	(20 131)
Other administrative expenses	(3 955)	(7 159)
Other provision	423	(372)
Total general administrative expenses	(47 386)	(51 975)

The decrease in IT expenses was caused by insourcing IT maintenance personnel from the Hungarian branch of KBC Group N.V.

NOTE 12 – BANK TAX

The Group paid a bank tax of HUF 15 754 million in 2015 (HUF 15 840 million in 2014). The basis and the tax rate of the tax payable by financial institutions can differ per group members, dependent on their activities.

The tables below present the details of the bank tax paid by the group members in 2015 and 2014.

2015	**Activity**	**Tax base**	**Tax rate**	**Tax**
		MHUF	**%**	**MHUF**
Group members:				
K&H Bank Zrt.	Credit institution	2 888 110	0.542*	15 648
K&H Befektetési Alapkezelő Zrt.	Asset management	211 992	0.050	106
Total		3 100 102	0.508	15 754

2014	**Activity**	**Tax base**	**Tax rate**	**Tax**
		MHUF	**%**	**MHUF**
Group members:				
K&H Bank Zrt.	Credit institution	2 888 110	0.542*	15 648
K&H Befektetési Alapkezelő Zrt.	Asset management	685 070	0.028	192
Total		3 573 180	0.443	15 840

*Effective rate

The bank tax payable by the Group members for the year 2015 is calculated as follows.

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

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

The bank tax for credit institutions is payable at 0.15% on tax base below HUF 50 000 million and 0.53% on tax base above HUF 50 000 million in 2015 and 2014.

NOTE 12 – BANK TAX (continued)

In 2014 the tax base of asset management companies was calculated based on the net asset value (NAV) of all portfolios managed less all liabilities relating to these portfolios, as at 31 December 2009. The tax rate used for asset management companies was 0.028%.

In 2015 the bank tax of asset management companies described above has been replaced by a new type of tax to be applied for investment funds. The base of the tax is the quarterly calculated average value (sum of daily NAVs divided by the number of days in the quarter, in HUF) of the distributed fund units kept on the client accounts by the distributor (excluding the shares held by a fund of fund). The applied tax rate is 0.05% per year.
The new law regulating the tax of investment funds entered into force as at 1 January 2015.

The bank tax for the Group is expected to be HUF 7 556 million in 2016 (including estimated amount for funds). The decrease of the bank tax expected in 2016 is caused by the change of the tax rate of 0.53% applied until 31 December 2015 on tax base above 50 000 million to 0.24%.

For the Bank the liability of HUF 7 443 million is established on January 1, 2016.

NOTE 13 – AVERAGE NUMBER OF PERSONNEL

	2015	2014
White-collar staff	3 327	3 136
Blue-collar staff	29	19
Management	180	177
Total average number of persons employed	3 536	3 332

The increase in the total average number of persons employed was caused by insourcing IT maintenance personnel from the Hungarian branch of KBC Group N.V.

NOTE 14 – IMPAIRMENT (income statement)

	2015 MHUF	2014 MHUF
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for loans and receivables	(12 564)	(15 392)
Specific provisions on credit commitments	(1 515)	(1 076)
Portfolio-based impairments and provisions	1 791	1 791
Total impairments and provisions on loans and receivables and credit commitments	(12 288)	(14 677)

For more detailed information on changes in the impairment loss see Note 28.

	2015 MHUF	2014 MHUF
Impairment on other		
Intangible assets	(8)	(22)
Investment property	(11)	(67)
Property and equipment	(777)	(366)
Other	(6)	27
Total impairment on other	(802)	(428)

NOTE 15 – SHARE IN THE RESULTS OF ASSOCIATED COMPANIES

	2015	2014
	MHUF	MHUF
Giro Elszámolásforgalmi Zrt.	-	42
K&H Lízingház Zrt. "v.a"	-	(1)
Share of the results of associates	-	41

The carrying amount of HAGE Zrt. amounted to HUF 542 as at 31 December 2015 (and 2014). Management believes that this carrying amount best represents the Group's share in the investment. The share in result of HAGE is fully impaired in 2015 similarly to previous years. The impairment recorded on HAGE Zrt. was HUF 26 million in 2015 (HUF 118 million in 2014). The current year's result and the impairment of the associates are recorded net within the consolidated income statement as "Share in the results of associated companies". (For further information on the main financial figures of the associated companies see Note 32.)

NOTE 16 – INCOME TAXES

The components of income tax expense for the year ended 31 December 2015 and 2014 are:

	Notes	2015	2014
		MHUF	MHUF
Statutory income tax expense		(1 376)	(9 450)
Statutory income tax from self-revision of prior years		(217)	(3)
Local business tax expense		(3 195)	(3 700)
Deferred taxes on income	31	(4 884)	13 145
Income tax (expense) / benefit		(9 672)	(8)

Statutory income tax expense

In 2015 and 2014, corporate income tax is payable at 10% on yearly profits below a limit of HUF 500 million and 19% on profits above the limit.

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

There is no procedure for final agreement of tax assessments in Hungary. The tax authorities may examine the accounting records and revise assessments for up to five years after the period to which they relate. Consequently, the Group may be subject to further assessments in the event of an audit by the tax authorities. The corporate tax returns for the Bank have been reviewed and closed off by the taxation authorities for the years up to 2013 excluding 2011. Management is not aware of any additional significant non-accrued potential tax liability which might arise relating to years not audited by the tax authorities.

In accordance with the Act on Settlements the corporate tax payable for the tax year 2015 was decreased with the amount the Group would have deducted from the total tax due to a related self-revision (since the deductible amount exceeds the corporate tax payable for 2015, the remaining amount shall be deducted from the corporate tax of the subsequent years). The deductible amount is based on the self revision of corporate tax, local business tax, innovation contribution, special tax and banking tax declared and paid for the tax years from 2008 to 2014. Based on the Group's financial plans for 2016-2018 the Group will utilize the remaining tax allowance until 2018 as such the related deferred tax asset was recorded in amount of HUF 5 128 million in the consolidated financial statement.

NOTE 16 – INCOME TAXES (continued)

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

	2015 MHUF	2014 MHUF
Profit / (loss) before tax	47 535	(28 282)
Income tax rate	19.00%	19.00%
Income tax calculated	(9 032)	5 374
Plus/minus tax effects attributable to:		
Tax base decreasing items from permanent differences	1 629	807
Adjustments related to prior years	(217)	(3)
Local taxes	(3 195)	(3 700)
Tax base increasing items from permanent differences	1 143	(3 975)
Other	-	1 489
Total tax effects	(640)	(5 382)
Income tax expense (income tax calculated + total tax effects)	(9 672)	(8)

The effective income tax rate for 2015 is 20.35% (2014: 0.03%).

NOTE 17 – EARNINGS / (LOSS) PER SHARE

Earnings / (loss) per share is the profit attributable to shareholders of the Group divided by the weighted average number of shares outstanding during the period, excluding treasury shares. There were no other potentially dilutive securities in existence at 31 December 2015 and 2014. The following amounts were used in the calculation of earnings / (loss) per share:

	2015	2014
Net profit attributable to shareholders (MHUF)	37 863	(28 290)
Weighted average shares outstanding (in millions)	140 978	140 978
Earnings / (loss) per share in HUF (basic)	0.2685738	(0.2006696)

The figures of earnings / (loss) per share calculated for basic and diluted shares do not differ.

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2015							
Loans and advances to central banks*	-	-	-	523 338	-	-	523 338
Loans and advances to credit institutions and investment firms**	-	-	-	73 632	-	-	73 632
Loans and advances to customers	-	-	-	1 133 989	-	-	1 133 989
Trading receivables	-	-	-	20 740	-	-	20 740
Consumer credit	-	-	-	21 094	-	-	21 094
Credit card	-	-	-	4 884	-	-	4 884
Mortgage loans	-	-	-	432 627	-	-	432 627
Term loans	-	-	-	531 915	-	-	531 915
Finance leasing	-	-	-	36 981	-	-	36 981
Current account advances	-	-	-	84 910	-	-	84 910
Other	-	-	-	838	-	-	838
Equity instruments	1 013	-	4 995	-	-	-	6 008
Debts instruments	40 555	-	158 250	15 953	428 371	-	643 129
issued by public bodies	40 555	-	158 250	1 430	428 371	-	628 606
issued by financial corporations	-	-	-	14 523	-	-	14 523
Derivatives	40 167	-	-	-	-	11 023	51 190
Total carrying value	81 735	-	163 245	1 746 912	428 371	11 023	2 431 286

Debt instruments issued by public bodies include Hungarian government and Hungarian municipality bonds.
*The maturity of loans and advances to central banks is less than 90 days.
**From the total balance of loans and advances to credit institutions and investment firms HUF 1 908 million is either repayable on demand or is maturing in less than 90 days. Loans and advances to credit institutions, investment firms and customers include reverse repo transactions of HUF 13 413 million.

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Available for sale	Reclassified Loans and receivables	Held to maturity	Hedging derivatives	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2014							
Loans and advances to central banks*	-	-	-	346 104	-	-	346 104
Loans and advances to credit institutions and investment firms**	-	-	-	57 398	-	-	57 398
Loans and advances to customers	-	-	-	1 196 590	-	-	1 196 590
Trading receivables	-	-	-	21 819	-	-	21 819
Consumer credit	-	-	-	19 598	-	-	19 598
Credit card	-	-	-	4 708	-	-	4 708
Mortgage loans	-	-	-	420 921	-	-	420 921
Term loans	-	-	-	605 945	-	-	605 945
Finance leasing	-	-	-	29 074	-	-	29 074
Current account advances	-	-	-	93 763	-	-	93 763
Other	-	-	-	762	-	-	762
Equity instruments	2 653	-	646	-	-	-	3 299
Debts instruments issued by public bodies	53 879	2 571	125 933	2 393	421 915	-	606 691
Derivatives	42 997	-	-	-	-	10 768	53 765
Total carrying value	99 529	2 571	126 579	1 602 485	421 915	10 768	2 263 847

Debt instruments issued by public bodies include Hungarian government and Hungarian municipality bonds.
*The maturity of loans and advances to central banks is less than 90 days.
**From the total balance of loans and advances to credit institutions and investment firms HUF 4 972 million is either repayable on demand or is maturing in less than 90 days. Loans and advances to credit institutions, investment firms and customers include reverse repo transactions of HUF 4 815 million.

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2015					
Deposits from central banks	-	-	-	188 096	188 096
Deposits from credit institutions and investment firms*	-	-	-	161 666	161 666
Deposits from customers and debt certificates	-	216 315	-	1 684 182	1 900 497
Deposits from customers	-	209 820	-	1 655 800	1 865 620
Demand deposits	-	-	-	1 025 232	1 025 232
Time deposits	-	209 820	-	354 045	563 865
Savings deposits	-	-	-	276 523	276 523
Debt certificates	-	6 495	-	28 382	34 877
Certificates of deposits	-	-	-	241	241
Non-convertible bonds	-	6 495	-	-	6 495
Non-convertible subordinated liabilities	-	-	-	28 141	28 141
Derivatives	25 971	-	11	-	25 982
Short positions	9 888	-	-	-	9 888
In debt instruments	9 888	-	-	-	9 888
Other	-	-	-	725	725
Total carrying value	35 859	216 315	11	2 034 669	2 286 854

*Of which HUF 57 429 million is deposits from banks repayable on demand.

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

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Reclassified Measured at amortised cost	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2014					
Deposits from central banks	-	-	-	151 363	151 363
Deposits from credit institutions and investment firms*	-	-	-	298 344	298 344
Deposits from customers and debt certificates	-	196 709	-	1 483 511	1 680 220
Deposits from customers	-	188 372	-	1 464 386	1 652 758
Demand deposits	-	-	-	724 233	724 233
Time deposits	-	188 372	-	483 178	671 550
Savings deposits	-	-	-	256 975	256 975
Debt certificates	-	8 337	-	19 125	27 462
Certificates of deposits	-	-	-	244	244
Non-convertible bonds	-	8 337	-	-	8 337
Non-convertible subordinated liabilities	-	-	-	18 881	18 881
Derivatives	41 083	-	138	-	41 221
Short positions	5 059	-	-	-	5 059
In debt instruments	5 059	-	-	-	5 059
Other	-	-	-	647	647
Total carrying value	46 142	196 709	138	1 933 865	2 176 854

*Of which HUF 160 438 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 5 570 million.

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

Assets pledged as collateral for liabilities and contingent liabilities

	2015 MHUF	2014 MHUF
Assets pledged for:		
Repo liabilities	5 407	5 091
Refinancing credits with EIB	34 892	49 961
Funding for Growth Scheme launched by NBH	196 500	160 160
Derivative transactions	14 738	16 164
Clearing transactions	53 865	-
Total assets pledged as collateral	305 402	231 376

For the terms and conditions of assets pledged as collateral for repo liabilities see Note 19.

Assets pledged as collateral for refinancing credits, derivatives and clearing transactions contain cash and cash equivalents and securities. These assets are not transferred to the counterparty. In case of derivatives the terms and conditions of collateral settlement are defined in separate CSAs (Credit Support Annexes) between the counterparties. In case of securities the collateral requirement is defined on portfolio basis and it is held in custody at a central clearing house (KELER).

The Group introduced the Continuous Linked Settlement (CLS) in 2015. To ensure the safety of this cash settlement system the Group pledged securities in amount HUF 53 865 million (Clearing transactions in the table above).

Details of financial instruments

Equity and debt instruments

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

	2015 MHUF	2014 MHUF
Held for trading		
Hungarian Treasury bills	558	16 995
Hungarian government bonds issued in HUF	38 545	25 519
Hungarian government bonds issued in foreign currency	1 452	11 365
Hungarian Listed equity instruments	551	482
Hungarian Unlisted equity instruments	462	2 171
Total held for trading securities	41 568	56 532

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	2015 MHUF	2014 MHUF
Available for sale		
Hungarian government bonds issued in HUF	147 437	122 994
Hungarian government bonds issued in foreign currency	10 813	2 939
Unlisted equity instruments	4 995	646
Total available for sale	163 245	126 579

Visa Inc. proposes to purchase Visa Europe in 2016. The Group has a share of 1.282 % in Visa Europe, which was held at cost in the consolidated financial statements in previous years. Based on the communication of Visa Europe related to the proposed transaction, parameters needed to the calculation of the fair value become available.

The Group has changed the valuation of its investment in Visa Europe from cost to fair value in 2015. The change in the valuation caused an increase of HUF 4 349 million in the book value of available-for-sale equity instruments. The fair value adjustment on the investment was recorded in the consolidated other comprehensive income. For further information on the fair value calculation of Visa Europe see Note 22.

Available-for-sale equity instruments contain as at 31 December 2015 unlisted equity instruments in a value of HUF 646 million (HUF 646 million at the end of 2014) for which a fair value cannot be measured reliably. These investments are not traded on active markets. Management believes that the carrying value of the investments held at cost approximates their fair value.

These available-for-sale investments contain long term investments in companies where the Group does not have significant influence. These participations are not consolidated as either a subsidiary or through equity consolidation.

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

	2015 MHUF	2014 MHUF
Garantiqa Hitelgarancia Zrt.	640	640
SWIFT S.C.	6	6
	646	646

The Group recorded HUF 689 million gain after tax in Other comprehensive income as a result of the fair value revaluation of available-for-sale debt instruments in 2015 (HUF 11 005 million gain after tax in 2014).

The unrealised result of available-for-sale debt instruments is cumulatively HUF 8 759 million gain after tax as at 31 December 2015 (HUF 8 662 million gain as at 31 December 2014).

