Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

Consolidated Annual Financial Statements prepared in accordance with International Financial Reporting Standards For the year ended 31 December 2009 with the report of Independent Auditors

Statement of the Issuer

K&H Bank Zrt. as the Issuer (represented by: Marko Voljč, CEO and Attila Gombás, Head of the Finance and Risk Management Division) hereby declare that the Year 2009 Annual Report and the Year 2009 Consolidated Annual Report of K&H Bank Zrt. have been prepared, to the best of the Issuer's knowledge, in compliance with the applicable accounting laws and regulations, and the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profitability of K&H Bank Zrt. and the enterprises involved in the consolidation, and the Business Report shows a faithful picture of the situation, development and performance of K&H Bank Zrt. and the enterprises involved in the consolidation, including the major risks and uncertainty factors.

Budapest, April 29, 2010

Marko Voljč
CEO

Attila Gombás
Head of the Finance and Risk Management Division

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Independent auditors' report

To the shareholder of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

We have audited the accompanying consolidated financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság and its subsidiaries, ("the Group") which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság as of 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Without qualifying our opinion we draw attention to note 27 of these consolidated financial statements. In 2003 a significant fraud was discovered at K&H Equities Rt., a member of the Group. As at 31 December 2009 the Group has a provision of HUF 25,529 million for its potential liability to clients as a result of the fraud, and an asset of HUF 17,300 million for expected reimbursements. The ultimate outcome of this matter cannot presently be determined and due to its fundamental uncertainty the actual loss incurred by the Group might be significantly different from the provision and the asset created.

Ernst & Young Kft.
Budapest, Hungary
26 March 2010

CONTENTS OF THE CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

	Notes	2009	Reclassified 2008
		MHUF	MHUF
Interest income (reclassified)		233 976	187 876
Interest expense		(146 174)	(122 714)
Net interest income	4	87 802	65 162
Fee and commission income		44 931	43 929
Fee and commission expense (reclassified)		(16 759)	(17 160)
Net fee and commission income	5	28 172	26 769
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange (reclassified)	6	19 979	38 529
Net realised gains / (losses) from available-for-sale assets	7	218	(49)
Dividend income	8	3	956
Other net income (reclassified)	9	1 589	3 912
Total income		137 763	135 279
Operating expenses		(80 925)	(86 618)
Staff expenses (reclassified)		(32 027)	(31 149)
General administrative expenses (reclassified)	10	(47 687)	(36 900)
Depreciation and amortisation of fixed assets		(7 783)	(8 043)
Provisions for risks and charges		6 572	(10 526)
Impairment:	12	(40 315)	(7 578)
Loans and receivables (reclassified)		(40 142)	(7 525)
Available-for-sale assets		-	2
Other		(173)	(55)
Share in results of associated companies	13	454	587
Profit before tax		16 977	41 670
Income tax expense	14	(6 942)	(15 687)
Profit after tax		10 035	25 983
Earnings per share (HUF)	15	0.14	0.39

Approved by the Board of Directors on 26 March 2010.

Marko Voljč	*Attila Gombás*
Chief Executive Officer	*Chief Financial and*
Member of the Board	*Risk Officer*

For changes in the presentation of the consolidated income statement see note 2.6.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	2009 MHUF	2008 MHUF
Profit after tax	10 035	25 983
Other comprehensive income		
Available for sale equity instruments		
Net change in revaluation reserve	45	(56)
Transfer from available for sale reserve to net profit		
Losses on disposal	(16)	(340)
Deferred income tax	3	73
Available for sale debt instruments		
Net change in revaluation reserve	6 738	(8 065)
Transfer from available for sale reserve to net profit		
(Losses)/ gains on disposal	(138)	113
Deferred income tax	30	(24)
Net change in cash flow hedge reserve	104	(998)
Transfer from cash flow hedge reserve to net profit		
Gross amount	598	(1 578)
Deferred income tax	(128)	341
Other movements	(122)	-
Total other comprehensive income	7 114	(10 534)
Total comprehensive income	17 149	15 449

In 2009 other movements include deferred tax expense resulting from change in the future tax rate (for more details see Note 14).

Approved by the Board of Directors on 26 March 2010.

Marko Voljč
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial and
Risk Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	2009 MHUF	2008 MHUF
ASSETS			
Cash and cash balances with central banks		147 343	124 624
Financial assets	16	2 839 742	2 977 829
Held for trading	21	117 658	228 267
Designated at fair value through profit or loss	18	9 145	9 411
Available for sale	19	1 075 978	884 326
Loans and receivables	20	1 636 614	1 854 786
Hedging derivatives	21	347	1 039
Tax assets		7 018	3 402
Current tax assets		6 270	3 166
Deferred tax assets	23	748	236
Investments in associated companies	24	2 125	2 212
Property and equipment	25	29 268	30 385
Other intangible assets	26	7 796	4 437
Other assets	22	31 205	39 602
Total assets		3 064 497	3 182 491
LIABILITIES AND EQUITY			
Financial liabilities	16	2 767 677	2 890 365
Held for trading	21	60 400	92 995
Designated at fair value through profit or loss	18	155 663	133 563
Measured at amortised cost		2 550 137	2 660 790
Hedging derivatives	21	1 477	3 017
Tax liabilities		2 778	3 947
Current tax liabilities		136	188
Deferred tax liabilities	23	2 642	3 759
Provisions for risks and charges	27;20	41 811	47 644
Other liabilities	28	41 586	47 039
Total liabilities		2 853 852	2 988 995
Total equity	29;38	210 645	193 496
Total liabilities and equity		3 064 497	3 182 491

Approved by the Board of Directors on 26 March 2010.

Marko Voljč
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial and
Risk Officer

For breakdown of assets and liabilities by remaining maturity see Note 37.2.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital MHUF	Share premium MHUF	Statutory risk reserve MHUF	Available for sale reserve MHUF	Cash flow hedge reserve MHUF	Retained earnings MHUF	Total equity MHUF
2008							
Balance at the beginning of the period	66 307	48 775	9 358	(942)	1 373	82 339	207 210
Net profit for the year	-	-	-	-	-	25 983	25 983
Other comprehensive income for the period	-	-	-	(8 299)	(2 235)	-	(10 534)
Total comprehensive income	-	-	-	(8 299)	(2 235)	25 983	15 449
Dividend	-	-	-	-	-	(29 163)	(29 163)
Transfer from retained earnings to statutory risk reserve	-	-	1 346	-	-	(1 346)	-
Total change	-	-	1 346	(8 299)	(2 235)	(4 526)	(13 714)
Balance at the end of the period	66 307	48 775	10 704	(9 241)	(862)	77 813	193 496
of which revaluation reserve for equity instruments	-	-	-	(36)	-	-	(36)
of which revaluation reserve for bonds	-	-	-	(9 205)	-	-	(9 205)
2009							
Balance at the beginning of the period	66 307	48 775	10 704	(9 241)	(862)	77 813	193 496
Net profit for the year	-	-	-	-	-	10 035	10 035
Other comprehensive income for the period	-	-	-	6 546	568	-	7 114
Total comprehensive income	-	-	-	6 546	568	10 035	17 149
Dividend	-	-	-	-	-	(7 402)	(7 402)
Capital increase	7 402	-	-	-	-	-	7 402
Transfer from retained earnings to statutory risk reserve	-	-	1 832	-	-	(1 832)	-
Total change	7 402	-	1 832	6 546	568	801	17 149
Balance at the end of the period	73 709	48 775	12 536	(2 695)	(294)	78 614	210 645
of which revaluation reserve for equity instruments	-	-	-	(4)	-	-	(4)
of which revaluation reserve for bonds	-	-	-	(2 691)	-	-	(2 691)

The dividend paid on ordinary shares was HUF 7 402 million - 0.111632 HUF/share in 2009 (HUF 29 163 million – 0.439816 HUF/share in 2008).

For dividend proposed on ordinary shares see Note 38.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2009	Reclassified 2008
		MHUF	MHUF
OPERATING ACTIVITIES			
Profit before tax		16 977	41 670
Adjustments for:			
Net transfer from available for sale reserve		(154)	(227)
Net transfer from cash flow hedge reserve		598	(1 578)
Depreciation and impairment of property, plant and equipment, intangible assets, available for sale financial assets and other assets	25;26	7 956	8 096
(Profit)/Loss on the disposal of subsidiaries and associated companies	9	(98)	-
(Profit)/Loss on the disposal of property and equipment	9	7	(178)
Change in impairment on loans and advances[1]	12;20	40 142	7 759
Change in other provisions	27	(6 572)	10 526
Unrealised valuation differences		30 726	3 414
Income from associated companies	35	(454)	(587)
Cash flows from operating profit before tax and before changes in operating assets and liabilities		89 128	68 895
Changes in financial assets held for trading		65 138	(93 533)
Changes in financial assets designated at fair value through profit or loss		(10 728)	903
Changes in financial assets available for sale		(183 114)	(533 602)
Changes in loans and receivables		134 028	(194 455)
Changes in other assets		3 684	7 581
Changes in operating assets		9 008	(813 106)
Changes in financial liabilities held for trading		286	(3 481)
Changes in financial liabilities designated at fair value through profit or loss		15 499	27 420
Changes in financial liabilities measured at amortised cost		(12 322)	419 439
Changes in other liabilities		(5 283)	(31 394)
Changes in operating liabilities		(1 820)	411 984
Income taxes paid		(7 108)	(11 848)
Net cash from/(used in) operating activities		89 208	(344 075)

1. Including impairments on loans and receivables and loan commitments.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2009 MHUF	Reclassified 2008 MHUF
INVESTING ACTIVITIES			
Proceeds from the disposal of shares in associated companies		98	42
Dividends received from associated companies	8	443	398
Purchase of intangible fixed assets	26	(4 098)	(2 010)
Purchase of property, plant and equipment	25	(8 332)	(8 256)
Proceeds from the sale of property, plant and equipment		327	1 192
Net cash from/(used in) investing activities		(11 562)	(8 634)
FINANCING ACTIVITIES			
Proceeds from the issuance of share capital		7 402	-
Dividends paid		(7 402)	(29 163)
Net cash from/(used in) financing activities		-	(29 163)
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents		77 646	(381 872)
Cash and cash equivalents at beginning of the period		(146 118)	235 754
Cash and cash equivalents at end of the period		(68 472)	(146 118)
ADDITIONAL INFORMATION			
Interest received (reclassified)	4	233 976	187 876
Interest paid	4	(146 174)	(122 714)
Dividend received		3	956
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash and cash balances with central banks		147 343	124 624
Loans and advances to banks repayable on demand and term loans to banks < 3 months		16 372	59 776
Deposits from banks repayable on demand and redeemable at notice		(232 187)	(330 518)
Total cash and cash equivalents		(68 472)	(146 118)

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.

NOTE 1 – GENERAL

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság (K&H Bank Zrt. or "the Bank") is a limited liability company incorporated in the Republic of Hungary. K&H Bank and its subsidiaries ("the Group") provide a full range of banking services through a nation-wide network of 241 branches. K&H Bank's registered office is at Vigadó tér 1, Budapest.

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

NOTE 2 – ACCOUNTING POLICIES

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

2.1 Basis of presentation

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

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

2.1.1 Statement of compliance

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

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

Certain accounting principles prescribed for statutory purposes are different from IFRS. In order to present the financial position and results of operations of the Group in accordance with IFRS certain adjustments have been made to the Group's Hungarian consolidated statutory accounts. Details on these adjustments are presented in note 36.

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 2009. The Bank and the entities which it controls are referred to collectively as "the Group". Control is presumed to exist where the Bank holds, directly or indirectly, more than 50% of the registered capital or where the Bank can exercise more than 50% of the voting rights or where the Bank can appoint or dismiss a majority of the members of the Board of Directors. The effects of all material intercompany balances and transactions are eliminated.

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

A list of subsidiary and associated companies is provided in Note 34.

2.2 Significant accounting judgements and estimates

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

Going concern

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

Fair value of financial instruments

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

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

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

Provision for litigations and claims

The amount of provision required to meet losses incurred as a result of litigations and claims is another principal area of estimation uncertainty in these financial statements. Refer to note 27 for further details.

Allowance for impairment of available-for-sale investments

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

NOTE 2 – ACCOUNTING POLICIES (continued)

Deferred tax assets

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

2.3 Changes in accounting policies

Changes in IFRSs

The International Accounting Standards Board (IASB) has issued new accounting Standards and has introduced numerous changes to the Standards that became effective in 2009.