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	2015 MHUF	2014 MHUF
Loans and receivables		
Bonds issued by municipality – issued in HUF	1 430	-
Bonds issued by municipality - issued in foreign currency	-	2 393
Bonds issued by financial corporations in HUF	14 523	-
Total loans and receivables debt instruments	15 953	2 393

Bonds held in the Bonds issued by municipality were converted to HUF in 2015. Bonds issued by financial corporations include bonds issued by the Investor Protection Fund and the National Deposit Insurance Fund of Hungary.

	2015 MHUF	2014 MHUF
Held to maturity		
Hungarian government bonds issued in foreign currency	34 216	32 533
Hungarian government bonds issued in HUF	394 155	389 382
Total held to maturity	428 371	421 915

Refinancing credits

The Bank has entered into several refinancing credit facilities with financial institutions (such as EIB, FHB – Mortgage Bank, MFB – Development Bank, EXIM Bank) for the purpose of funding portions of the Bank's activities. There are several covenants governing the determination of qualified recipients, the on-going monitoring process of the ultimate recipients and the repayment process. In all cases the Bank assumes all credit risk related to the ultimate borrower and must check compliance with all covenants.

The National Bank of Hungary (NBH) launched a program called Funding for Growth Scheme in 2013. The aim of the program is the refinancing of small and medium enterprises (SME) through the Hungarian bank system. The NBH funds the credit institutions attending the program through below market rate refinancing loans during a temporary period and in a limited amount. These funds are used by the credit institutions for granting credits to SMEs with similar, favourable conditions for pre-determined purposes. The maximum maturity of the refinancing loans is 10 years at initiation and it corresponds to the maturity of the loans granted to the customers.

At 31 December 2015, Management believes that the Bank is in compliance with all significant covenants. Refinancing credits are presented as financial liabilities at amortised cost in the consolidated statement of financial position.

NOTE 18 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	2015 MHUF	2014 MHUF
Refinancing credits in the frame of the Funding for Growth Scheme	188 096	151 363
Other refinancing credits	98 800	125 359
Total refinancing credits	286 896	276 722

Non-convertible subordinated liabilities

	2015 MHUF	2014 MHUF
Subordinated loan from KBC Group	28 141	18 881
	28 141	18 881

In June 2006, the Group borrowed EUR 60 million of subordinated debt from KBC Bank N.V. Dublin branch, a member of the KBC Group. In 2014 KBC Bank N.V. has taken over the facility from its branch. In March 2015 the loan's original maturity of 30 June 2016 was extended with 10 years. The loan bears a variable interest rate of 3 month-EURIBOR plus 2.70 percent per annum.

In September 2015 the Group agreed on an additional subordinated debt of EUR 30 million with KBC Bank N.V. with conditions of 10 years maturity and a variable interest rate of 3 month-EURIBOR plus 3.05 percent per annum.

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

NOTE 19 – TRANSFERRED FINANCIAL ASSETS

The following table includes transferred financial assets continued to be recognised in their entirety.

	2015		2014	
	Carrying amount of transferred asset MHUF	Carrying amount of associated liability MHUF	Carrying amount of transferred asset MHUF	Carrying amount of associated liability MHUF
Held-for-trading debt instruments	4 674	4 717	-	-
Available-for-sale debt instruments	-	-	596	601
Held-to-maturity debt instruments	733	739	4 495	4 969
Total transferred assets and associated liabilities	5 407	5 456	5 091	5 570

NOTE 19 – TRANSFERRED FINANCIAL ASSETS (continued)

Repo and reverse repo agreements

Under reverse repo transactions, the Group obtains legal ownership of the respective collateral received and, thus, is permitted to utilise the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity, which generates a liability recorded as financial liability held at amortised cost in the consolidated financial position. The fair value of securities accepted as collateral in connection with reverse repo transactions as at 31 December 2015 was HUF 13 233 million, of which HUF 9 888 million (reported as short positions in the consolidated statement of financial position) has been sold (31 December 2014 HUF 6 434 million and HUF 5 059 million respectively).

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

The Group has no associated liabilities which have recourse limited only to the transferred assets.

NOTE 20 – RECLASSIFICATION OF FINANCIAL ASSETS

The Group reclassified foreign currency denominated municipality bonds from available-for-sale to the loans and receivables portfolio, in order to eliminate the volatility in equity caused by the fair value changes of the instruments. The bonds have met the definition of loans and receivables and the Group has had both the intention and ability to hold the asset for the foreseeable future or until maturity as at the date of the reclassification (as of 1 July 2011).

The carrying value and the fair value of the assets classified out of the available-for-sale portfolio and classified to the Loan and receivables portfolio amounted to HUF 49 376 million as at 1 July 2011.

The following tables present the bonds' carrying amount and their impact before income tax on the comprehensive income as they are recognised after reclassification in the Consolidated Financial Statements and as they would be recognised, if no reclassification had been done.

	After reclassification	Without reclassification
	MHUF	**MHUF**
Carrying amount as at 31 December 2015	1 430	1 417
Available for sale reserve (before tax)	-	(12)
Income statement (before tax)	-	-

	After reclassification	Without reclassification
	MHUF	**MHUF**
Carrying amount as at 31 December 2014	2 393	2 330
Available for sale reserve (before tax)	-	(54)
Income statement (before tax)	438	-

NOTE 20 – RECLASSIFICATION OF FINANCIAL ASSETS (continued)

The fair value gain that the Group would have recognised in other comprehensive income if the financial assets had not been reclassified amounted to HUF 42 million gain in 2015 (HUF 1 023 million gain in 2014).

The reclassified bonds are valued at amortised cost after reclassification, their fair value adjustment recognised in other comprehensive income and included in the carrying amount as at the date of reclassification is amortised to the Income Statement.

Without reclassification these bonds would be valued at fair value and the changes in the fair value would be recognised in other comprehensive income.

The Group expected the following cash flows from reclassified assets as at 1 July 2011:

	Expected cash flows MHUF
Less than three months	363
More than three months but not more than one year	1 513
More than one but not more than five years	21 294
More than five years	48 270
Total	71 440

The average effective interest rate of the bonds was 5.21% as at 1 July 2011.

A part of the municipality bonds reclassified to the loans and receivables portfolio was taken over by the Hungarian State on the nominal amount of the bonds as at 28 February 2014. The nominal amount of the bonds taken over amounted to HUF 21 066 million. The Group derecognised a carrying amount of HUF 18 344 million and decreased the loss recorded in the other comprehensive income by HUF 2 309 million. The takeover resulted in a gain of HUF 413 million and was recorded as interest income.

NOTE 21 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

The following tables present the financial assets and liabilities which are subject to enforceable master netting agreements as at 31 December 2015:

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial assets	Gross amount of financial liabilities set off	Net amounts of financial assets	Financial instruments	Cash collateral received	Securities collateral received	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	51 190	-	51 190	21 573	14 311	-	15 306
Reverse repurchase agreements	13 413	-	13 413	-	-	13 233	180
Total financial assets subject to offsetting or master netting agreements	64 603	-	64 603	21 573	14 311	13 233	15 486

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial liabilities	Gross amount of financial assets set off	Net amounts of financial liabilities	Financial instruments	Cash collateral pledged	Securities collateral pledged	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	25 982	-	25 982	21 573	2 811	11	1 587
Repurchase agreements	5 456	-	5 456	-	-	5 407	49
Total financial liabilities subject to offsetting or master netting agreements	31 438	-	31 438	21 573	2 811	5 418	1 636

NOTE 21 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES (continued)

The following tables present the financial assets and liabilities which are subject to enforceable master netting agreements as at 31 December 2014:

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial assets	Gross amount of financial liabilities set off	Net amounts of financial assets	Financial instruments	Cash collateral received	Securities collateral received	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	53 765	-	53 765	35 495	588	1	17 681
Reverse repurchase agreements	6 470	-	6 470	-	-	6 434	36
Total financial assets subject to offsetting or master netting agreements	60 235	-	60 235	35 495	588	6 435	17 717

	Amounts presented in the statement of financial position			Amounts not set off in the statement of financial position			
	Gross amount of recognised financial liabilities	Gross amount of financial assets set off	Net amounts of financial liabilities	Financial instruments	Cash collateral pledged	Securities collateral pledged	Net amount
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Derivatives	41 221	-	41 221	35 495	4 700	7	1 019
Repurchase agreements	5 570	-	5 570	-	-	5 091	479
Total financial liabilities subject to offsetting or master netting agreements	46 791	-	46 791	35 495	4 700	5 098	1 498

NOTE 21 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES (continued)

Derivatives, repurchase and reverse repurchase agreements are subject to different netting agreements as ISDA (International Swaps and Derivatives Association) Master Agreements, CSAs (Credit Support Annex) and GMRAs (Global Master Repurchase Agreement) in case of institutional clients (credit institutions and investment firms) or treasury limits in case of corporate customers.

Financial assets and liabilities subject to master netting agreements are not netted in the consolidated statements of financial position, since the Group has no intention to settle these instruments on a net basis in the normal course of business.

Given cash collaterals are recognised in the loans-and-receivables portfolio as loans and advances to credit institutions and investment firms repayable on demand. Cash collaterals received are included in financial liabilities held on amortised cost and are recognised as demand deposits from credit institutions and investment firms.

Securities collaterals received are not recorded in the consolidated statements of financial position. Securities collaterals pledged are recognised in the consolidated statements of financial position in the appropriate portfolio (and are presented as assets pledged as collateral for liabilities and contingent liabilities in Note 18).

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The table below presents information concerning the fair value of financial assets and liabilities for year 2015:

	Fair value							
	Quoted market price	Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs	Total fair value	Total carrying amount	Unrecognised gain/(loss)	Recognised in other comprehensive income non-market observable input	Recognised in profit or loss non-market observable inputs*
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Cash and cash balances with central banks	33 148	35 567	-	68 715	68 715	-	-	-
Financial assets	526 685	810 409	1 135 821	2 472 915	2 431 286	41 629	-	6 376
Held for trading	39 986	39 369	2 380	81 735	81 735	-	-	2 027
Designated at fair value through profit or loss	-	-	-	-	-	-	-	-
Available for sale	127 535	30 715	4 995	163 245	163 245	-	4 349	-
Loans and receivables	-	623 027	1 128 446	1 751 473	1 746 912	4 561	-	-
Held to maturity	359 164	106 275	-	465 439	428 371	37 068	-	-
Hedging derivatives	-	11 023	-	11 023	11 023	-	-	-
Total financial assets and cash and cash balances with central banks	559 833	845 976	1 135 821	2 541 630	2 500 001	41 629	4 349	6 376
Financial liabilities								
Held for trading	9 899	23 580	2 380	35 859	35 859	-	-	(2 032)
Designated at fair value through profit or loss	-	216 315	-	216 315	216 315	-	-	-
Measured at amortised cost	-	118 492	1 920 172	2 038 664	2 034 669	(3 995)	-	-
Hedging derivatives	-	11	-	11	11	-	-	-
Total financial liabilities	9 899	358 398	1 922 552	2 290 849	2 286 854	(3 995)	-	(2 032)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange in the Consolidated income statement.

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The table below presents information concerning the fair value of financial assets and liabilities for year 2014:

	Fair value						
	Quoted market price	Reclassified Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs	Reclassified Total fair value	Reclassified Total carrying amount	Unrecognised gain/(loss)	Recognised loss non market observable inputs*
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Cash and cash balances with central banks	28 651	48 896	-	77 547	77 547	-	-
Financial assets	520 431	564 389	1 226 212	2 311 032	2 263 847	47 185	1 808
Held for trading	47 957	49 550	2 022	99 529	99 529	-	1 824
Designated at fair value through profit or loss	-	-	2 571	2 571	2 571	-	(16)
Available for sale	94 772	31 161	646	126 579	126 579	-	-
Loans and receivables	-	384 121	1 220 973	1 605 094	1 602 485	2 609	-
Held to maturity	377 702	88 789	-	466 491	421 915	44 576	-
Hedging derivatives	-	10 768	-	10 768	10 768	-	-
Total financial assets and cash and cash balances with central banks	549 082	613 285	1 226 212	2 388 579	2 341 394	47 185	1 808
Financial liabilities							
Held for trading	5 059	39 077	2 006	46 142	46 142	-	(1 837)
Designated at fair value through profit or loss	-	196 709	-	196 709	196 709	-	-
Measured at amortised cost	-	224 778	1 711 523	1 936 301	1 933 865	(2 436)	-
Hedging derivatives	-	138	-	138	138	-	-
Total financial liabilities	5 059	460 702	1 713 529	2 179 290	2 176 854	(2 436)	(1 837)

*Recognised as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange in the Consolidated income statement.
The fair value of Loans and receivables and Financial liabilities measured at amortised cost calculated by valuation techniques based on non-market observable inputs have been changed compared to the figures presented in the Consolidated financial statements of the previous year (HUF 1 218 135 million fair value and HUF 229 million unrecognised loss for Loans and receivables and HUF 1 705 456 million fair value and HUF 3 631 million unrecognised gain for Financial liabilities measured at amortised cost). The changes resulted from the recalculation of the estimated fair value of refinanced loans and refinanced funds in order to better comply with the valuation methodology of the Group.

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Hungarian government bonds have quoted market price except for some treasury bills and bonds maturing within 3 months, which are valued based on BUBOR yield curve within 3 months maturity. In 2015 held-for-trading debt instruments in an amount of HUF 50 million were transferred from Quoted market price to Valuation techniques-market observable inputs category due to this change in valuation (HUF 4 566 in 2014).

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

Financial assets	Held-for trading-derivatives	Government bonds at fair value through profit or loss	Available-for-sale equity instruments	Total
	MHUF	MHUF	MHUF	MHUF
Balance as at 31 December 2014	2 022	2 571	-	4 593
Net gains / (losses)				
In profit or loss	778	(127)	-	651
In other comprehensive income	-	-	4 349	4 349
Settlement	(420)	(2 444)	-	(2 864)
Balance as at 31 December 2015	2 380	-	4 349	6 729

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Financial assets	**Held-for trading-derivatives**	**Government and corporate bonds at fair value through profit or loss**	**Total**
	MHUF	**MHUF**	**MHUF**
Balance as at 31 December 2013	1 269	2 505	3 774
Net gains / (losses)			
In profit or loss	1 087	66	1 153
Settlement	(334)	-	(334)
Balance as at 31 December 2014	2 022	2 571	4 593

Financial liabilities	**Held-for-trading derivatives**
	MHUF
Balance as at 31 December 2014	2 006
Net (gains) / losses	
In profit or loss	646
Settlement	(272)
Balance as at 31 December 2015	2 380

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Financial liabilities	**Held-for-trading derivatives**
	MHUF
Balance as at 31 December 2013	998
Net (gains) / losses	
In profit or loss	1 174
Settlement	(166)
Balance as at 31 December 2014	2 006

Fair value of financial instruments

Financial instruments at fair value

Held-for-trading instruments, financial instruments designated at fair value through profit or loss, available-for-sale instruments and hedging derivatives are carried at their fair value.

Financial instruments which have an active market with regularly published price quotations are marked to market. Usually treasury bills, Hungarian government bonds, other listed bonds and listed equity instruments belong to this category, excluding Hungarian government bonds denominated in HUF and maturing within 3 months, premium Hungarian government bonds denominated in EUR, bonus Hungarian government bonds denominated in HUF and some treasury bills. There are no price quotations for Hungarian government bonds denominated in HUF and maturing within 3 months therefore they are valued based on BUBOR yield curve within 3 months maturity. For premium Hungarian government bonds denominated in EUR no active secondary market exists therefore they are valued at the price quoted at issuance. Since the Government grants the repurchase of the bonds at the issuance price management believes that the carrying amount of these bonds approximates their fair value.