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

IFRS 1	First-time Adoption of International Financial Reporting Standards - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate
IFRS 2	Share-based Payment - Vesting Conditions and Cancellations
IFRS 7	Financial Instruments: Disclosures - Improving Disclosures about Financial Instruments
IFRS 8	Operating Segments
IAS 1	Presentation of Financial Statements
IAS 1	Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation
IAS 23	Borrowing cost
IAS 27	Consolidated and Separate Financial Statements - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate
IAS 32	Financial Instruments: Presentation - Puttable Financial Instruments and Obligations Arising on Liquidation
IFRIC 13	Customer Loyalty Programmes
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 18	Transfers of Assets from Customers

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

The principal effects of these changes are as follows:

IFRS 1 First-time Adoption of International Financial Reporting Standards - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (amendment)
and
IAS 27 Consolidated and Separate Financial Statements - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (amendment)

The amendments were issued in May 2008. The amendments are required to be applied for annual periods beginning on or after 1 January 2009. The above amendments include minor interpretation related to the settlement of the cost of investments.

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

NOTE 2 – ACCOUNTING POLICIES (continued)

Amendment to IFRS 2 Share-based Payment

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

The amendment has no impact on the consolidated financial statements.

IFRS 7 Financial Instruments: Disclosures - Improving Disclosures about Financial Instruments (amendment)

The amendments outline additional disclosure requirements for fair value measurement and liquidity risk. These amendments were issued in March 2009 and are applicable to annual periods beginning on or after 1 January 2009.
The Group has adopted the amendment.

IFRS 8 Operating Segments

IFRS 8 sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.

The standard is effective for annual periods beginning on or after 1 January 2009. This new standard replaces IAS 14 Segment Reporting and adopts a management approach to segment reporting.

The Group has adopted this standard and the disclosures are shown in Note 3.

IAS 1 Presentation of Financial Statements (revised)

IAS 1 sets overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main objective of the International Accounting Standards Board (IASB) in revising IAS 1 was to aggregate information in the financial statements on the basis of shared characteristics.

An entity shall apply the revised Standard for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

This revised standard has been adopted in the current financial period.

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

In February 2008 the IASB amended IAS 32 and IAS 1 by requiring some financial instruments that meet the definition of a financial liability to be classified as equity.

Entities should apply the amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

The amendments have no impact on the consolidated financial statements.

IAS 23 Borrowing Cost (revised)

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

The amendments have no impact on the consolidated financial statements.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRIC 13 Customer Loyalty Programmes

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

The IFRIC 13 has no impact on the consolidated financial statements.

IFRIC 15 Agreements for the Construction of Real Estate

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

The IFRIC 15 has no impact on the consolidated financial statements.

IFRIC 16 Hedges of a Net Investment in a Foreign Operation

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

The IFRIC 16 has no impact on the consolidated financial statements.

IFRIC 18 Transfers of Assets from Customers (new)

The IFRIC was issued in January 2009. This interpretation provides guidance on the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers. This interpretation is effective for assets from customers received on or after 1 July 2009.

The IFRIC 18 has no impact on the consolidated financial statements.

2.4 Summary of significant accounting policies

2.4.1 Foreign currency translation

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

2.4.2 Financial instruments

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2.1 Trade and settlement date accounting

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

2.4.2.2 Financial instruments at fair value through profit or loss

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

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

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

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

The change in the fair value of non interest-bearing assets is recorded in the consolidation income statement as net gains / (losses) from financial instruments at fair value and 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.

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

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

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

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

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

2.4.2.4.3 Held-to-maturity instruments

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

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

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

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

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

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 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 besides publicly traded investment notes on fair value investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured. These investments are measured at cost less impairment.

2.4.3 Day 1 profit

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

2.4.4 Repo and reverse repo agreements

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

2.4.5 Securities lending and borrowing

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

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 and foreign exchange.

2.4.6 Allowances for impairment of financial assets

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

2.4.7 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.

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

2.4.10.2 Where the Group is the lessor

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

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

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

2.4.11 Revenue recognition

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

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

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

2.4.13 Cash and cash equivalents

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

2.4.14 Bank premises and equipment

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

2.4.15 Intangible assets

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

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

Standard software and other intangibles	5 years

2.4.16 Commitments, contingent liabilities

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

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

Any increase in the liability relating to financial guarantees is taken to the consolidated income statement in 'Provision for possible loan and commitment losses'. The premium received is recognized in the consolidated income statement in 'Net fee and commission income' on a straight line basis over the life of the guarantee.

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

2.4.17 Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

2.4.18 Taxation

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

2.4.19 Fiduciary assets

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

2.4.20 Dividend on ordinary shares

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

2.4.21 Equity reserves

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

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

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

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

2.4.22 Collateral pending sale

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

2.5 Future changes in accounting policies

IFRSs and IFRIC interpretations not yet effective

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

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

IFRS 3 Business Combinations (revised)

The objective of this IFRS is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statement about a business combination and its effects.

The revised IFRS 3 shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted.

IFRS 9 Financial Instruments (new)

IFRS 9 is a new standard dealing with the accounting for financial instruments. IFRS 9 shall be applied for annual periods beginning on or after 1 January 2013. Early application is permitted.

The standard will have a significant impact on the Group financial statements. Due to the uncertainties about the provisions of the subsequent two phases the impact of the IFRS 9 is not reasonably estimable. The IASB's work on the second phase on impairment of financial instruments, the third phase on hedge accounting, accounting treatment of financial liabilities and derecognition of financial instruments are still ongoing.

IAS 24 Related Party Disclosures (revised)

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

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

Amendment to IAS 27 Consolidated and Separate Financial Statements

In 2008 the Standard was amended as part of the second phase of the business combinations project. The amendments related, primarily, to accounting for non-controlling interests and the loss of control of a subsidiary.

An entity shall apply the amendments to IAS 27 made in 2008 for annual periods beginning on or after 1 July 2009. Earlier application is permitted.

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

Paragraphs 11 and 16 were amended by Classification of Rights Issues issued in October 2009. An entity shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted.

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

IAS 39 Financial Instruments: Recognition and Measurement - Embedded Derivatives (amendment)
and
IFRIC 9 Reassessment of Embedded Derivatives - Embedded Derivatives (amendment)

The amendments to IFRIC 9 and IAS 39 were issued in March 2009 and are effective for annual periods ending on or after 30 June 2009. The amendments require an entity to assess whether an embedded derivative must be separated from a host contract when the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category.