If there is no active market or quoted prices for a financial instrument then valuation techniques based on observable market parameters are used, such as discounted cash flow analysis or option pricing models. Bonus Hungarian government bonds denominated in HUF, most of the financial liabilities designated at fair value through profit or loss and most of the derivatives are valued based on these techniques, such as currency forwards and swaps, foreign exchange and interest rate options, cross currency- and interest rate swaps and forward rate agreements.

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

When market parameters are not available, the Group uses its best estimations and assumptions to determine the relevant circumstances which have to be taken into account during the model valuation. Valuation techniques based on unobservable market parameters are used in case of held-for-trading exotic derivatives.

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

The Group provides exotic derivatives on back to back basis, accordingly immaterial result is recorded on held-for-trading exotic derivatives in the consolidated income statement.

For valuation of JPY denominated Hungarian government bonds valued at fair value through profit or loss the Group used internal valuation model where base curves were derived from the yield curves of EUR denominated Hungarian government bonds. JPY denominated Hungarian government bonds expired in 2015.

The Group has changed the valuation of its investment in Visa Europe from cost to fair value in 2015 (see Note 18) because information needed to the calculation of the fair value become available. In 2015 Visa Europe has informed its principal member companies about the proposed purchase of Visa Europe by Visa Inc. in 2016. In its communication Visa Europe has indicated the expected up-front consideration consisting of two parts; cash component (being the non-market observable parameter of the valuation) and preferred shares in Visa Inc.. The up-front consideration is calculated based on the distribution of the members, the eligible entities relating to the memberships and the net qualifying fees. Visa Europe used a 30-trading-day average trading price of its class A common stock and the average Euro/Dollar exchange rate for the calculation. The Group valued its investment in Visa Europe at the fair value being the up-front consideration communicated by Visa Europe.

The difference between the fair value and the transaction price of financial instruments not recognised in profit or loss as at the beginning and the end of the period was immaterial in 2015 and 2014.

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

Available-for-sale equity instruments held at cost

Available-for-sale equity instruments contain as at 31 December 2015 equity instruments in a value of HUF 646 million (HUF 646 million at the end of 2014) which fair value cannot be measured reliably.

Management believes that the carrying value of the investments held at cost approximates their fair value (for more information see Note 18).

Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operations or to undertake a transaction on adverse terms.

Held-to-maturity instruments

Held-to-maturity instruments include Hungarian government bonds issued in HUF and EUR. The fair value of held-to-maturity Hungarian government bonds denominated in HUF and maturing over 3 months disclosed in this Note is calculated based on regularly quoted market prices, since these instruments have an active market. Hungarian government bonds denominated in HUF and maturing within 3 months are valued based on BUBOR yield curve within 3 months maturity. Hungarian government bonds issued in EUR have an active market with regularly published price quotations and are marked to market.

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

For premium Hungarian government bonds denominated in EUR no active secondary market exists therefore held-to-maturity premium Hungarian government bonds are held at the price quoted at issuance in the consolidated financial position. Since the Government grants the repurchase of the bonds at an exit price of 98% the Group considers this exit price for calculation of the fair value in this note.

Bonus Hungarian government bonds denominated in HUF are valued by a valuation technique where the future cash flow is discounted by a curve calculated from IRS curves modified by asset swap and illiquidity spreads. Although illiquidity spread is non-market observable input, due to its immaterial effect in the fair value of the asset the bond is classified as financial instrument valued by valuation techniques – market observable inputs in the fair value hierarchy.

Loans and receivables and financial liabilities measured at amortized cost

For financial assets and financial liabilities that are liquid or have a short term remaining maturity (less than one year) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity, and variable rate financial instruments. Fair value adjustments of refinanced loans with fixed or variable interest are included in unrecognised gain / (loss) of loans and receivables, fair value adjustments of refinancing liabilities with fixed or variable interest are included in unrecognised gain / (loss) of financial liabilities measured at amortised cost.

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

The estimated fair value of fixed interest bearing assets with more than one year remaining maturity and refinanced loans (carried at amortized cost) is based on discounted cash flows using current interbank market yield curve appropriate for the remaining term to maturity which is adjusted with the average margin of the retail and corporate loan portfolio of the Bank to arrive at the estimated market yield curve of the asset.

The Group believes that the carrying amount of the impaired loans is the best estimation of their fair value and therefore does not present any unrecognised gain or loss on impaired loans and advances in this Note.

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

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

The municipality bond as such can be split to two components which fair values give the total fair value of the bond. The two instruments are (1) bonds and, (2) swaptions. The market value of the bonds is calculated using discounted present value of the future cash flows. The future cash flow of the bond is predicted by the default money market yield curve. The value of swaptions is calculated regularly.

All municipality bonds were converted to HUF in 2015.

NOTE 22 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

There is no active market for these municipality bonds to get market observable parameters for the revaluation especially for credit spread which is a risk on the top of the Hungarian government bonds. To challenge the fair valuation model, the Group uses a reasonably possible alternative assumption to increase the applied credit spread.

NOTE 23 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2015 MHUF	2014 MHUF
Financial assets designated at fair value through profit or loss		
Hungarian government bonds issued in foreign currencies	-	2 571
	-	2 571

	2015 MHUF	2014 MHUF
Financial liabilities designated at fair value through profit or loss		
Term deposits:		
- retail	7 432	4 052
- corporate	9 425	3 682
- investment funds	192 963	180 638
Other issued bonds	6 495	8 337
	216 315	196 709

In 2014 in financial assets designated at fair value through profit or loss were fixed rate Hungarian government bonds and a corporate loan which are economically hedged by interest derivatives starting from the acquisition.

The Group did not recognise any changes in the fair value of loans designated at fair value through profit or loss due to credit risk in the consolidated income statement in 2015 (nor in 2014).

The carrying amount of the loan designated at fair value through profit or loss was zero as at 31 December 2014. The loan had no credit risk exposure as at 31 December 2014. The loan was written-off in 2015.

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

NOTE 23 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

Upon initial recognition the bonds were designated by the Bank at fair value through profit or loss as the bonds are economically hedged by derivatives which do not achieve the criteria for hedge accounting.

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

Based on the Group's treasury policy the long term fixed rate deposits from investment funds included in financial liabilities designated at fair value through profit or loss are economically hedged by interest rate derivatives, and do not qualify for hedge accounting.

The amount that the Group would contractually be required to pay at maturity is HUF 6 152 million higher than the fair value of the deposits and issued bonds (HUF 8 109 million higher in 2014).

NOTE 24 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND GEOGRAPHIC LOCATION

The Group's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2015 can be analysed by the following geographical regions.

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Hungary	56 654	-	158 798	1 667 813	428 371	-	-	2 311 636
EMU countries	23 534	-	88	55 652	-	10 867	-	90 141
East-European countries	9	-	-	4 695	-	-	-	4 704
Russia	-	-	-	9 041	-	-	-	9 041
Other European countries	1 538	-	4 359	4 572	-	156	-	10 625
Non-European countries	-	-	-	5 139	-	-	-	5 139
Total	81 735	-	163 245	1 746 912	428 371	11 023	-	2 431 286
Financial liabilities								
Hungary	15 992	215 700	-	-	-	-	1 865 173	2 096 865
EMU countries	16 890	30	-	-	-	4	151 875	168 799
East-European countries	1 019	55	-	-	-	-	4 237	5 311
Russia	-	-	-	-	-	-	4 808	4 808
Other European countries	1 958	160	-	-	-	7	3 917	6 042
Non-European countries	-	370	-	-	-	-	4 659	5 029
Total	35 859	216 315	-	-	-	11	2 034 669	2 286 854

NOTE 24 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND GEOGRAPHIC LOCATION (continued)

The geographical breakdown of financial assets and financial liabilities as at 31 December 2014 is presented below:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Reclassified Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Hungary	74 755	2 571	126 573	1 543 067	421 915	-	-	2 168 881
EMU countries	22 604	-	6	22 996	-	10 637	-	56 243
East-European countries	58	-	-	12 988	-	-	-	13 046
Russia	-	-	-	10 538	-	-	-	10 538
Other European countries	2 112	-	-	2 867	-	131	-	5 110
Non-European countries	-	-	-	10 029	-	-	-	10 029
Total	99 529	2 571	126 579	1 602 485	421 915	10 768	-	2 263 847
Financial liabilities								
Hungary	9 800	196 472	-	-	-	-	1 630 844	1 837 116
EMU countries	33 585	237	-	-	-	138	266 230	300 190
East-European countries	62	-	-	-	-	-	11 599	11 661
Russia	-	-	-	-	-	-	15 069	15 069
Other European countries	2 695	-	-	-	-	-	4 934	7 629
Non-European countries	-	-	-	-	-	-	5 189	5 189
Total	46 142	196 709	-	-	-	138	1 933 865	2 176 854

NOTE 25 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY

Credit quality per class of financial assets

The table below presents the credit quality by asset classes as at 31 December 2015:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Performing assets	81 634	-	163 245	1 676 155	428 371	11 023	2 360 428
Non-performing assets	101	-	-	120 984	-	-	121 085
Impairment	-	-	-	(50 227)	-	-	(50 227)
Total carrying value	81 735	-	163 245	1 746 912	428 371	11 023	2 431 286

The credit quality of assets as at 31 December 2014 can be presented as follows:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Reclassified Loans and receivables	Held to maturity	Hedging derivatives	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Performing assets	99 434	2 571	126 579	1 514 353	421 915	10 768	2 175 620
Non-performing assets	95	-	-	208 761	-	-	208 856
Impairment	-	-	-	(120 629)	-	-	(120 629)
Total carrying value	99 529	2 571	126 579	1 602 485	421 915	10 768	2 263 847

For more information on the change of the impairment and carrying amount of non-performing assets related to the Curia Act see Note 10.

NOTE 25 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

The balances of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2015 are shown in the following table.

	Available-for-sale equity instruments	Loans and receivables	Commitments and contingent liabilities	Total
	MHUF	MHUF	MHUF	MHUF
Individually impaired assets	-	32 412	12 345	44 757
Individually assessed impairment	-	(29 890)	(5 960)	(35 850)
Total	-	2 522	6 385	8 907

The balance of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2014 are presented in the table below.

	Available-for-sale equity instruments	Loans and receivables	Commitments and contingent liabilities	Total
	MHUF	MHUF	MHUF	MHUF
Individually impaired assets	-	57 438	11 714	69 152
Individually assessed impairment	-	(42 395)	(4 465)	(46 860)
Total	-	15 043	7 249	22 292

NOTE 25 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

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

Aging analysis of past due but not impaired financial assets as at 31 December 2015 is as follows:

	Less than 30 days MHUF	30 days or more, but less than 90 days MHUF	Total MHUF
Loans to customers			
- Corporate	2 675	297	2 972
- Retail	30 719	8 351	39 070
Total	33 394	8 648	42 042

Aging analysis of past due but not impaired financial assets as at 31 December 2014 is as follows:

	Less than 30 days MHUF	30 days or more, but less than 90 days MHUF	Total MHUF
Loans to customers			
- Corporate	2 529	1 121	3 650
- Retail	40 513	8 613	49 126
Total	43 042	9 734	52 776

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

Collaterals behind impaired or past due financial assets amounted to HUF 139 308 million as at 31 December 2015 (HUF 183 319 million as at 31 December 2014). The amount of the collaterals includes the indexed or reviewed collateral value limited to the carrying amount of the related asset.

NOTE 25 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

Maximum exposure to credit risk without taking into account of any collateral and credit enhancements

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

	2015	2014
	MHUF	MHUF
Equity instruments*	6 008	3 299
Debt instruments*	643 129	606 691
Loans and advances	1 799 674	1 677 639
Derivatives*	51 190	53 765
Other assets	18 790	37 213
Total assets	2 518 791	2 378 607
Commitments to extend credit	373 190	311 553
Guarantees	148 037	137 291
Letters of credit	11 752	10 592
Total commitments and contingent liabilities	532 979	459 436
Total credit exposure	3 051 770	2 838 043

*For more information see Note 18.

The amounts shown above represent the current credit risk exposure, which may change over time as a result of changes in values (derivative financial instruments, financial investments, etc.) and changes in FX rates (due to FCY lending). The effect of collateral and other risk mitigation techniques is shown in Note 46.4.

Risk concentration of the maximum exposure to credit risk

Concentration of risk is managed by client/client group and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2015 was HUF 25 180 million (HUF 36 759 million as of 31 December 2014) before taking account of any collateral or other credit enhancements.

NOTE 26 – REMAINING MATURITY OF ASSETS AND LIABILITIES

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2015:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Not more than one year	14 626	-	2 880	938 844	88 113	60	-	1 044 523
More than one but not more than five years	47 898	-	69 664	437 980	207 374	5 678	-	768 594
More than five years	18 198	-	85 706	370 088	132 884	5 285	-	612 161
Without maturity	1 013	-	4 995	-	-	-	-	6 008
Total	81 735	-	163 245	1 746 912	428 371	11 023	-	2 431 286
Financial liabilities								
Not more than one year	17 770	79 812	-	-	-	-	1 703 785	1 801 367
More than one but not more than five years	8 138	132 186	-	-	-	7	241 003	381 334
More than five years	9 951	4 317	-	-	-	4	89 881	104 153
Without maturity	-	-	-	-	-	-	-	-
Total	35 859	216 315	-	-	-	11	2 034 669	2 286 854

Financial assets and liabilities repayable on demand are included in the not more than one year category.

NOTE 26 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2014:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Reclassified Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Not more than one year	46 273	2 571	2 251	790 938	65 443	-	-	907 476
More than one but not more than five years	35 133	-	15 341	442 633	221 857	966	-	715 930
More than five years	15 470	-	108 341	368 914	134 615	9 802	-	637 142
Without maturity	2 653	-	646	-	-	-	-	3 299
Total	99 529	2 571	126 579	1 602 485	421 915	10 768	-	2 263 847
Financial liabilities								
Not more than one year	24 740	60 237	-	-	-	-	1 649 029	1 734 006
More than one but not more than five years	9 359	132 190	-	-	-	47	223 032	364 628
More than five years	12 043	4 282	-	-	-	91	61 804	78 220
Without maturity	-	-	-	-	-	-	-	-
Total	46 142	196 709	-	-	-	138	1 933 865	2 176 854

Financial assets and liabilities repayable on demand are included in the not more than one year category.

NOTE 26 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The remaining maturity of non-financial assets and liabilities held as at 31 December 2015 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	13 603	100	13 703
Investments in associated companies	-	542	542
Investment property	740	-	740
Property and equipment	4 926	32 531	37 457
Intangible assets	2 676	9 047	11 723
Other assets	18 790	-	18 790
Total assets	40 735	42 220	82 955
Fair value changes of hedged item under portfolio hedge of interest rate risk	3 164	-	3 164
Tax liabilities	15	-	15
Provisions for risks and charges	7 292	473	7 765
Other liabilities	63 771	-	63 771
Total liabilities	74 242	473	74 715

The remaining maturity of non-financial assets and liabilities held as at 31 December 2014 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	8 194	5 271	13 465
Investments in associated companies	-	542	542
Investment property	850	-	850
Property and equipment	4 641	34 683	39 324
Intangible assets	2 275	7 773	10 048
Other assets	14 003	23 210	37 213
Total assets	29 963	71 479	101 442
Fair value changes of hedged item under portfolio hedge of interest rate risk	1 236	-	1 236
Tax liabilities	12	-	12
Provisions for risks and charges	20 669	32 580	53 270
Other liabilities	31 769	-	31 769
Total liabilities	53 686	32 580	86 266

NOTE 27 – IMPAIRMENT ON AVAILABLE-FOR-SALE FINANCIAL ASSETS

No impairment was recognised on available-for-sale assets in 2015 and 2014.