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

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

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

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

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

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (new)

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

The Group expects that the adoption of the pronouncements listed above – other than IFRS 9 - will have no significant impact on the Group's consolidated financial statements in the period of initial application.

2.6 Reclassification

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

	As previously reported 2008	Reclassification	Reclassified 2008
	MHUF	MHUF	MHUF
Interest income	189 133	(1 257)	187 876
Fee and commission expense	(17 135)	(25)	(17 160)
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	37 506	1 023	38 529
Other net income	4 947	(1 035)	3 912
Staff expenses	(32 169)	1 020	(31 149)
General administrative expenses	(36 940)	40	(36 900)
Impairment on loans and receivables	(7 759)	234	(7 525)

NOTE 2 – ACCOUNTING POLICIES (continued)

The reclassification between interest income and net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange results from the change in the presentation of available for sale municipality bonds.

All other items result from the implementation of updated reporting definitions as introduced within the KBC Group as from the fourth quarter of 2009.

Management believes the above reclassifications relating to 2008 are immaterial to the consolidated financial statements taken as a whole.

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 a turnover of less than HUF 700 million. Services provided: loans and financing products, deposits and other savings products, transactional services.

Corporate: companies with a turnover of greater than HUF 700 million, municipalities, project financing, and non-banking institutions in the financial sector. Services: loans and other credit facilities, deposits and transactional services.

Treasury: proprietary trading activity.

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

General Management: consists of items which are not directly attributable to the business activity of the above defined segments. These include the result of tax and commercial litigations (see Note 27) and fair value changes recognised under IFRS on derivatives used for hedging purposes that do not qualify for fair value hedge accounting for a portfolio hedge of interest rate risk.

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

The Group has been operating only in the Hungarian Republic.

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2009:

	Retail	Corporate	Treasury	Leasing	General management	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net interest income / (expense)	53 247	28 627	2 054	6 011	(2 137)	87 802
Net fee and commission income / (expense)	23 194	5 701	-	408	(1 131)	28 172
Net gains / (losses) from financial instruments at fair value through profit or loss	5 736	6 979	8 812	642	(2 191)	19 979
Net realised gains / (losses) from available-for-sale assets	-	-	-	-	218	218
Dividend income	-	-	-	-	3	3
Other net income / (expense)	576	(474)	-	1	1 486	1 589
Total income / (expense)	82 752	40 834	10 866	7 063	(3 752)	137 763
of which:						
external income / (expense)	82 269	41 317	10 866	7 063	(3 752)	137 763
internal income / (expense)	483	(483)	-	-	-	-
Operating expenses	(50 068)	(14 871)	(2 702)	(3 892)	(9 392)	(80 925)
Impairment	(19 914)	(15 932)	-	(4 469)	-	(40 315)
Share in results of associated companies	-	-	-	-	454	454
Profit / (loss) before tax	12 771	10 030	8 164	(1 298)	(12 690)	16 977
Income tax benefit / (expense)	(4 032)	(2 531)	(1 265)	48	838	(6 942)
Segment profit / (loss)	8 739	7 499	6 899	(1 250)	(11 852)	10 035
Total assets	790 052	818 266	76 045	147 695	1 232 439	3 064 497
Total liabilities and equity	1 306 957	729 455	6 660	4 425	1 016 999	3 064 497

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2008:

	Retail	Corporate	Treasury	Leasing	General management	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Net interest income / (expense)	46 015	25 062	1 200	3 974	(11 089)	65 162
Net fee and commission income / (expense)	20 573	6 988	-	711	(1 503)	26 769
Net gains / (losses) from financial instruments at fair value through profit or loss	6 882	8 790	6 442	2 833	13 581	38 529
Net realised gains / (losses) from available-for-sale assets	-	-	-	-	(49)	(49)
Dividend income	-	-	-	-	956	956
Other net income / (expense)	800	(525)	-	1	3 637	3 912
Total income / (expense)	74 271	40 315	7 642	7 519	5 532	135 279
of which:						
external income / (expense)	73 690	40 896	7 642	7 519	5 532	135 279
internal income / (expense)	581	(581)	-	-	-	-
Operating expenses	(49 110)	(14 957)	(1 869)	(7 148)	(13 534)	(86 618)
Impairment	(6 045)	(175)	-	(1 357)	-	(7 578)
Share in results of associated companies	-	-	-	-	587	587
Profit / (loss) before tax	19 116	25 182	5 773	(986)	(7 415)	41 670
Income tax benefit / (expense)	(5 683)	(5 619)	(1 235)	(667)	(2 483)	(15 687)
Segment profit / (loss)	13 433	19 564	4 538	(1 654)	(9 898)	25 983
Total assets	807 747	908 252	139 771	190 865	1 135 856	3 182 491
Total liabilities and equity	1 284 254	689 628	23 399	6 933	1 178 277	3 182 491

NOTE 4 – NET INTEREST INCOME

	2009 MHUF	Reclassified 2008 MHUF
Loans and receivables (reclassified)	134 436	142 532
Available-for-sale assets (reclassified)	92 075	35 747
Subtotal, interest income from financial assets not measured at fair value through profit or loss	226 511	178 279
of which: impaired financial assets	*1 707*	*600*
Financial assets held for trading	6 468	8 766
Other financial assets at fair value through profit or loss	997	831
Total interest income	233 976	187 876
Financial liabilities measured at amortised cost	(135 374)	(113 396)
Financial liabilities held for trading	(171)	(30)
Other financial liabilities at fair value through profit or loss	(10 629)	(9 288)
Total interest expenses	(146 174)	(122 714)
Net interest income	87 802	65 162

NOTE 5 – NET FEE AND COMMISSION INCOME

	2009 MHUF	Reclassified 2008 MHUF
Brokerage services	5 266	4 012
Trust and fiduciary activities	4 211	3 534
Credit and guarantee fee income	3 607	4 318
Structured finance	272	271
Payment services	20 687	20 153
Card services	10 055	10 708
Other	833	933
Fee and commission income	44 931	43 929
Brokerage services	(820)	(640)
Credit and guarantee fee expense	(1 973)	(1 628)
Commissions to agents	(60)	(234)
Payment transactions	(5 507)	(5 754)
Card services	(5 046)	(5 987)
Insurance services	(2 359)	(2 022)
Other (reclassified)	(994)	(895)
Fee and commission expense	(16 759)	(17 160)
Net fee and commission income	28 172	26 769

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 FOREIGN EXCHANGE

	2009 MHUF	Reclassified 2008 MHUF
Trading securities	1 533	1 694
Interest rate derivatives (including interest and fair value changes in trading derivatives)	8 508	6 097
Other financial instruments initially recognised at fair value through profit or loss	(4 381)	136
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives) (reclassified)	14 798	29 903
Fair value adjustments in hedge accounting*	(479)	699
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	19 979	38 529

* Realised results of micro cash flow hedge derivatives amounted to HUF 598 million loss in 2009 (HUF 1 578 million gain in 2008), and HUF 119 million gain was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 879 million loss in 2008).

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

- derivatives
- held for trading government bonds, treasury bills and equity instruments
- other financial instruments at fair value through profit or loss (see note 18),

The change in the fair value of financial instruments at fair value through profit or loss, where the fair value calculation is based on non-observable parameters amounts to HUF 2 228 million loss in 2009 (HUF 1 510 million loss in 2008).

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

	2009 MHUF	2008 MHUF
Fixed-income securities	(137)	(27)
Equity instruments	(81)	(22)
Net realised gains from available for sale	(218)	(49)

NOTE 8 – DIVIDEND INCOME

	2009 MHUF	2008 MHUF
Available-for-sale shares	3	956

Of dividend income HUF 954 million relates to the dividend paid by VISA Europe Limited in 2008 and HUF 3 million by VISA Inc. in 2009.

NOTE 9 – OTHER NET INCOME

	2009	Reclassified 2008
	MHUF	MHUF
Gain on property, plant and equipment	120	169
Sale of goods	1 138	1 342
Gain / (loss) on disposal of investments	(8)	864
Gain on other services	940	847
Losses due to operational risks (reclassified)	(746)	(312)
Other (reclassified)	145	1 002
Other net income	1 589	3 912

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

Gains resulting from services provided by K&H Csoportszolgáltató Kft. are presented as gain on other services. In 2008 other income contains HUF 965 million compensation income for covering the contributory expenses of the fraud occurred at K&H Equities (excluding any payments to clients).

NOTE 10 – GENERAL ADMINISTRATIVE EXPENSES

	2009	2008
	MHUF	MHUF
IT expenses	(11 043)	(10 309)
Rental expenses	(4 610)	(3 552)
Repair and maintenance	(914)	(860)
Marketing expenses	(2 315)	(3 244)
Professional fees	(2 556)	(3 152)
Other facilities expenses	(6 932)	(6 735)
Communication expenses	(255)	(352)
Travel expenses	(65)	(156)
Training expenses	(194)	(676)
Personnel related expenses	(814)	(859)
Other administrative expenses	(17 989)	(7 005)
Total general administrative expenses	(47 687)	(36 900)

NOTE 11 – AVERAGE NUMBER OF PERSONNEL

	2009	2008
White-collar staff	3 664	3 868
Blue-collar staff	5	6
Management	6	6
Total average number of persons employed	3 675	3 880

NOTE 12 – IMPAIRMENT (income statement)

	2009 MHUF	Reclassified 2008 MHUF
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for loans and receivables (reclassified)	(37 025)	(12 466)
Specific provisions on credit commitments	535	2 640
Portfolio-based impairments and provisions	(3 652)	2 301
Total impairments and provisions on loans and receivables and credit commitments	(40 142)	(7 525)

	2009 MHUF	2008 MHUF
Impairment on other available-for-sale assets	-	2

	2009 MHUF	2008 MHUF
Impairment on other		
Other intangible assets	(4)	-
Property and equipment	(173)	(51)
Other	4	(4)
Total impairment on other	(173)	(55)

NOTE 13 – SHARE IN THE RESULTS OF ASSOCIATED COMPANIES

	2009 MHUF	2008 MHUF
Giro Elszámolásforgalmi Zrt.	454	552
Budatrend III. Ingatlanhasznosító Zrt.	-	2
HAGE Zrt.	-	33
Share of the results of associates	454	587

The impairment made on HAGE Zrt. was a HUF 83 million loss in 2009 (HUF 24 million gain in 2008). 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.

NOTE 14 – INCOME TAXES

The components of income tax expense for the year ended 31 December 2009 and 2008 are:

	2009 MHUF	2008 MHUF
Statutory income tax expense	(5 871)	(6 848)
Local business tax expense	(4 707)	(4 586)
Deferred taxes on income	3 636	(4 253)
Income tax expense	(6 942)	(15 687)

Statutory income tax expense

In 2008 and 2009, corporate income tax is payable at 16% (19% from 2010 on) on taxable statutory profits. The additional 4% solidarity tax payable on taxable statutory profit is revoked from 2010.

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

There is no procedure for final agreement of tax assessments in Hungary. The tax authorities may examine the accounting records and revise assessments for up to five years after the period to which they relate. Consequently, the Group may be subject to further assessments in the event of an audit by the tax authorities. The corporate tax returns for the Bank have been reviewed and closed off by the taxation authorities for the years up to 2005. Management is not aware of any additional significant unaccrued potential tax liability which might arise relating to years not audited by the tax authorities.

Reconciliation of the total tax charge

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

	2009 MHUF	2008 MHUF
Profit before tax	16 977	41 670
Income tax rate*	20.62%	21.6%
Income tax calculated	(3 501)	(9 001)
Plus/minus tax effects attributable to:		
Tax base decreasing items	4 467	2 315
Adjustments, opening balance of deferred taxes due to change in tax rate	301	-
Unused tax losses to reduce current tax expense	19	-
Unused tax losses and tax credits to reduce deferred tax expense	494	169
Reversal of previously recognised deferred tax on unused tax losses and tax credits	(9)	(4)
Tax base increasing items	(8 739)	(9 344)
Other	26	178
Total tax effects	(3 441)	(6 686)
Income tax expense (income tax calculated + total tax effects)	(6 942)	(15 687)

NOTE 14 – INCOME TAXES (continued)

*The 20% of statutory income tax rate was modified, because local business taxes are presented as income taxes in the consolidated income statements, which causes an increase of about 1.6% in the statutory income tax rate in 2008. This tax rate needs further adjustment in 2009, as local business taxes are not corporate income tax deductable from 2010. The effective income tax rate for 2009 is 40.89% (2008: 37.65%).