NOTE 28 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position)

	2015 MHUF	2014 MHUF
Breakdown by type		
Specific impairment for loans and receivables	46 666	115 438
Specific provision on credit commitments	5 960	4 465
Portfolio-based impairment and provision	3 813	5 385
Impairment and provision on loans and receivables and credit commitments	56 439	125 288

	2015 MHUF	2014 MHUF
Breakdown by counterparty		
Impairment for loans and advances to customers (excluding banks)	50 227	120 628
Impairment for debt instruments issued by municipalities	-	1
Specific and portfolio based provision, credit commitments	6 212	4 659
Total impairment and provision on loans and receivables and credit commitments	56 439	125 288

For more information on the change in specific impairment for loans and receivables related to the Curia Act see Note 10.

NOTE 28 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

	Specific impairment for loans and receivables MHUF	Specific provision on credit commitments MHUF	Portfolio-based impairments and provisions MHUF	Total MHUF
Opening balance as at 1 January 2015	115 438	4 465	5 385	125 288
Movements with an impact on results				
Loan loss expenses	36 183	2 702	9 841	48 726
Loan loss recoveries	(23 619)	(1 186)	(11 633)	(36 438)
Discount effect	(376)	7	-	(369)
Movements without an impact on results				
Write-offs	(18 874)	-	-	(18 874)
Other	(62 086)	(28)	220	(61 894)
Closing balance as at 31 December 2015	46 666	5 960	3 813	56 439

As a consequence of legislatory changes related to Settlement Act (see Note 10), buffer account scheme ceased to exist as from 1 February 2015 (the related HUF 439 million impairment recorded as at 31 December 2013 was reversed in 2014).

HUF 62 086 million other movement in specific impairments for loans and receivables relates mainly to loans converted to HUF according to the Curia Act representing the shift between the gross carrying amount and impairment at the conversion date (see Note 10).

NOTE 28 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

	Specific impairment for loans and receivables	Specific provision on credit commitments	Portfolio-based impairments and provisions	Total
	MHUF	MHUF	MHUF	MHUF
Opening balance as at 1 January 2014	111 329	3 196	6 968	121 493
Movements with an impact on results				
Loan loss expenses	59 078	1 659	11 301	72 038
Loan loss recoveries	(43 685)	(584)	(13 092)	(57 361)
Discount effect	(726)	6	-	(720)
Movements without an impact on results				
Write-offs	(14 311)	-	-	(14 311)
Other	3 753	188	208	4 149
Closing balance as at 31 December 2014	115 438	4 465	5 385	125 288

The Group realised HUF 7 198 million loss on loans and advances sold (HUF 6 244 million in 2014). This loss was presented as write-offs in the tables above.

NOTE 29 – DERIVATIVE FINANCIAL INSTRUMENTS

	Year ended 31 December 2015				Year ended 31 December 2014			
	Notional amount Assets	Notional amount Liabilities	Positive fair value Assets	Negative fair value Liabilities	Notional amount Assets	Notional amount Liabilities	Positive fair value Assets	Negative fair value Liabilities
Derivatives held for trading	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**
Foreign exchange derivatives								
Currency forwards	91 803	93 077	299	(1 079)	91 071	91 478	672	(653)
Currency futures	21 229	21 223	16	(11)	26 016	26 050	8	(7)
Currency swaps	448 177	448 455	1 538	(1 977)	473 408	473 316	3 472	(3 179)
Currency options	194 555	194 555	3 036	(3 110)	159 180	159 180	3 527	(3 489)
Total foreign exchange derivatives	755 764	757 310	4 889	(6 177)	749 675	750 024	7 679	(7 328)
Interest rate derivatives								
Interest rate swaps	525 241	525 241	32 016	(15 962)	514 779	514 779	32 444	(18 446)
Cross currency interest rate swaps	268 360	268 068	1 917	(2 456)	338 525	350 135	2 258	(14 610)
Interest rate options	51 730	51 730	299	(299)	59 235	59 235	513	(531)
Forward rate agreements	51 312	-	-	(29)	30 000	-	-	(24)
Total interest rate derivatives	896 643	845 039	34 232	(18 792)	942 539	924 149	35 215	(33 611)
Equity options		448		(2)	-	1 364	-	(80)
Commodity swaps	7 802	7 802	833	(833)	4 825	4 825	103	(64)
Commodity options	3 780	3 780	213	(213)				
Total derivatives held for trading	1 663 989	1 614 379	40 167	(25 971)	1 697 039	1 680 362	42 997	(41 083)
Derivatives designated as cash flow hedges								
Interest rate swaps	86 878	86 878	6 482	-	120 616	120 616	8 860	-
Derivatives designated as portfolio fair value hedges								
Interest rate swaps	158 100	158 100	4 541	(11)	104 100	104 100	1 908	(138)
Total derivatives held for hedging	244 978	244 978	11 023	(11)	224 716	224 716	10 768	(138)
Total derivative financial instruments	1 908 967	1 859 357	51 190	(25 982)	1 921 755	1 905 078	53 765	(41 221)

NOTE 29 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Options

Although options are not accounted for as hedges, the Group has an operational policy where the risks of options sold and purchased are matched on a one to one basis with offsetting deals conducted with counterparties of sound credit standing.

The Group has started to apply hedge accounting for some of its derivatives concluded in frame of Asset and Liability Management.

Cash flow hedge of interest rate risk

The aim of the cash-flow hedges designated by the Group is to hedge changes in cash flows group of assets and liabilities related to changes in interest and foreign exchange rates. The hedging instruments are EUR and HUF interest rate swaps.

Hedging relationships are subject to prospective and retrospective effectiveness measurement. Fair value changes in hedging instruments for the effective part of the hedging relationship are recognised in Other comprehensive income and are accumulated to Cash flow hedge reserve. Since the exchange revaluation result of the hedged assets and liabilities is recorded as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange, the foreign exchange revaluation effect of the hedging cross currency interest rate swaps recorded in Other comprehensive income was transferred to the Consolidated income statement at the same time.

The Group transferred HUF 536 million gain to the net profit from other comprehensive income excluding the ineffective part (5 575 million gain in 2014). In 2015 the Group transferred HUF 313 million loss to the net profit due to ineffectiveness (HUF 239 million gain in 2014).

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

	2015		2014	
	Expected cash flows		Expected cash flows	
	Inflow	Outflow	Inflow	Outflow
	MHUF	MHUF	MHUF	MHUF
< 3 months	208	(213)	217	(130)
3-6 months	206	(83)	343	(131)
6 months - 1 year	1 191	(276)	972	(329)
1-2 years	1 697	(557)	1 648	(612)
2-5 years	4 605	(2 324)	4 416	(2 157)
> 5 years	971	(572)	2 484	(1 485)
Total	8 878	(4 025)	10 080	(4 844)

The comparative figures presented in the table above have been changed compared to the figures presented in the Notes to the consolidated financial statements of the previous year. Changes were needed to correct an error in the calculation of the expected cash inflows and outflows.

There is no forecast transactions for which hedge accounting had previously been used but which is no longer expected to occur as at 31 December 2015 (HUF 293 million as at 31 December 2014).

NOTE 29 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Portfolio fair value hedge of interest rate risk

The Group designated a fair value hedging relationship in 2014. The risk to be hedged is interest rate risk, arising from changes in fair value of portfolio of non-maturity deposits to changes in the risk-free (interest rate swap) yield curve. The hedging instruments are HUF interest rate swaps.

The accumulated fair value changes of hedged item under portfolio hedge of interest rate risk is presented separately in the consolidated statement of financial position and amounted to HUF 3 164 million loss in 2015 (HUF 1 236 million loss in 2014). The loss recorded on the hedged item was compensated by a gain recorded on the hedging instrument in the same amount. The fair value changes of the hedged item and the hedging instrument in the current year is recorded as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange in the consolidated income statement.

Individual fair value hedge of fixed rate available-for-sale bonds

The Group usually ensures the sufficient level of liquid assets by purchase of available-for-sale government bonds. The Group defines the risk to be hedged as the interest rate risk arising from changes in fair value of available-for-sale bonds to changes in the risk-free (interest rate swap) yield curve. The hedging instruments are fixed rate payer-floating rate receiver (BUBOR 3M-6M) interest rate swaps.

The changes in the fair value of the available-for-sale government bonds and the interest rate swaps due to interest rate risk are offset in the consolidated income statement and the unhedged credit spread of the bonds remains in the consolidated other comprehensive income.

NOTE 30 – OTHER ASSETS

	2015 MHUF	2014 MHUF
Prepayments	3 141	1 528
Trade receivables	649	555
Receivables from employees	15	16
Receivables from bankcard service	4 521	4 413
Items in transit due to payment services	550	1 017
Receivables from compensation (see Note 36)	30	23 212
Items in transit due to trading in securities	53	51
Income accruals and cost prepayments	4 365	3 656
Inventories	4 916	2 340
Other receivables	550	425
	18 790	37 213

NOTE 31 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES

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

For the period ended 31 December 2015:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	-	-	-
Losses carry forward	26	-	(75)	-
Tangibles and intangibles assets	1 468	-	(113)	-
Provision for expected loss in relation to the Curia Act and adjustment of carrying amount of loans and advances due to re-estimation of future cash flows	5 128	-	(4 246)	-
Other provisions for risk and charges and credit commitments	151	-	2 546	-
Impairment for losses on loans and advances	204	-	37	-
Financial instruments at fair value	2 890	-	344	-
Fair value adjustments AFS	(3 172)	-	-	(922)
Cash flow hedge	(1 109)	-	-	(68)
Other*	314	-	(3 377)	-
Total	5 900	-	(4 884)	(990)

For the period ended 31 December 2014:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	-	-	-
Losses carry forward	101	-	(19)	-
Tangibles and intangibles assets	1 581	-	4	-
Provision for expected loss in relation to the Curia Act and adjustment of carrying amount of loans and advances due to re-estimation of future cash flows	9 374	-	9 374	-
Other provisions for risk and charges and credit commitments	(2 395)	-	(2 559)	-
Impairment for losses on loans and advances	167	-	(151)	-
Financial instruments at fair value	2 546	-	1 977	-
Fair value adjustments AFS	(2 250)	-	-	(2 505)
Cash flow hedge	(1 041)	-	-	(1 574)
Other*	3 691	-	4 519	-
Total	11 774	-	13 145	(4 079)

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

NOTE 31 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (continued)

In 2015 and 2014, based on the actual corporate income tax law income taxes were calculated on all temporary differences under the asset and liability method using a tax rate of 20.62% (19% corporate income tax and 1.62% local business tax).
Deferred income tax for tax losses carried forward is calculated to the extent that realisation of the related tax benefit is assessed as probable. The tax benefit resulting from losses arising before 1 January 2015 can be realised for 10 years after the financial period they arose in. Losses carry forward from financial periods beginning on or after 1 January 2015 can be utilized for 5 years.

From the total of HUF 1 308 million tax losses carried forward as at 31 December 2015 (HUF 1 804 million at 31 December 2014), HUF 1 171 million (HUF 1 272 million at 31 December 2014) has been assessed as not being probable, and therefore was not included in the base of the deferred tax calculation. Tax loss carried forward for which the tax asset was recognised in the consolidated statement of financial position amounted to HUF 137 million as at 31 December 2015 (HUF 532 million as at 31 December 2014).

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

NOTE 32 – INVESTMENTS IN ASSOCIATED COMPANIES

	2015 MHUF	2014 MHUF
HAGE Zrt.	542	542
Total	542	542

	2015 MHUF	2014 MHUF
Opening balance	542	2 142
- Sale of investments	-	(1 625)
- Carrying value, transfers, liquidation	-	(16)
- Share in the result for the period	-	41
Closing balance	542	542

The Group sold its investment in GIRO Elszámolásforgalmi Zrt. in 2014. The result realised on the sale was recorded as Other income in the consolidated income statement (see Note 9).

NOTE 32 – INVESTMENTS IN ASSOCIATED COMPANIES (continued)

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

The table below includes the financial information of the associates as at 31 December 2015.

	Total assets	Revenue	Profit or loss
	MHUF	MHUF	MHUF
HAGE Zrt.	10 852	7 437	169

The table includes preliminary financial data for HAGE Zrt.

The table below includes the financial information of the associates as at 31 December 2014.

	Total assets	Revenue	Profit or loss
	MHUF	MHUF	MHUF
HAGE Zrt.	10 825	7 499	435

NOTE 33 – INVESTMENT PROPERTIES

	Investment properties MHUF
At 31 December 2013	
Cost	629
Accumulated depreciation	(36)
Net book value	593
Movements in 2014	
Additions	720
Disposals - net	(391)
Impairment charge	(67)
Depreciation charge	(5)
At 31 December 2014	
Cost	900
Accumulated depreciation	(50)
Net book value	850
Movements in 2015	
Additions	156
Disposals - net	(242)
Impairment charge	(11)
Depreciation charge	(13)
At 31 December 2015	
Cost	798
Accumulated depreciation	(58)
Net book value	740

Investment properties include collaterals obtained by taking in possession. The Group intends to sell investment properties within a reasonable time period.

NOTE 33 – INVESTMENT PROPERTIES (continued)

The difference between the fair value and the carrying amount of the assets is immaterial as at 31 December 2015 (and as at 31 December 2014).

The Group believes that the carrying amount of investment properties approximates their fair value (classified as level 3 in the fair value hierarchy).

NOTE 34 – PROPERTY AND EQUIPMENT

	Land and buildings	IT equipment	Office equipment	Other	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
At 1 January 2014					
Cost	48 961	16 126	9 933	3 571	78 591
Accumulated depreciation	(14 755)	(12 838)	(7 535)	(1 531)	(36 659)
Net book value	34 206	3 288	2 398	2 040	41 932
Movements in 2014					
Additions (acquired separately)	914	1 146	313	305	2 678
Disposals - net	-	-	(1)	(418)	(419)
Impairment charge	(223)	(17)	(35)	(91)	(366)
Depreciation charge	(2 304)	(1 032)	(761)	(376)	(4 473)
Other	(7)	10	115	(146)	(28)
At 31 December 2014					
Cost	49 109	14 797	9 793	2 685	76 384
Accumulated depreciation	(16 523)	(11 402)	(7 764)	(1 371)	(37 060)
Net book value	32 586	3 395	2 029	1 314	39 324
Movements in 2015					
Additions (acquired separately)	1 923	404	558	566	3 451
Disposals - net	(17)	(1)	-	(330)	(348)
Impairment charge	(690)	(3)	(13)	(71)	(777)
Depreciation charge	(2 278)	(981)	(648)	(284)	(4 191)
Other	-	(2)	-	-	(2)
At 31 December 2015					
Cost	47 895	11 424	9 824	2 616	71 759
Accumulated depreciation	(16 371)	(8 612)	(7 898)	(1 421)	(34 302)
Net book value	31 524	2 812	1 926	1 195	37 457

NOTE 34 – PROPERTY AND EQUIPMENT (continued)

Expenditure on items in the course of construction amounted to HUF 4 259 million as at 31 December 2015 (HUF 4 195 million as at 31 December 2014).

Fully amortised tangible assets which were still in use amounted to HUF 15 278 million as at 31 December 2015 (HUF 17 042 million as at 31 December 2014).