NOTE 15 – EARNINGS PER SHARE

Earnings per share is the profit attributable to shareholders of the Group divided by the weighted average number of shares outstanding during the period, excluding treasury shares. There were no other potentially dilutive securities in existence at 31 December 2009 and 2008. The following amounts were used in the calculation of earnings per share:

	2009	2008
Net profit attributable to shareholders (MHUF)	10 035	25 983
Weighted average shares outstanding (in millions)	71 289	66 307
Earnings per share (HUF)	0.14	0.39

NOTE 16 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2009						
Loans and advances to credit institutions and investment firms*	-	-	-	46 692	-	46 692
of which reverse repos	-	-	-	*2 716*	-	*2 716*
Loans and advances to customers	-	2 329	-	1 589 922	-	1 592 251
Consumer credit	-	-	-	95 214	-	95 214
Mortgage loans	-	-	-	665 480	-	665 480
Term loans	-	2 329	-	685 137	-	687 466
Finance leasing	-	-	-	44 698	-	44 698
Current account advances	-	-	-	89 578	-	89 578
Other	-	-	-	9 815	-	9 815
Equity instruments	7 402	-	884	-	-	8 286
Debts instruments issued by	69 067	6 816	1 075 094	-	-	1 150 977
Public bodies	69 067	6 523	1 071 901	-	-	1 147 491
Credit institutions and investment firms	-	-	541	-	-	541
Corporates	-	293	2 652	-	-	2 945
Derivatives	41 189	-	-	-	347	41 536
Total carrying value	117 658	9 145	1 075 978	1 636 614	347	2 839 742

*From the total balance of loans and advances to credit institutions and investment firms HUF 16 372 million is either repayable on demand or is maturing in less than 90 days.

NOTE 16 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

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

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

NOTE 16 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2009					
Deposits from credit institutions and investment firms*	-	-	-	892 725	892 725
of which repos	-	-	-	*21 934*	*21 934*
Deposits from customers and debt certificates	-	155 663	-	1 654 764	1 810 427
Deposits from customers	-	148 880	-	1 627 826	1 776 706
Demand deposits	-	-	-	415 631	415 631
Time deposits	-	148 880	-	1 118 447	1 267 327
Savings deposits	-	-	-	93 748	93 748
Debt certificates	-	6 783	-	26 938	33 721
Certificates of deposits	-	-	-	273	273
Non-convertible bonds	-	6 783	-	5 735	12 518
Non-convertible subordinated liabilities	-	-	-	20 930	20 930
Derivatives	57 771	-	1 477	-	59 248
Short positions	2 629	-	-	-	2 629
In debt instruments	2 629	-	-	-	2 629
Total carrying value	60 400	155 663	1 477	2 550 137	2 767 677

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

NOTE 16 – 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 2008					
Deposits from credit institutions and investment firms*	-	-	-	778 508	778 508
of which repos	-	-	-	*7 946*	*7 946*
Deposits from customers and debt certificates	-	133 563	-	1 880 399	2 013 962
Deposits from customers	-	132 427	-	1 859 543	1 991 970
Demand deposits	-	-	-	386 047	386 047
Time deposits	-	132 427	-	1 367 976	1 500 403
Savings deposits	-	-	-	105 520	105 520
Debt certificates	-	1 136	-	20 856	21 992
Certificates of deposits	-	-	-	292	292
Non-convertible bonds	-	1 136	-	-	1 136
Non-convertible subordinated liabilities	-	-	-	20 564	20 564
Derivatives	90 652	-	3 017	-	93 669
Short positions	2 343	-	-	-	2 343
In debt instruments	2 343	-	-	-	2 343
Other	-	-	-	1 883	1 883
Total carrying value	92 995	133 563	3 017	2 660 790	2 890 365

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

Details of financial instruments

Repo and reverse repo agreements

Under reverse repo transactions, the Group obtains legal ownership of the respective collateral received and, thus, is permitted to utilise the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity. The fair value of securities accepted as collateral in connection with reverse repo transactions as at 31 December 2009 was HUF 2 722 million, of which HUF 2 629 million (reported as short positions in the consolidated statement of financial position) has been sold (31 December 2008 HUF 22 792 million and HUF 2 343 million respectively).

The carrying amount of Hungarian government bonds pledged as collateral for repo liabilities amounted to HUF 22 886 million as at 31 December 2009 (HUF 8 028 million as at 31 December 2008).

NOTE 16 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

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

Equity and debt instruments

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

	2009 MHUF	2008 MHUF
Held for trading		
Treasury bills	42 879	56 684
Government bonds	26 188	77 724
Listed equity instruments	6 491	7 312
Unlisted equity instruments	911	-
Total trading securities	76 469	141 720

	2009 MHUF	2008 MHUF
Available for sale		
Treasury bills	168 708	126 879
Consolidation bonds issued in HUF	112 719	112 605
Other government bonds issued in HUF	747 247	600 585
Bonds issued by municipality - issued in HUF	31 234	28 591
Bonds issued by municipality - issued in foreign currency	11 993	11 947
Other bonds – listed issued in HUF	3 193	2 367
Other bonds – unlisted issued in HUF	-	39
Unlisted equity instruments	884	1 313
Total available for sale	1 075 978	884 326

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

Available-for-sale equity instruments contain as at 31 December 2009 unlisted equity instruments in a value of HUF 883 million (HUF 887 million at the end of 2008) which fair value cannot be measured reliably. These investments are not traded on active markets. Management believes that the carrying value of these investments approximates their fair value.

NOTE 16 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT (continued)

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

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

	2009 MHUF	2008 MHUF
Hitelgarancia Zrt.	640	640
VISA Inc.	239	238
SWIFT S.C.	5	9
	884	887

The table does not contain Risk Kft., as it is fully impaired as at the end of 2009 and 2008.

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

Refinancing credits

The Bank has entered into several refinancing credit facilities with financial institutions (such as EIB, FHB – Mortgage Bank, MFB – Development Bank, EXIM Bank) for the purpose of funding portions of the Bank's activities. There are several covenants governing the determination of qualified recipients, the on-going monitoring process of the ultimate recipients and the repayment process. In all cases the Bank assumes all credit risk related to the ultimate borrower and must check compliance with all covenants. At 31 December 2009, 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.