NOTE 35 – INTANGIBLE ASSETS

	Acquired software MHUF	Other intangible assets MHUF	Total MHUF
At 1 January 2014			
Cost	34 114	90	34 204
Accumulated depreciation	(24 868)	(51)	(24 919)
Net book value	9 246	39	9 285
Movements in 2014			
Additions (acquired separately)	3 241	-	3 241
Impairment charge	(22)	-	(22)
Depreciation charge	(2 306)	-	(2 306)
Other	(113)	(37)	(150)
At 31 December 2014			
Cost	37 179	6	37 185
Accumulated depreciation	(27 133)	(4)	(27 137)
Net book value	10 046	2	10 048
Movements in 2015			
Additions (acquired separately)	4 368	-	4 368
Impairment charge	(8)	-	(8)
Depreciation charge	(2 685)	-	(2 685)
At 31 December 2015			
Cost	41 453	6	41 459
Accumulated depreciation	(29 732)	(4)	(29 736)
Net book value	11 721	2	11 723

Fully amortised intangible assets which were still in use amounted to HUF 23 459 million as at 31 December 2015 (HUF 23 547 million as at 31 December 2014).

NOTE 36 – PROVISIONS FOR RISK AND CHARGES

	Provision for restructuring MHUF	Provision for tax litigation and pending legal disputes MHUF	Other MHUF	Total MHUF
Balance as at 1 January 2014	69	33 431	15	33 515
Amounts allocated	-	698	16 012	16 710
Amounts used	(14)	(1 503)	-	(1 517)
Unused amounts reversed	-	(257)	(4)	(261)
Discount effect	-	216	-	216
Other (foreign exchange revaluation)	-	-	(73)	(73)
Balance as at 31 December 2014	55	32 585	15 950	48 590
Amounts allocated	-	1 002	713	1 715
Amounts used	(31)	(21 933)	(16 065)	(38 029)
Unused amounts reversed	-	(10 820)	(3)	(10 823)
Discount effect	-	100	-	100
Other (foreign exchange revaluation)	-	-	(1)	(1)
Balance as at 31 December 2015	24	934	594	1 552

In 2014 HUF 15 511 million other provision was recorded related to the Curia Act on the expected loss arising from the pay-offs due to loans matured before 31 December 2014 (see Note 9 and Note 10). In 2015 an additional provision of HUF 279 million was recorded for the expected loss to reflect the changes in the regulation in 2015 . The total loss of the Curia Act realized in 2015 amounted to HUF 15 639 million in 2015 which is presented as Amounts used in the table above.

From the total of HUF 32 585 million provision for pending legal disputes at the end of 2014 the Group had a provision of HUF 31 795 million for its liability to clients as a result of the fraud that occurred at K&H Equities during and prior to 2003. In 2003, the two shareholders of the Bank, KBC Bank N.V. and ABN Amro Bank N.V., issued a letter of commitment that they will maintain the legally required level of equity in the Bank. The Bank also issued a letter of commitment that it will maintain the legally required level of equity at K&H Equities.

In 2006 the letter of commitment of ABN Amro Bank N.V. was replaced by an indemnity agreement between KBC Bank N.V., ABN Amro Bank N.V., K&H Bank and K&H Equities. Under this agreement ABN Amro Bank N.V. indemnifies 40% of the payments to clients based on finalised Court decisions. According to the insurance agreement which was subscribed in 2008, the insurance company partly reimburses the loss of the Group resulting from compensation payments to clients.

The total compensation income expected and recorded in other net income / (expense) in previous years and recorded as an asset at 31 December 2014 amounted to HUF 23 210 million.

NOTE 36 – PROVISIONS FOR RISK AND CHARGES (continued)

The loss realized by the Group amounted to HUF 21 802 million in 2015 presented as Amounts used in the table above. The remaining provision of HUF 10 094 million and the previously expected compensation amount of HUF 7 076 million were reversed in 2015 in other net income / (expense) (see Note 9).

The K&H Group is also party to litigation and claims arising in the normal course of business, the provision of HUF 934 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2015 relates to these litigations (HUF 790 million at 31 December 2014). Management considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 6 213 million as at 31 December 2015 (HUF 4 659 million as at 31 December 2014) is presented in Note 28. The total of HUF 1 552 million provision for risk and charges and the total of HUF 6 213 million provisions for credit commitments amounts to HUF 7 765 million (HUF 53 249 million in 2014).

NOTE 37 – OTHER LIABILITIES

	2015 MHUF	2014 MHUF
Trade creditors	11 522	8 032
Lease liabilities	510	514
Items in transit due to payment services	33 876	7 738
Items in transit due to lending activity	675	228
Liabilities from bankcard service	2 500	2 032
Other	14 688	13 225
Total other liabilities	63 771	31 769

Other includes trading tax liabilities, social charges, liability from transactional levy not settled yet, liabilities due to employees and other accrued charges and deferred income arising from the normal course of business recorded as general administrative expenses in the Consolidated income statement.

NOTE 38 – SHARE CAPITAL

	2015 MHUF	2014 MHUF
Ordinary shares issued and outstanding	140 978	140 978

The nominal value of the ordinary shares issued and outstanding at 31 December 2015 is HUF 1 per share (31 December 2014: HUF 1).

NOTE 38 - SHARE CAPITAL (continued)

Shareholders of the Bank:

	2015 Shareholding %	2014 Shareholding %
KBC Bank N. V.	100.00%	100.00%
	100.00%	100.00%

NOTE 39 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES

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

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

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

Financial guarantees are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. The credit risk involved in issuing guarantees is essentially the same as that involved in extending credit facilities to other customers. The Group applies similar principles as those applied in assessing the required allowance for losses under other credit facilities when assessing the likelihood of loss under the guarantee.

Letters of credit represent a financing transaction by a Group to its customer where the customer is usually the buyer/importer of goods and the beneficiary is typically the seller/exporter. Credit risk is limited as the merchandise shipped serves as collateral for the transaction.

NOTE 39 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

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

	2015	2014
	MHUF	MHUF
Credit commitments – undrawn amount		
Received	25 069	10 373
Given		
Irrevocable	213 433	176 330
Revocable	160 091	135 537
Total given	373 524	311 867
Collaterals		
Given	153 748	141 637
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets	228 334	327 389
Financial assets	2 204	11 797
For assets that are not impaired or past due		
Non-financial assets	1 180 957	1 245 860
Financial assets	298 018	237 537
Total guarantees received/collateral	1 709 513	1 822 583
Other commitments given – irrevocable	11 920	10 592

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

The total of collateral received to mitigate the maximum exposure to credit risk (value of the collateral as described below limited to the carrying amount of the related asset) amounts to HUF 829 696 million as at 31 December 2015 (HUF 913 252 million as at 31 December 2014). Collaterals include the fair value for financial instruments. The collateral value of retail mortgages comprise the indexed property value calculated from the property value at loan origination revalued via house price index. Corporate non-financial collaterals are presented based on their periodically reviewed collateral value.

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Group has an established protocol of dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Group makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year-end the Group had several unresolved legal claims in the amount of HUF 5 192 million (HUF 5 791 million as at 31 December 2014) where the Group has been advised by its legal advisor that it is possible, but not probable, that the action will succeed. Accordingly no provision for these claims has been made in these consolidated financial statements.

NOTE 40 – FINANCE AND OPERATING LEASES

Lessor position

The Group operates in the domestic leasing market and provides both finance and operating lease products to customers. Certain lease contracts designated as operating lease under Hungarian Accounting Standards are designated as finance lease according to the IFRS terminology.

The assets leased out by the Group are predominantly cars and trucks. In finance lease, the lessee selects an asset and the Group purchases that asset and gives it to the lessee. In this way the Group acts as a financier of the assets borrowed by the lessee. The lessee will have to use the asset during the lease period and will have to pay for the cost of repairs, maintenance and insurance of the asset. The Group is the legal owner of the asset during the period of lease and recovers a major part of the cost of the asset plus interest earned from lease payment by the lessee. The lessee assumes some risks of the ownership and enjoys some of the benefits. The lessee or the third party has the option to acquire ownership of the asset by paying a nominal price which is the repurchase price.

The following tables indicate the key amounts of the Group's lease activity:

	2015 MHUF	2014 MHUF
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	15 968	15 886
one to five years	26 317	20 688
more than five years	5 709	277
	47 994	36 851
The present value of minimum lease payments receivables*:		
less than one year	12 244	12 724
one to five years	22 739	16 114
more than five years	1 998	237
	36 981	29 075
Unearned finance income	11 013	7 776
Contingent rents recognized as income - gross	1 143	1 472
Non-guaranteed residual values	11 896	6 932

*Net of impairment.

The total impairment recorded on finance lease receivables amounted to HUF 2 926 million as at 31 December 2015 (HUF 4 232 million as at 31 December 2014).

NOTE 40 – FINANCE AND OPERATING LEASES (continued)

The Group has car lease contracts with third parties that do not comply with the definition of a finance lease under IFRS, such contracts are treated as operating leases in the consolidated financial statements:

	2015 MHUF	2014 MHUF
Total of future minimum lease payments:		
less than one year	31	568
	31	568
Contingent rents recognised as income - gross	32	175

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

	2015 MHUF	2014 MHUF
Other equipment	1 668	1 946
Accumulated depreciation	59	235

Lessee position

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

	2015 MHUF	2014 MHUF
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	1 002	857
one to five years	7 595	7 883
more than five years	1 323	2 514
	9 920	11 254

	2015 MHUF	2014 MHUF
Minimum lease payments recognized as expense	3 732	3 696

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

Half of the future minimum lease payments results from the renewable agreement related to a part of the new headquarter building, which part is not owned by the Group.

NOTE 41 – RELATED PARTY TRANSACTIONS

For the purposes of these financial statements, related parties include all enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with the Bank (this includes parents, subsidiaries and fellow subsidiaries), key management and associated companies.

Parent:

KBC Bank N.V. owns 100.00% of the ordinary shares in K&H Bank (2014: 100.00%). The ultimate parent of the Group is KBC Group N.V.

Subsidiaries:

See list of subsidiaries in Note 43.

Associates:

See list of associates in Note 43.

Members of KBC Group and other related parties:

CBC Banque SA
Československa Obchodni Banka a.s.
Československa Obchodna Banka a.s.
KBC Bank Ireland Plc.
KBC Asset Management Ltd
KBC Asset Management N.V.
KBC Fund Management Limited
KBC Groep N.V.
KBC Securities N.V.
K&H Biztosító Zrt.
KBC Lease N.V. (merged into KBC Bank N.V. in 2015)
Omnia N.V.

Other related parties through key management

If the Group's key management has direct or indirect authority and responsibility for planning, directing and controlling the activity of a company outside of KBC Group, the companies are presented as other related parties through key management. The banking transactions entered into with related parties in the normal course of business including loans and deposits were carried out on normal commercial terms and conditions and at market rates. All loans and advances to related parties are performing and are free of any provision for possible loan losses.

NOTE 41 - RELATED PARTY TRANSACTIONS (continued)

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

	Parent	**Associ-ates**	**Other related parties (KBC Group)**	**Other related parties (through key management)**	**Total**
	MHUF	**MHUF**	**MHUF**	**MHUF**	**MHUF**
As at 31 December 2015					
Assets					
Loans and advances	47 406	271	2 372	6 814	56 863
Current accounts	774	-	2 372	8	3 154
Term loans	46 632	271	-	6 806	53 709
Finance leases	-	-	-	-	-
Other receivables	13	-	627	-	640
Total assets	47 419	271	2 999	6 814	57 503
Liabilities					
Deposits	47 001	46	20 562	1 905	69 514
Current accounts	14 951	46	18 681	1 390	35 068
Term deposits (with agreed maturity)	32 050	-	1 881	515	34 446
Subordinated liabilities	28 141	-	-	-	28 141
Other liabilities	354	-	947	-	1 301
Total liabilities	75 496	46	21 509	1 905	98 956
Income statement					
Net interest income	(380)	14	(129)	189	(306)
Interest income	151	14	3	192	360
Interest expense	(531)	-	(132)	(3)	(666)
Net fee and commission income	(472)	4	628	303	463
Fee and commission income	365	4	2 300	359	3 028
Fee and commission expense	(837)	-	(1 672)	(56)	(2 565)
Other net income / (expense)	(96)	-	(3 198)	-	(3 294)
Other income	41	-	936	-	977
Other expense	(137)	-	(4 134)	-	(4 271)
Total income statement	(948)	18	(2 699)	492	(3 137)
Off-statement of financial position items					
Commitments and contingent liabilities	30 977	-	5 227	154	36 358
Guarantees received	23 126	-	-	252	23 378
Notional amount of derivatives	970 134	-	6 900	-	977 034

The table excludes the fair value of derivatives.

NOTE 41 - RELATED PARTY TRANSACTIONS (continued)

	Parent	Associ-ates	Other related parties (KBC Group)	Other related parties (through key management)	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2014					
Assets					
Loans and advances	4 701	362	4 308	4 616	13 987
Current accounts	4 543	-	4 308	4	8 855
Term loans	158	362	-	4 612	5 132
Finance leases	-	-	-	-	-
Other receivables	-	-	516	-	516
Total assets	4 701	362	4 824	4 616	14 503
Liabilities					
Deposits	150 834	45	16 623	746	168 248
Current accounts	3 466	45	12 459	736	16 706
Term deposits (with agreed maturity)	147 368	-	4 164	10	151 542
Subordinated liabilities	18 881	-	-	-	18 881
Other liabilities	361	-	1 168	-	1 529
Total liabilities	170 076	45	17 791	746	188 658
Income statement					
Net interest income	(376)	22	(256)	129	(481)
Interest income	63	22	2	130	217
Interest expense	(439)	-	(258)	(1)	(698)
Net fee and commission income	(730)	29	851	200	350
Fee and commission income	167	29	2 437	237	2 870
Fee and commission expense	(897)	-	(1 586)	(37)	(2 520)
Other net income / (expense)	(139)	-	(5 661)	-	(5 800)
Other income	4	-	867	-	871
Other expense	(143)	-	(6 528)	-	(6 671)
Total income statement	(1 245)	51	(5 066)	329	(5 931)
Off-statement of financial position items					
Commitments and contingent liabilities	28 574	-	4 983	168	33 725
Guarantees received	34 843	-	-	214	35 057
Notional amount of derivatives	1 007 542	-	7 372	-	1 014 914

The table excludes the fair value of derivatives.

NOTE 41 - RELATED PARTY TRANSACTIONS (continued)

Transactions with key management

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

Loans

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

The outstanding amount of the housing loans of key management at 31 December 2015 was HUF 410 million (HUF 355 million at 31 December 2014), with the long-term maturity obligations ranging from 15-20 years.

Deposits

In accordance with the Group's internal policy, all the employees of the Group, including key management staff are entitled to have a bank account and a securities/bond account with condition of K&H 4000+ account package offered for companies with number of employees over 4 000. According to this package the interest paid on deposit is the basic interest rate of the Hungarian National Bank less 3.25% but if it is negative, then the interest rate for the K&H Demand Deposit Account.

At 31 December 2015 the outstanding amount of deposits was HUF 659 million (HUF 685 million at 31 December 2014). In 2015 the Bank paid HUF 4 million interest on these deposits (HUF 10 million in 2014).

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

Type of benefit	**2015** **MHUF**	**2014** **MHUF**
Short-term employee benefits	2 012	1 997
Other long-term benefits	57	54
Share based payment (cash settled)	91	104
Total benefits	2 160	2 155

The liability of HUF 336 million (HUF 335 million in 2014) resulting from the carrying amount of share based payment is recorded as other liability in the consolidated statement of financial position.

Share based payment

The Group applies specific rules for Key Identified Staff (KIS). The performance-based remuneration of Key Identified Staff is awarded in a manner which promotes sound risk management and does not induce excessive risk-taking. This is ensured by specific rules, which are applicable to the variable remuneration of Key Identified Staff:

- At least 40% of variable remuneration awarded to Key Identified Staff may not be paid straightaway and its payment is spread over a period of three years;
- Half of the total amount of variable remuneration for Key Identified Staff is awarded in the form of non-cash instruments (phantom shares) with a one-year retention period;
- No advance payments may be made in relation to the variable component and claw-back/holdback is put in place (evidence of misconduct or serious error; significant deterioration in the financial performance of the Group; major shortcomings in risk management; significant changes in the economic or regulatory capital base of the Group).

NOTE 41 - RELATED PARTY TRANSACTIONS (continued)

Key Identified Staff who are allocated variable compensation of less than the amount stated in the Remuneration Policy are considered exempt Key Identified Staff. (In this case, variable remuneration is not subject to three years' deferral and payment in non-cash instruments, but 100% of the variable remuneration is settled upfront in cash.) The employees whose variable remuneration is subject to deferral and payment in non-cash instruments are called material Key Identified Staff.

Structure for 2015 variable compensation of material Key Identified Staff

	Individual variable remuneration awarded for 2015 performance year			
	Upfront part		Deferred part	
General deferral rule	(60% of award)		(40% of award)	
In case of the CEO, provided the total variable compensation is below the limit prescribed in the Remuneration Policy	(50% of award)		(50% of award)	
In case of all KIS whose variable compensation is equal to or exceeds the limit prescribed in the Remuneration Policy	(40% of award)		(60% of award)	
	Cash (50% of Upfront)	Non-cash instrument (50% of Upfront)	Cash (50% of Deferred)	Non-cash instrument (50% of Deferred)
Vesting schedule	fully vested at Grant (April 2016)	fully vested at Grant (April 2016)	3-year equal vesting tranches (April 2017, 2018, 2019)	3-year equal vesting tranches (April 2017, 2018, 2019)
Retention period		retention period ends April 2017		retention period ends one year after vesting (April 2018, 2019, 2020)

The cash is payable following vesting. The non-cash instrument is payable following the retention period.

The number of phantom shares to which each Key Identified Staff is entitled is calculated based on the average price of the KBC share during the first three months of the year following the year to which the variable remuneration relates. Phantom shares are converted into cash on the basis of the average price of the KBC share during the first three months of the pay-out year.

NOTE 41 - RELATED PARTY TRANSACTIONS (continued)

	2015		2014	
	number of shares	weighted average share price* HUF/share	number of shares	weighted average share price* HUF/share
Outstanding as at the beginning of the period	19 553	10 069	18 654	6 932
Granted	4 037	15 936	9 017	13 711
Exercised	(8 360)	10 043	(8 118)	7 254
Transferred**	(178)	10 043	-	-
Outstanding as at the end of the period	15 052	11 748	19 553	10 069

*Share prices as at the grant date weighted by the number of shares granted at that date.
**Shares granted to employees moving between KBC entities during the year may increase/decrease the number of shares to be exercised or paid off by the Group. These changes are presented as transferred shares.

The value of the phantom shares outstanding as at 31 December 2015 based on the year-end closing price of KBC shares was 17 385 HUF/share (13 337 HUF/share as at 31 December 2014).

There were no shares exercisable as at 31 December 2015 (and as at 31 December 2014).

The weighted average share price of shares converted to cash as at the date of the exercise was 15 936 HUF/share in 2015 (13 711 HUF/share in 2014).

The weighted average remaining contractual life of phantom shares outstanding as at 31 December 2015 is 13 months (14 months in as at 31 December 2014).

The Group applied the share based payment plan for the 2015 performance as well.

As at 31 December 2015 the information related to the number of phantom shares for the 2015 performance is not available, since the first grant date is in April 2016.

From the grant date phantom shares are valued based on the quoted market prices of KBC shares. No intrinsic value is recorded.

NOTE 42 – AUDITOR'S REMUNERATION

The remuneration recognised due to the audit of annual accounts performed by Ernst & Young Audit Kft. amounted to HUF 209 million in 2015 (HUF 192 million in 2014). In 2015 an additional remuneration of HUF 5 million was either accrued or paid to the auditor for other services, such as agreed upon procedures related to internal control statement of management (HUF 3 million in 2014).

NOTE 43 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2015	Effective Shareholding 2014
Fully consolidated subsidiaries		%	%
K&H Autópark Kft.	Operating lease	100	100
K&H Eszközlízing Kft.	Operating lease	100	100
K&H Alkusz Kft. "v.a."	Insurance broker	100	100
K&H Lízing Zrt. "v.a."	Finance lease	100	100
K&H Ingatlanlízing Zrt.	Finance lease	100	100
K&H Befektetési Alapkezelő Zrt.	Fund manager	100	100
K&H Csoportszolgáltató Kft.	Group service center	100	100
K&H Equities Zrt.	Business and management consultancy	100	100
K&H Faktor Zrt.	Other financial services	100	100
Not consolidated investments under control			
K&H csúcstámadás zártkörű alap	Investment fund	91	91
Associates consolidated using the equity method			
HAGE Zrt.	Meat processing	25	25

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

The principal place of business of the companies mentioned in the table is Hungary.

NOTE 44 – SUBSEQUENT EVENTS

There were no subsequent events to be reported till the approval of the Consolidated Financial Statement.

NOTE 45 – RECONCILIATION OF STATUTORY ACCOUNTS TO IFRS ACCOUNTS

	Profit for the year MHUF	Shareholders' equity [1] MHUF	Assets MHUF	Subordinated debt and liabilities MHUF
Bank accounts prepared under Hungarian Accounting Rules	32 081	179 414	2 607 217	2 395 722
Adjustments for IFRS accounts				
Capitalization of VAT, finance leases and revaluation of real estates	201	(3 394)	(2 683)	510
Portfolio-based allowance for loan losses	286	(1 907)	(1 368)	253
Specific allowance for loan losses	(569)	1 691	850	(272)
Carrying amount of securities[2]	622	(3 221)	(6 348)	(3 749)
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	(1 344)	(7 059)	2 818	11 221
Fair valuation of AFS portfolio	(118)	15 261	15 143	-
Cash flow hedge	(327)	327	-	-
Funding for Growth Scheme launched by the National Bank of Hungary	-	-	(12 604)	(12 604)
Amortisation of loan origination fees	1 228	(383)	924	79
Adjustment of carrying amount of loans and advances due to re-estimation of future cash flows	9 993	(10 028)	(51)	(16)
Income tax	(4 874)	10 447	5 848	275
Bank standalone IFRS	37 179	181 133	2 609 746	2 391 434
Subsidiaries accounts prepared under Hungarian Accounting Standards	6 084	4 972	55 049	43 993
Adjustments for IFRS accounts				
Portfolio-based allowance for loan losses	20	(31)	(9)	2
Finance leases	(266)	66	(70)	130
Specific allowance for loan losses	1	-	-	(1)
Deferred tax	4	53	58	1
Subsidiaries standalone IFRS	5 843	5 060	55 028	44 125
Adjustments for consolidation	(5 159)	(2 669)	(81 818)	(73 990)
Balance per IFRS report	37 863	183 524	2 582 956	2 361 569

[1] Excluding the current year profit
[2] The carrying amount of securities differs under Hungarian and International Accounting Rules. The difference results from the diverse accounting treatment of delivery repos in the past.

NOTE 46 – RISK MANAGEMENT

46.1 General

The Group is not only a universal commercial bank and a major player in the Hungarian market but also part of the KBC Group. As such the activities of the Group cover a wide range including the retail, corporate and the professional money market segments. In its role as a financial intermediary, the Group faces different uncertainties presenting both risk and opportunity at the same time. The challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value.

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

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

The Group risk management activity is primarily based on the on-going Internal Capital Adequacy Assessment Process (ICAAP) that is aligned with international standards and KBC Group principles. The ICAAP is subject of annual Supervisory Review and Evaluation Process (SREP) conducted by the local supervisor in the frame of Joint Capital Decision of home and host supervisors.

The Group has Recovery Plan prepared according to the guidelines set out by local supervisor.

Risk management governance model

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

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

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

NOTE 46 – RISK MANAGEMENT (continued)

Risk measurement and – monitoring

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

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

- Measurement of risks; qualitative and quantitative assessment of exposure to risk. The Group uses amongst others the following risk measures for the following most significant risk types:
  - Credit default and migration risks: nominal positions (outstanding/exposure), PD (probability of default), LGD/EL (loss given default/expected loss), credit concentration ratios, loan delinquency ratios, renegotiated loan ratios, credit loss ratios, RWA, stress test results;
  - Trading risk: BPV (basis point value), historic VaR (value at risk), and stress test results;
  - ALM (asset-liability management) risk: BPV, results of stress test on interest income, parametric VaR;
  - Operational risk: KRI (key risk indicator), results of risk self-assessment, level of compliance with Group Standards, availability of crisis management plans;
  - Liquidity risk: liquidity gaps, loan-to-deposit ratio, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), liquidity concentration ratios, stress test results.

- Setting limits; is a way of authorizing specific forms of risk taking. A limit indicates how much risk the Group considers being ‘an acceptable maximum’ for a portfolio or a segment of a portfolio. They reflect the general risk appetite, set by the Board of Directors. This general risk appetite cascades down in specific risk limits or tolerances that reflect the degree of acceptable variation to the achievement of objectives. Risk limits are agreed upon by the Board of Directors.

- Reporting; delivery of risk measurement results and compliance with the limits (comparison of risk exposure with the risk limit) to the decision makers (relevant risk committees) in a structured format. The main types of reports used in the Group:
  - exposures to key risk types,
  - key risk indicators,
  - limit breaches,
  - losses,
  - advice from risk management department regarding the risk response.

  A dual reporting system by the local value and risk departments exists: hierarchical reporting to the local Executive Committee via the local risk committees, and functional reporting via the KBC Group Value and Risk Management to the group risk committees and on to the KBC Group Executive Committee.

- Monitoring and response to shortcomings; the purpose of responding to risks is to constrain threats and take advantage of the opportunities. Management (or respective decision makers) need to come up with a response to risk and define, implement and execute controls instruments that help to achieve a residual risk level aligned with the Group’s risk limits.

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

46.2 Liquidity risk and funding management

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

NOTE 46 – RISK MANAGEMENT (continued)

The objective of the liquidity risk management framework is to limit liquidity risks by taking into account an adequate level of funding, the potential growth of the Group, and in considering liquidity shocks to guarantee the availability of sufficient cash flow to meet all of the Group's financial commitments:

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

The Group assesses the following liquidity risk aspects:

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

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

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

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

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

NOTE 46 – RISK MANAGEMENT (continued)

The following tables present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2015. For held-for-trading derivatives fair values are disclosed in the table.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	41	-	1 364 741	1 364 782
Less than three months	2 851	9 824	24 761	-	244 494	281 930
More than three months but not more than one year	5 031	-	55 864	1 038	109 548	171 481
More than one but not more than five years	8 138	-	138 219	3 416	247 748	397 521
More than five years	9 951	-	3 568	399	99 164	113 082
Total	25 971	9 824	222 453	4 853	2 065 695	2 328 796

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	373 524	153 748	11 752	539 024
Less than three months	-	-	-	-
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	373 524	153 748	11 752	539 024

NOTE 46 – RISK MANAGEMENT (continued)

The tables below present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2014. For held-for-trading derivatives fair values are disclosed in the table.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	158	-	1 156 611	1 156 769
Less than three months	4 397	4 938	20 281	88	365 854	395 558
More than three months but not more than one year	15 284	-	40 597	855	142 797	199 533
More than one but not more than five years	9 359	-	140 093	3 294	229 126	381 872
More than five years	12 043	-	3 827	999	64 748	81 617
Total	41 083	4 938	204 956	5 236	1 959 136	2 215 349

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	311 866	141 637	10 592	464 095
Less than three months	-	-	-	-
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	311 866	141 637	10 592	464 095

The Group's exposure to the risk arising from the outflows of cash or other financial asset which can occur significantly earlier or can be for significantly different amounts from the data presented in the tables above is immaterial.

NOTE 46 – RISK MANAGEMENT (continued)

The Group uses different ratios to measure and limit liquidity risk that arises from financial intermediation. The operational liquidity is monitored via limits on the unsecured liquidity gap, stress tests and “Basel III” and local regulatory liquidity indicators. From a structural liquidity point of view a group wide stable funding ratio is used. The Group is also analysing liquidity stress test results.

Operational liquidity is measured by the unsecured liquidity gap limit. The operational liquidity gap is the difference between the cash in and outflows in different time horizons (5 day, 30 days) and an internal limit was set for the gap to be covered by National Bank of Hungary eligible collaterals. The Group had sufficient liquidity gap surplus in 2015 and 2014, having increasing reliance on sight deposits.

Liquidity stress tests

Contingency liquidity risk is assessed in the Group on the basis of several liquidity stress scenarios. The aim of the stress tests is to measure how the liquidity buffer of the Group evolves under stressed scenarios. For each scenario the evolution of the liquidity buffer is calculated: this is the amount of excess liquidity per time bucket. Excess liquidity is the amount of cash that is available which is not required to cover immediately maturing liabilities. The simulated liquidity buffer is the sum of two components: the expected cash evolution under stressed scenarios and the expected liquidity increasing actions under stressed scenarios. In essence, there are four different types of stress tests: K&H specific empirical scenario, 2013’s Cyprus banking crisis inspired empirical scenario, Combined general market turmoil and Central Europe specific scenarios, and a reverse stress scenario. Under all scenarios the Group would achieve the internally set survival period of one month.

Basel III and regulatory ratios

LCR and NSFR ratios prescribed in regulation from Basel III origin on liquidity measurement are calculated and reported regularly as key liquidity risk measure even until the method comes into law (from 2015 and 2018 respectively). LCR is effective from 2015 with a 60%, from January 2016 to March 2016 70%, and from April 2016 100% threshold. The Group’s LCR ratio stood at 125% at the end of 2015 and at 81% at the end of 2014 meeting all time the regulatory minimum requirement. NSFR is effective from 2018 with 100% threshold. The Group stood at 158% at the end of 2015 and at 103% at the end of 2014.

Regulatory liquidity limits on Balance Sheet Coverage, Deposit Coverage and FX funding adequacy ratios are measured and monitored on a monthly basis to achieve full compliance.

46.3 Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchange rates. The Group classifies exposures to market risk into either trading or non-trading portfolios.

NOTE 46 – RISK MANAGEMENT (continued)

Market risk – trading

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

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

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

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

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

VaR results can be presented as follows:

	Foreign exchange	Interest rate	Total VAR
	MHUF	MHUF	MHUF
2015 – 31 December	69	260	263
2015 – Average daily	157	285	361
2015 – Highest	696	507	767
2015 – Lowest	28	136	150
2014 – 31 December	542	204	626
2014 – Average daily	110	246	275
2014 – Highest	1 846	698	1 887
2014 – Lowest	-	98	98

NOTE 46 – RISK MANAGEMENT (continued)

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

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

Market risk – Non-trading

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

Majority of the Group's ALM risks are interest rate related risks; consequently the tolerance level is limited in BPV terms (10-basispoint upward parallel yield curve shift impact on net present value). The interest rate risk is also measured with scenario analyses (including stressed environment). In December 2015 new pillar 2 ALM capital model (ALM CM) was introduced. ALM-CM is used to determine the amount of capital that is required in view of the ALM risk profile in the banking. ALM-CM measures the impact of very severe events on the Available Capital under Pillar I. Its scope is limited to 'risks to capital', i.e. the risks that cause a decrease of the regulatory available capital. Banking book's inherent risks are interest rate risk, inflation and equity risk that are measured and monitored according to the Group approach. Foreign currency or real-estate risk is not inherent in the banking book.