	2009 MHUF	2008 MHUF
Refinancing credits	181 931	200 813

Non-convertible subordinated liabilities

	2009 MHUF	2008 MHUF
Subordinated loan from KBC Group	16 204	15 834
Bonds issued to the State	4 714	4 714
	20 918	20 548

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

The Bank also issued subordinated debt in the form of bonds to the State in December 1994 and bought long-term state bonds from the proceeds. Interest on the bonds issued is the same as on the state bonds acquired. Both securities mature in 2014. Non-convertible subordinated liabilities are presented as financial liabilities at amortised cost in the consolidated statement of financial position.

NOTE 17 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

	At fair value							
	Quoted market price	Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs	At amortised cost	Total carrying amount	Recognised in profit or loss - non market observable inputs	Fair value	Unrecognised gain/(loss)
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Held for trading	75 537	39 633	2 488	-	117 658	(539)	117 658	-
Designated at fair value through profit or loss	-	8 851	294	-	9 145	-	9 145	-
Available for sale	915 955	113 261	45 879	883	1 075 978	-	1 075 978	-
Loans and receivables	-	-	-	1 636 614	1 636 614	-	1 636 629	15
Hedging derivatives	-	347	-	-	347	-	347	-
Total financial assets	991 492	162 092	48 661	1 637 497	2 839 742	(539)	2 839 757	15
Financial liabilities								
Held for trading	2 629	55 283	2 488	-	60 400	485	60 400	-
Designated at fair value through profit or loss	-	155 627	36	-	155 663	(2 174)	155 663	-
Measured at amortised cost	-	-	-	2 550 137	2 550 137	-	2 550 136	(1)
Hedging derivatives	-	1 477	-	-	1 477	-	1 477	-
Total financial liabilities	2 629	212 387	2 524	2 550 137	2 767 677	(1 689)	2 767 676	(1)

NOTE 17 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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

	At fair value							
	Quoted market price	Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs	At amortised cost	Total carrying amount	Recognised in profit or loss - non market observable inputs	Fair value	Unrecognised gain/(loss)
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Held for trading	141 720	64 609	21 938	-	228 267	21 885	228 267	-
Designated at fair value through profit or loss	-	9 333	78	-	9 411	(4 558)	9 411	-
Available for sale	728 006	113 071	42 363	887	884 326	-	884 326	-
Loans and receivables	-	-	-	1 854 786	1 854 786	-	1 854 772	(14)
Hedging derivatives	-	1 039	-	-	1 039	-	1 039	-
Total financial assets	869 726	188 052	64 379	1 855 673	2 977 829	17 327	2 977 815	(14)
Financial liabilities								
Held for trading	2 343	68 647	22 005	-	92 995	(21 952)	92 995	-
Designated at fair value through profit or loss	-	133 467	96	-	133 563	3 115	133 563	-
Measured at amortised cost	-	-	-	2 660 790	2 660 790	-	2 660 771	(19)
Hedging derivatives	-	3 017	-	-	3 017	-	3 017	-
Total financial liabilities	2 343	205 131	22 101	2 660 790	2 890 365	(18 837)	2 890 346	(19)

NOTE 17 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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

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

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

NOTE 17 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Fair value of financial instruments

Financial instruments at fair value

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

Financial instruments which have an active market with regularly published price quotations are marked to market. Treasury bills, government bonds, other listed bonds and listed equity instruments belong to this category.

If there is no active market or quoted prices for a financial instrument then valuation techniques based on observable market parameters are used, such as discounted cash flow analysis or option pricing models. Most of the derivatives are valued based on these techniques, such as currency forwards and swaps, foreign exchange and interest rate options, cross currency- and interest rate swaps and forward rate agreements.

When market parameters are not available, the Group uses its best estimations and assumptions to determine the relevant circumstances which have to be taken into account during the model valuation. Valuation techniques based on unobservable market parameters is used in case of exotic derivatives, fixed rate corporate bonds and issued bonds linked to these bonds, where the normal valuation technique is adjusted with a credit spread. During the fair value calculation of municipality bonds, the Group adjusts the normal valuation technique with an additional liquidity spread.

During the fair value calculation of municipality bonds, the Group changed the valuation technique in 2009 with introducing a more advanced method. At origination these bonds were issued either in HUF or in CHF. There is a feature of these bonds that the municipality has the option to change the denomination of the bond at any point of time during its duration to EUR, CHF or HUF at the spot rate of the conversion date. Nevertheless the interest spread that remains unchanged over the reference rate. This 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. At the conversion date the Group recognises a technical cross currency interest rate swaps showing the change in the FX denomination of the Bond. The municipality bond as such can be split into three different components whose fair values give the total fair value of the bond. The three instruments are (1) bonds, (2) technical cross currency swaps and (3) swaptions. The market value of the bonds comes from the discounted present value of the future cash flows. The future cash flow of the bond is predicted by the default money market yield curve. In 2008 the Group valuated the technical CCIRS separately similarly to other mark-to-market derivatives. In 2009 these technical CCIRSs were treated as integral part of the municipality bond and valued similarly together with the bond itself. In 2009 the Group introduced a more sophisticated method to determine the discount yield curves: while in 2008 the discount yield curve was the money market swap curve shifted with a liquidity spread, in 2009 the Group determined the yield curve from Hungarian Government Bond benchmark yield curves shifted with a credit spread determined by the Group for all municipalities individually.

According to the valuation method used in 2008 the value of the municipality bonds would be HUF 2 103 million higher.

In the Group there are local municipality bonds in fair value measurements Level 3. There is no active market for these municipality bonds to get market observable parameters for pricing especially with regards to the determine credit spread as risk in addition to the Hungarian Government bond prices. To challenge the fair valuation model the Group used a reasonably possible alternative assumptions with increasing the applied credit spread. The credit spread was shifted with the bp difference between the current and one PD (probability of default) class worse the municipality is rated in. Between the PD rating categories there is a 40 and 80 bp difference which was added to the existing margin based credit spread. This would assume migration in PD classes. This alternative valuation would change the current carrying value by HUF 1 710 million.

NOTE 17 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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

Financial instruments at amortized cost

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

Assets and liabilities for which fair value approximates carrying value

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

Loans with a net book value of HUF 36 billion (HUF 42 billion at 31 December 2008), a portion of which is at fixed rate, are refinanced through facilities with the FHB on substantially the same terms and conditions. As such any difference in the fair values from the carrying value will be largely offset by a corresponding variance between the carrying value and the fair value of refinancing credits that were used to finance the loans.