The BPV tables below present the results of reasonable possible changes of the fair value of the financial instruments held at fair value on 31 December 2015 and 2014. Possible alternatives were calculated based on the scenarios of 10, 100, and 200 basis point parallel shifts in yield curves. The banking book is limited in BPV by an internally set limit. The results contain the impact of derivative exposures too.

NOTE 46 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2015	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel up	CHF	-	-	-
	EUR	(168)	(56)	(224)
	HUF	(800)	(35)	(834)
	USD	-	(2)	(2)
10 bp parallel up total		(968)	(93)	(1 060)
100 bp parallel up	CHF	-	-	-
	EUR	(1 637)	(548)	(2 184)
	HUF	(7 740)	(337)	(8 077)
	USD	-	(22)	(22)
100 bp parallel up total		(9 377)	(907)	(10 283)
200 bp parallel up	CHF	-	-	-
	EUR	(3 183)	(1 066)	(4 250)
	HUF	(14 943)	(653)	(15 597)
	USD	-	(44)	(44)
200 bp parallel up total		(18 126)	(1 763)	(19 891)

DOWN Scenarios, 31 December 2015	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel down	CHF	-	-	-
	EUR	169	56	225
	HUF	805	35	840
	USD	-	2	2
10 bp parallel down Total		974	93	1 067
100 bp parallel down	CHF	-	-	-
	EUR	1 374	578	2 312
	HUF	8 327	359	8 686
	USD	-	22	22
100 bp parallel down total		9 701	959	11 020
200 bp parallel down	CHF	-	-	-
	EUR	3 573	1 189	4 762
	HUF	17 295	742	18 037
	USD	-	44	44
200 bp parallel down total		20 868	1 975	22 843

NOTE 46 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2014	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel up	CHF	-	28	28
	EUR	(109)	(98)	(207)
	HUF	(1 273)	(108)	(1 381)
	USD	-	(2)	(2)
10 bp parallel up total		(1 382)	(179)	(1 562)
100 bp parallel up	CHF	-	284	284
	EUR	(1 067)	(936)	(2 004)
	HUF	(12 304)	(1 064)	(13 368)
	USD	-	(24)	(24)
100 bp parallel up total		(13 371)	(1 740)	(15 111)
200 bp parallel up	CHF	-	568	568
	EUR	(2 081)	(1 791)	(3 872)
	HUF	(23 711)	(2 099)	(25 810)
	USD	-	(48)	(48)
200 bp parallel up total		(25 792)	(3 370)	(29 162)

DOWN Scenarios, 31 December 2014	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel down	CHF	-	(28)	(28)
	EUR	110	98	208
	HUF	1 283	108	1 391
	USD	-	2	2
10 bp parallel down Total		1 393	180	1 573
100 bp parallel down	CHF	-	(285)	(285)
	EUR	1 124	1 026	2 150
	HUF	13 286	1 096	14 382
	USD	-	24	24
100 bp parallel down total		14 410	1 860	16 271
200 bp parallel down	CHF	-	(570)	(570)
	EUR	2 309	2 148	4 458
	HUF	27 651	2 225	29 876
	USD	-	48	48
200 bp parallel down total		29 960	3 851	33 811

NOTE 46 – RISK MANAGEMENT (continued)

Currency risk

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

Fair valuation

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

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

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

46.4 Credit risk

Credit risk is the potential shortfall relative to the value expected consequent on non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to an inter-professional transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay, or to events or measures taken by the political or monetary authorities of a particular country. The latter risk is also referred to as 'country risk'.

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the consolidated statement of financial position. The Group makes available to its customers guarantees which may require that the Group makes payment on their behalf. Such payments are collected from customers based on the terms of the credit contracts. They expose the Group to similar risks to loans and these are mitigated by the same control processes and policies.

Credit risk is managed at both transactional and portfolio level. Managing credit risk at the transactional level means that there are sound procedures, processes and applications in place to estimate the risks before and after accepting individual credit exposures. Managing the risk at portfolio level encompasses periodic reporting on (parts of) the consolidated loan portfolio, monitoring limit discipline and the specific portfolio management function.

NOTE 46 – RISK MANAGEMENT (continued)

Credit quality per class of financial assets

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

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

Credit risk management at transactional level

Acceptance

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

Supervision and monitoring

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

NOTE 46 – RISK MANAGEMENT (continued)

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

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

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

Class 12 comprises borrowers if:

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

Credit risk management at portfolio level

Monitoring is also conducted on a portfolio basis, inter alia by means of regular reports on the consolidated credit portfolio. The largest risk concentrations are, in addition, monitored via periodic reports. Limits are in place at borrower or counterparty level and for specific activities. Whereas some limits are still in notional terms, more advanced concepts (such as 'risk weighted asset', 'expected loss' and 'loss given default') are increasingly being used. During 2015 and 2014 more emphasis was put on reports that show risk information on portfolios with higher risk, or altogether new portfolios (such as Funding for Growth portfolio).

NOTE 46 – RISK MANAGEMENT (continued)

Country risk, banking

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

The following risks are included:

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

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

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

NOTE 46 – RISK MANAGEMENT (continued)

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

	2015	Reclassified 2014
	MHUF	MHUF
Industry sector		
Agriculture, forestry and fishing	81 008	88 389
Mining and quarrying	1 106	26 501
Manufacturing	188 088	188 384
Electricity, gas, steam and air conditioning supply	12 876	35 023
Water supply	10 331	12 321
Construction	16 877	17 434
Wholesale and retail trade	112 213	116 847
Transport and storage	53 540	52 259
Accommodation and food service activities	23 936	23 325
Information and communication	4 595	23 529
Financial and insurance activities	40 989	4 264
Real estate activities	49 904	63 040
Professional, scientific and technical activities	33 529	25 250
Administrative and support service activities	6 355	6 663
Public administration and defence, compulsory social security	1	14
Education	741	458
Human health services and social work activities	2 915	3 469
Arts, entertainment and recreation	467	186
Central bank	523 338	346 104
Individuals	512 123	558 995
Central governments	16 166	53 503
Municipalities	9 803	10 898
Credit institutions	73 636	57 365
Other services	6 649	6 500
Gross loans and advances	1 781 186	1 720 721
Portfolio-based impairment for loan losses	(3 561)	(5 191)
Specific impairment for loan losses	(46 666)	(115 438)
Total impairment on loans and advances (see Note 28)	(50 227)	(120 629)
Total loans and advances	1 730 959	1 600 092

For more information on the change in specific impairment for loan losses related to the Curia Act see Note 10.

NOTE 46 – RISK MANAGEMENT (continued)

Collateral and other credit enhancements

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

The inclusion of any type of collateral is subject to the assessment of the credit solvency of the client/guarantor, in the course of which the assets in question must be evaluated in compliance with the concerning internal regulations.

The main types of collateral applied are as follows:

- for retail lending, mortgages over residential real estate,
- for commercial lending, mortgage on real estate properties (both commercial and residential), state and institutional guarantees, and pledge on inventory and trade receivables,
- for securities lending cash deposits or security pledges.

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

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

The carrying amount of investment properties and other assets, which were obtained by the Group by taking possession during 2015 to HUF 261 million (HUF 741 million in 2014).

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

Credit quality of not impaired nor past due assets

The credit quality of unimpaired and not past due assets as at 31 December 2015 is presented in the table below:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	65 795	-	158 250	179 021	428 371	10 870	842 307
Standard grade	2 938	-	4 995	1 053 477	-	-	1 061 410
Sub-standard grade	12 901	-	-	437 388	-	153	450 442
Non-performing	101	-	-	10 174	-	-	10 275
Total carrying value	81 735	-	163 245	1 680 060	428 371	11 023	2 364 434

NOTE 46 – RISK MANAGEMENT (continued)

The credit quality of unimpaired and not past due assets as at 31 December 2014 is presented in the table below:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Reclassified Loans and receivables	Held to maturity	Hedging derivatives	Reclassified Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	78 550	2 571	125 933	21 368	421 915	10 636	660 973
Standard grade	2 838	-	646	1 048 017	-	-	1 051 501
Sub-standard grade	18 046	-	-	392 192	-	132	410 370
Total carrying value	99 434	2 571	126 579	1 461 577	421 915	10 768	2 122 844

Credit risk exposure for each internal risk rating

The table below includes outstanding exposure of loans and loan commitments to customers and banks (without any money market position). Past due assets are distributed to the internal risk rating classes.

	Historical default rates* 2015	Average unsecured share of exposure 2015	Total 2015	Historical default rates* 2014	Average unsecured share of exposure 2014	Total 2014
	%	%	MHUF	%	%	MHUF
High grade	0.00	65.18	299 428	0.00	52.62	181 376
Standard grade	0.20	55.19	567 105	0.32	64.99	696 043
Sub-standard grade	2.39	38.28	617 247	5.93	34.12	746 094
Impaired	100.00	23.88	177 070	100.00	32.81	238 731
Total			1 660 851			1 862 244

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

NOTE 46 – RISK MANAGEMENT (continued)

Impairment assessment

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

- individually assessed impairments
- collectively assessed impairments

Collectively assessed impairments

Portfolio-based impairment

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

Statistical impairment

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

Individually assessed impairments

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

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

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

In some cases no impairment is presented for non-performing loans and advances in the consolidated financial statements. In case of loans and advances converted to HUF according to the Curia Act and derecognised and recognised again under IAS 39 the decrease of the loan's carrying amount resulting from credit quality worsening before the conversion is recorded as adjustment of the carrying amount before any impairment at initial recognition instead of recording impairment (see Note 10).

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

NOTE 46 – RISK MANAGEMENT (continued)

Internal credit risk models and Basel III

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

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

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

46.5 Credit risk – forborne loans

The new policy on forbearance is based on the directive of the European Banking Authorities (EBA) harmonizing the definitions of forbearance and non-performing loans within the EU from 30/09/2014 on.

Forbearance is similar to distressed renegotiations, whereby the bank agrees to renegotiate the existing contracts and obligations for a borrower with financial difficulties in order to avoid default (e.g. in order to avoid overdue interest, rent, capital and/or fees).

Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments.

A concession refers to either of the following actions:

a) a modification of the terms and conditions of an existing contract because the debtor is considered unable to comply with the terms and conditions of the contract due to its financial difficulties and whereby the modification in principle would not have been granted in case the debtor would not have been in financial difficulties;
b) a total or partial refinancing of a troubled debt contract because the debtor is considered unable to comply with the terms and conditions of the troubled debt due to its financial difficulties and whereby the partial refinancing in principle would not have been granted in case the debtor would not have been in financial difficulties.

The above means that an exposure should be perceived as forborne in case that two conditions are met:

a) The bank granted concessions towards the borrower
b) due to the fact that he borrower has financial difficulties.

NOTE 46 – RISK MANAGEMENT (continued)

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

- the contract is considered as performing, including if it has been reclassified from the non-performing category after an analysis of the financial condition of the debtor showed it no longer met the conditions to be considered as non-performing;
- a minimum 2 year probation period has passed from the date the forborne exposure was considered as performing;
- regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period;
- none of the exposures to the debtor is more than 30 days past-due at the end of the probation period.

A non-performing exposure for which forbearance measurement has been applied cannot be considered as performing for at least one year after the forbearance measurement.

The rating category of the debtor does not improve due to the forbearance measurement. The Group classify borrowers with forborne exposures to at least PD9. In the following cases forborne borrowers are classified to a default status (i.e. at least PD 10):

- a second forbearance during the probation period;
- in case of 30 days past due for an amount exceeding the default materiality threshold of 2% of the exposure or HUF 250 000 during the probation period;
- partial and/or full debt forgiveness.

Forbearance measurement is applied on facility level (not on entire exposure).

The following table presents forborne loans, loan commitments and guarantees in comparison to loans, loan commitments and guarantees for which no forbearance measurement has been applied.

	2015		2014	
	Forborne	Not forborne	Forborne	Not forborne
	MHUF	MHUF	MHUF	MHUF
Gross loans	35 276	1 756 719	64 602	1 304 774
Specific impairment	(9 129)	(37 537)	(22 708)	(92 730)
Portfolio based impairment	(108)	(3 477)	(101)	(5 088)
Total loans and advances	26 039	1 715 705	41 793	1 206 956

For more information on the change in specific impairment for forborne loans and receivables related to the Curia Act see Note 10.

NOTE 46 – RISK MANAGEMENT (continued)

For comparative information to the total loan portfolio see Note 28.

	2015		2014	
	Forborne	Not forborne	Forborne	Not forborne
	MHUF	MHUF	MHUF	MHUF
Commitments and guarantees	187	539 004	264	463 829
Specific impairment	(77)	(5 883)	(84)	(4 381)
Portfolio based impairment	-	(252)	-	(194)
Total Commitments and guarantees	110	532 869	180	459 256

The table includes the amount of forborne commitments and guarantees given to corporate clients. The amount of forborne commitments and guarantees for which specific impairment was recognised amounted to HUF 187 million as at 31 December 2015 (HUF 211 million as at 31 December 2014).

The following table explains the change of forborne loans during 2015.

	2015
	MHUF
Balance as at the beginning of the period	41 793
Loans which have become forborne	5 187
Loans which are no longer considered to be forborne	(561)
Repayments	(19 924)
Change in the impairment of forborne loans	416
Other	(872)
Balance as at the end of the period	26 039

The following table explains the change of forborne loan commitments and guarantees during 2015.

	2015
	MHUF
Balance as at the beginning of the period	180
Loan commitments and guarantees which are no longer considered to be forborne	(52)
Change in the provision on forborne loan commitments and guarantees	7
Other	(25)
Balance as at the end of the period	110

The “forborne” definition as determined by the European Banking Authority was applied by the Group first in the local consolidated supervisory reports (Finrep reports) of the third quarter in 2014 therefore no comparative data is available for the tables presenting the change of forborne loans, loan commitments and guarantees during 2015.

NOTE 46 – RISK MANAGEMENT (continued)

The Group recorded HUF 1 406 million interest income on forborne loans in the consolidated income statement in 2015 (HUF 4 565 million in 2014).

The Group did not derecognise assets due to forbearance measurement in 2014.

The following table includes the analysis of forborne loans as at 31 December 2015.

	Impaired	Past due but not impaired	Not impaired nor past due	Total
	MHUF	MHUF	MHUF	MHUF
Gross loans	17 653	5 762	11 861	35 276
Specific impairment	(9 129)	-	-	(9 129)
Portfolio based impairment	-	(11)	(97)	(108)
Total forborne loans and advances	8 524	5 751	11 764	26 039

The table below presents the analysis of forborne loans as at 31 December 2014.

	Impaired	Past due but not impaired	Not impaired nor past due	Total
	MHUF	MHUF	MHUF	MHUF
Gross loans	60 756	20	3 826	64 602
Specific impairment	(22 708)	-	-	(22 708)
Portfolio based impairment	-	(3)	(98)	(101)
Total forborne loans and advances	38 048	17	3 728	41 793

For comparative information to the total loan portfolio see Note 25.

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

	2015	2014
	MHUF	MHUF
Retail	17 679	24 758
Corporate	8 360	17 035
Total forborne loans and advances	26 039	41 793

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

NOTE 46 – RISK MANAGEMENT (continued)

	2015	2014
	MHUF	MHUF
Industry sector		
Agriculture, forestry and fishing	805	1 150
Manufacturing	102	477
Electricity, gas, steam and air conditioning supply	6 088	6 458
Construction	2 068	2 252
Wholesale and retail trade	887	2 939
Transport and storage	20	58
Accommodation and food service activities	2 230	2 712
Information and communication	26	6
Financial and insurance activities	-	1
Real estate activities	3 225	14 274
Professional, scientific and technical activities	-	7
Administrative and support service activities	1	13
Human health services and social work activities	-	2
Individuals	19 824	34 253
Forborne loans and advances - gross	35 276	64 602
Portfolio-based impairment for loan losses	(108)	(101)
Specific impairment for loan losses	(9 129)	(22 708)
Total impairment on forborne loans and advances	(9 237)	(22 809)
Total forborne loans and advances	26 039	41 793

For comparative information to the total loan portfolio see Note 46 – Credit risk.

The table below includes the geographical breakdown of forborne loans.

	2015	2014
	MHUF	MHUF
Hungary	35 276	51 876
East-European countries	-	12 726
Total forborne loans and advances	35 276	64 602

For comparative information to the total loan portfolio see Note 24.

NOTE 46 – RISK MANAGEMENT (continued)

46.6 Operational risk

In line with KBC Group, the Group applies the official Basel definition of Operational Risk and Operational Risk Management. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems and from external events. It includes legal and tax risks, but excludes strategic and systemic risks. The Group takes reputation risk into account to a certain level. When controls fail to adequately perform, operational risks can result in financial loss, damage to reputation, have legal or regulatory consequences. The operational risks cannot be completely eliminated; but using sound control framework these risks can be mitigated to an acceptable level.

Processes and risk event types together are used as common and universal/uniform framework of reference for reporting purposes. The Group implemented the use of a uniform set of processes, risk event types, risk mitigating/measuring processes and a toolkit for operational risk management.

The first element of the toolkit is the use of *Group-wide Control requirements (Group Key Controls)* which are the key controls, defined by a centre of competence intended to control or mitigate major inherent risks. All KBC Group entities must implement these Key Controls. The compliance with the Group Key Controls is monitored via a benchmarking (assessment) exercise, assessments which are used to determine the gap between the group-wide requirements and the local practice. The derived action plans are continuously monitored and reported to the Capital and Risk Oversight Committee and Operational Risk Councils. The Local line management is responsible for translating the Group Key Controls into local procedures as well as for the timely and proper implementation of action plans.

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

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

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

The method and framework of *Key Risk Indicators* were implemented in 2009. These are measurable metrics or indicators which help the organization with monitoring the inherent and / or residual exposure to certain key risks, and combine the measurement of risk with the actual management of risk. Changes in the risk exposure versus the risk tolerance of the Group are measured by warning and alert thresholds that are set for each Key risk indicator.

Risk scans for operational, and business and reputation risks were performed there by the main business lines, Information security and ICT (Information and Communication Technology), to assess the most important non-financial risks using a top-down approach.

In order to assure the continuity of its critical business services, the Group has an extensive business continuity framework in place, that includes business continuity plans for material activities, the testing of such plans in order to be prepared for potential crisis situations.

In the course of 2015 the Group has strengthened its internal control environment by implementing further system embedded control and reviewing the adequacy and effectiveness of selected key controls in certain processes.

NOTE 47 – SOLVENCY AND CAPITAL

In accordance with Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (banking law) and the EU Regulation No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), the Group must have a minimum capital in place. The Group reports its level of capital adequacy situation to the National Bank of Hungary (NBH) on a quarterly basis and also forecasts are prepared to the Capital and Risk Oversight Committee (CROC) of the Group. When needed, the Group's Executive Committee decides and proposes to KBC Group any necessary steps that the Committee believes need to be taken (such as capital increase, subordinated debt increase, dividend payment etc.).

The Group started to calculate its capital adequacy position according to IFRS consolidated figures in 2014, therefore the below table includes IFRS consolidated figures in both periods (in the previous years the Note over solvency and capital position was based on standalone figures according to the Hungarian Accounting Standards).

	2015 MHUF	2014 MHUF
Tier 1 capital elements	207 489	163 363
Adjustments due to prudential filters	(4 299)	(4 150)
Other transitional adjustments	(17 033)	(5 756)
Tier 1 total	186 157	153 457
Tier 2 capital elements	28 181	11 411
Other transitional adjustments	(643)	(2 482)
Tier 2 total	27 538	8 929
Guarantee capital	213 695	162 386

According to Hungarian capital adequacy regulations, the Group's capital adequacy ratio (tier 1 + tier 2; the latter includes subordinated debts) at 31 December 2015 was 13.90% (11.62% at 31 December 2014). The Group fulfilled the capital requirements set by NBH continuously during years 2015 and 2014 and at 31 December 2015 (and at 31 December 2014).

The Bank is required to set aside 10% of its profit calculated in accordance with Hungarian Accounting standards as a statutory reserve for use against future losses. The balance of this reserve as at 31 December 2015 was HUF 8 749 million (HUF 5 541 million as at 31 December 2014).

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

Accordingly, the Bank had distributable reserves of HUF 38 588 million as at 31 December 2015 (HUF 9 715 million as at 31 December 2014).

No dividend payment was proposed on ordinary shares.

Approved by the Board of Directors on 12 April 2016.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

K&H Bank Zrt.

Management report (consolidated)

31 December 2015

On 31 December 2015, the consolidated total assets of K&H Bank Group (hereunder "the Group") stood at HUF 2,583 billion. As a financial institution which offers banking and insurance products alike and has a nation-wide branch network of 209 branches, the Group offers the full range of financial services to its clients.

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. The Strategic Objectives of the Group

K&H Bank Group is a universal bank-insurer, providing banking, leasing, asset management and insurance services for individuals and corporate (focusing on SME and Mid-cap) customers.
In order to fulfil our mandate by our shareholder and our clients:

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

Customer strategy:

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

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

<u>Product strategy:</u>

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

Small and medium-sized enterprises (SME):
- Reliable and convenient transactional banking services
- More standard products fitting client needs with simple, easy to access services
- Fast and simple lending process to support financing SME businesses

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

<u>Strategy on distribution channels:</u>

Multi-channel distribution approach – best fit combination of:
- extensive branch network
- TeleCenter
- e-bank / mobile bank
- tied agents and brokers

Our intention is to provide a unique customer experience through our seamlessly integrated channels and by offering a simple and easy journey to our clients from the first interest through the application for the product and contracting to the use of our products.

<u>Key differentiators of the Bank Group:</u>
- being close to our clients: easy access both physically (via our large branch network) and virtually (via remote channels);
- K&H Group acts as a full service provider for our clients in banking and insurance (universal financial institution);
- expertise and advice in the whole spectrum of financial services;
- speaking our clients' language (simple and easy solutions, client-friendly communication).

3. The Group's consolidated activities

The Group's total assets increased by 5.7% in 2015.

HUF Billion	31 Dec 2014	31 Dec 2015	Variance
Total assets	2,442.8	2,583.0	+5.7%
Loans and receivables	1,602.5	1,746.9	+9.0%
Deposits from customers	1,652.8	1,865.6	+12.9%
Equity	179.7	221.4	+23.2%

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

- *Loans and receivables* increased by 9.0% primarily related to the increased receivables from credit institutions (MNB deposit). There was 6% growth in the loan portfolio of SME segment in 2015, while corporate loan volume decreased by 11% as a consequence of some individual transactions (prepayments) and the general unfavourable market trend. Retail loans volume increased by nearly 3% driven by the increasing loan demand and K&H's improving market share in new production.

- *Deposits from customers* increased by 12.9% during the year, and within that deposits of all business segments (retail, SME, corporate) increased including deposits placed by mutual funds managed by K&H Fund Management.
- *Shareholders' equity* increased by HUF 41.7 billion primarily due to the result of year 2015 (HUF +37.9 billion), the cash flow hedge reserves (HUF +0.3 billion) and AFS revaluation reserves (HUF +3.5 billion). According to the shareholder's resolution there is no dividend payment from the result of 2015.

HUF Billion	31 Dec 2014	31 Dec 2015
Profit after taxation	-28.3	+37.9

In 2015 the Group's net result amounted to HUF 37.9 billion, which is significant improvement compared to the previous year's result (the result in 2014 included a pre-tax loss of HUF 65.6 billion due to the consumer loan agreements related legislatory changes connected to the settlement of both the bid-offer spreads and the unilateral contact modifications).

The evolution of the main P&L items:

- In comparison with the previous year, *net interest income* decreased by nearly 10% (2015: HUF 73.9 billion, 2014: HUF 82.0 billion) mainly related to the lower margins and volumes as a result of the consumer loan settlement and conversion.
- The 2% increase in *net fee and commission income* (2015: HUF 52.3 billion, 2014: HUF 51.2 billion) is primarily driven by transactional income (increased transaction volume) and investment services (increasing fee income from mutual fund sales distribution).
- The increase in *net gains from financial instruments at fair value* (2015: HUF 17.8 billion, 2014: HUF 17.1 billion) mainly related to Treasury income.
- The P&L lines of *other net income* includes the one-off effects of the consumer loan settlement and conversion[1]:
  - in 2014 the Group recorded HUF 65.6 billion loss on the expected impact of the consumer loan agreements related settlements
  - in 2015 the Group accounted for a HUF 14.9 billion gain which consists of the following three components:
    - HUF 0.9 billion loss related to the FX consumer loans (primarily car loans) conversion in December 2015
    - HUF 5.3 billion write-back on consumer loan settlements (being the difference between the realized loss in 2015 and the expected loss in 2014)
    - HUF 10.4 billion gain from the subsequent adjustment of carrying amount of the converted loans derecognised and recognised based on IAS 39.
- *Operating expenses* amounted to HUF 102.1 billion in 2015 (2014: HUF 103.6 billion), disregarding banktax and financial transaction levy there is a 1% growth compared to the previous year.

Impairments on loans and receivables amounted to HUF 12.3 billion in 2015 (2014: HUF 14.7 billion). In Retail business the bank's own and the government's payment easement programs had positive impact on portfolio quality and the related credit cost ratio. The portfolio quality in corporate and SME segments was stable, the credit impairment was also favourable in the period.

Non-performing loans	31 Dec 2014	31 Dec 2015
Retail	26.1%	24.9%
Corporate	6.4%	4.2%
Retail Car loans	39.1%	51.9%
Total	14.7%	13.3%

[1] See details in the Consolidated Financial Statements (Note 10)

Detailed description on financial instruments' valuation is included in the consolidated financial statements (in the following notes: 18-25 and 29), while Note 46 in the consolidated financial statements is about risk management.

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

HUF million	2014	2015	variance
Cost / income	114.6%	62.7%	-51.9%
Cost / income *	56.3%	54.8%	-1.5%
Non-interest income/ total income *	47.4%	53.1%	5.6%
Commission income / total income *	32.8%	33.2%	+0.3%
Operating income * / average headcount	46.8	44.5	-4.8%
Operating costs * / average headcount	26.3	24.4	-7.3%
Operating profit * / average headcount	20.5	20.1	-1.7%
Credit cost ratio	0.94%	0.12%	-0.82%
Non-performing loans	14.7%	13.3%	-1.4%
Loan / deposit ratio	62.0%	44.5%	-17.5%
Loan / deposit ratio**	79.7%	66.3%	-13.4%
Capital ***/total liabilities	8.1%	9.7%	+1.6%
Solvency ratio (consolidated)	11.6%	13.9%	+2.3%
ROE (based on average balance of equity)	-14.7%	19.4%	+34.1%
ROE (based on average balance of equity) ****	14.5%	15.7%	+1.2%
ROA (based on average balance sheet total)	-1.1%	1.5%	+2.6%
ROA (based on average balance sheet total) ****	1.1%	1.2%	+0.1%

* excluding bank tax and provision for the new law on consumer loan agreements but including FTL related charges
** customer loans: based on gross carrying amount, deposits: refinancing funds are excluded
*** in addition to equity it also includes subordinated debt capital
**** excluding provision for the 2014 law on consumer loan agreements

Considering profitability, the Group is one of the most solid performers in the Hungarian banking sector with stable liquidity and solvency positions.

4. Introduction of strategically important subsidiaries

Leasing operation

At the end of 2015 the Leasing operation consisted of 3 separate active legal entities next to the leasing operations performed by the bank (3 entities were merged with K&H Bank Zrt. in previous years). 2 legal entities were inactive, under liquidation at the end of 2015.

Name	Main profile
K&H Autópark Kft.	Operative leasing, fleet management
K&H Eszközlízing Kft.	Operative leasing
K&H Ingatlanlízing Zrt.	Financial leasing
K&H Alkusz Kft. v.a.	Not active, under liquidation
K&H Lízing Zrt. v. a.	Not active, under liquidation

On 31 December 2015 the **Group's leasing** portfolio stood at HUF 45.3 billion, which represents a 4.1% decrease compared to the end of the previous year. This decrease was solely due to the run-off of the retail car financing portfolio (reduced by HUF 10.6 billion, which is a 56% reduction compared to the end of 2014), while the truck, real estate, machinery & equipment and fleet portfolio altogether increased by HUF 8.7 billion (by 30% compared to the end of 2014).

K&H Fund Management Zrt.

K&H Fund Management Zrt. is owned fully by K&H Bank. The assets managed in investment funds increased from HUF 873 billion to HUF 1,012 billion, while total assets managed by K&H FM increased from HUF 1,012 billion to HUF 1,164 billion in 2015. The amount of total assets managed means one of the highest market shares among the Hungarian Fund Management companies.
The decreasing yield environment continues to turn the attention of clients towards investment funds. Due to the changes in the interest rate environment challenging our money market and bond funds' yields, our balanced funds – with possible higher yields – were getting more and more attractive for our clients. In 2015, 19 funds were launched – 16 structured, 2 balanced and 1 absolute return.
Institutional portfolio managed assets increased from HUF 138 billion to HUF 152 billion.

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

In 2005 K&H Group decided to set up a group services centre under the management of K&H Bank, which is the 100% owner of K&H Csoportszolgáltató Kft. (KHCSK). The purpose of this unit was the centralisation and efficient organisation of supplementary service activities closely linked to the core activities of individual group members. Comprehensive service activities performed for the group include the management of the real estate portfolio, logistical and bank security tasks, operative business responsibilities (the booking of trade receivables and payables, fixed assets, tax accounting and payroll management).
The company takes out service level agreements and contracts with individual group members for each individual service. Since 2007, services offered by KHCSK have also been used by K&H Insurance and K&H leasing member companies as well. At present, KHCSK acts as a group services centre for 10 companies, including K&H Bank. Since May 1, 2008, KHCSK has also been performing the financial, accounting and operative services of the Hungarian branch of KBC Global Services N.V. (KBC GSC). On 1 January 2008 the Tendering Directorate was set up, which is responsible for advisory and support services related to EU tenders. In 2009, the scope of the company's activities was extended with financial and accounting services provided to K&H Factoring, a company 100% owned by K&H Bank. A directorate was established on 1 January 2012 for SZÉP Card operations. The SZÉP card is a cafeteria item and product at K&H Group. KHCSK is responsible for the entire operation of the SZÉP card system and the related transactions. As of 1st of January 2016, the Tendering Directorate continue his business operation in the K&H Bank Zrt.

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

The K&H Factoring Zrt's main activity is factoring (purchase of receivables, financing, discounting). The company's business activities have started in 2010, (factoring) turnover has been increasing since then (2010: 5.9 bln, 2011: 22.3 bln, 2012: 54.5 bln; 2013: 72.6 bln, 2014: 75.8 bln, 2015: 96.9 bln). The amount of trade receivables towards debtors was HUF 10.7 billion on 31 December 2015. The profit after tax of the company has reached HUF 128.6 million in year 2015.

Dated: Budapest, 29 April 2016

Hendrik Scheerlinck	Attila Gombás
Chief Executive Officer	Chief Financial Officer