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

Fixed rate financial instruments

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

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

NOTE 18 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2009 MHUF	2008 MHUF
Financial assets designated at fair value through profit or loss		
Government bonds issued in foreign currencies	6 523	6 903
Corporate bonds – unlisted issued in HUF	200	-
Corporate bonds – unlisted issued in foreign currency	93	78
Loans to customers	2 329	2 430
	9 145	9 411

	2009 MHUF	2008 MHUF
Financial liabilities designated at fair value through profit or loss		
Term deposits:		
- retail	9 035	2 657
- corporate	2 743	2 490
- investment funds	137 102	127 280
Issued bonds designated at fair value due to accounting mismatch	36	96
Other issued bonds	6 747	1 040
	155 663	133 563

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

The changes in the fair value of loans designated at fair value through profit or loss recognised due to credit risk in the consolidated income statement is immaterial in years 2009 and 2008.

The maximum credit risk exposure of the loan designated at fair value through profit or loss is its gross fair value, which was HUF 2 329 million as at 31 December 2009 (HUF 2 430 million as at 31 December 2008).

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.

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

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

NOTE 18 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

The fair value changes of financial liabilities recognised in the consolidated income statement due to credit risk was immaterial in 2009 and cumulatively amounted HUF 1 452 million gain (HUF 3 238 million gain in 2008 and cumulatively).

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

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

The fair value changes recognised in the consolidated income statement due to credit risk concerning financial liabilities (excluding issued bonds) were immaterial in years 2009 and 2008.

The amount that the Group would contractually be required to pay at maturity is HUF 1 304 million less than the fair value of the deposits and issued bonds (HUF 5 250 million more in 2008).

The difference between the fair value and the transaction price of financial instruments not recognised in profit or loss was immaterial in both 2009 and in 2008.

NOTE 19 – IMPAIRMENT ON AVAILABLE FOR SALE FINANCIAL ASSETS

	2009 MHUF	2008 MHUF
Opening balance	513	515
Impairment reversed	-	(2)
Closing balance	513	513

NOTE 20 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position)

	2009 MHUF	2008 MHUF
Breakdown by type		
Specific impairment for loans and receivables	65 230	41 647
Specific provision on credit commitments	2 565	2 898
Portfolio-based impairment and provision	9 635	5 983
Total impairment and provision on loans and receivables and credit commitments	77 430	50 528

NOTE 20 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

	2009 MHUF	2008 MHUF
Breakdown by counterparty		
Impairments on loans and advances to banks	386	-
Impairment for loans and advances to customers (excluding banks)	73 907	46 995
Specific and portfolio based provision, credit commitments	3 137	3 533
Total impairment and provision on loans and receivables and credit commitments	77 430	50 528

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

NOTE 20 – 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 2008	44 747	5 147	8 284	58 178
Movements with an impact on results				
Loan loss expenses	17 973	287	-	18 260
Loan loss recoveries	(5 507)	(2 927)	(2 301)	(10 735)
Interest accrued on impaired loans	234	-	-	234
Discount effect	(316)	388	-	72
Movements without an impact on results				
Write-offs	(16 168)	-	-	(16 168)
Other	684	3	-	687
Closing balance as at 31 December 2008	41 647	2 898	5 983	50 528

NOTE 21 – DERIVATIVE FINANCIAL INSTRUMENTS

	Year ended 31 December 2009				Year ended 31 December 2008			
Derivatives held for trading	**Notional amount Assets MHUF**	**Notional amount Liabilities MHUF**	**Positive fair value Assets MHUF**	**Negative fair value Liabilities MHUF**	**Notional amount Assets MHUF**	**Notional amount Liabilities MHUF**	**Positive fair value Assets MHUF**	**Negative fair value Liabilities MHUF**
Foreign exchange derivatives								
Currency forwards	118 965	125 468	1 129	(3 475)	146 590	147 259	4 757	(1 517)
Currency futures	3 930	3 945	11	(11)	-	-	-	-
Currency swaps	369 335	370 713	6 215	(6 125)	725 394	726 433	19 618	(17 556)
Currency options	562 222	562 222	10 102	(10 355)	1 049 932	1 050 103	27 157	(27 248)
Total foreign exchange derivatives	1 054 452	1 062 348	17 457	(19 966)	1 921 916	1 923 795	51 532	(46 321)
Interest rate derivatives								
Interest rate swaps	1 328 626	1 328 626	22 240	(18 747)	1 690 801	1 690 800	21 935	(14 541)
Cross currency interest rate swaps	617 866	632 658	499	(17 075)	690 519	704 536	11 139	(27 888)
Interest rate options	67 710	67 710	484	(484)	75 992	75 992	161	(161)
Forward rate agreements	155 700	172 723	458	(540)	401 850	546 193	1 689	(1 574)
Total interest rate derivatives	2 169 902	2 201 717	23 681	(36 846)	2 859 162	3 017 521	34 924	(44 164)
Equity options	15	4 318	4	(912)	-	3 653	-	(77)
Commodity swaps	170	170	47	(47)	514	514	90	(90)
Total derivatives held for trading	3 224 539	3 268 553	41 189	(57 771)	4 781 592	4 945 483	86 546	(90 652)
Derivatives designated as cash flow hedges								
Currency options	68 360	74 895	347	(1 477)	31 604	33 067	1 039	(3 017)
Total derivatives held for hedging	68 360	74 895	347	(1 477)	31 604	33 067	1 039	(3 017)
Total derivative financial instruments	3 292 899	3 343 448	41 536	(59 248)	4 813 196	4 978 550	87 585	(93 669)

NOTE 21 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Options

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

Derivatives designated as cash flow hedges

Currency options

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

In 2009 HUF 598 million loss was transferred from cash flow hedge reserve to “Net gains / (losses) from financial instruments at fair value and foreign exchange” in the consolidated income statement (HUF 1 578 million gain in 2008).

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

	31 December 2009				31 December 2008			
	Expected cash flows		Discounted cash flows		Expected cash flows		Discounted cash flows	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
< 3 months	16	(121)	16	(121)	20	(52)	20	(51)
3-6 months	34	(165)	33	(162)	13	(230)	13	(223)
6 months - 1 year	139	(537)	133	(514)	184	(727)	171	(678)
1-2 years	182	(743)	165	(680)	817	(1 819)	721	(1 603)
2-5 years	-	-	-	-	136	(549)	114	(462)
Total	371	(1 566)	347	(1 477)	1 170	(3 377)	1 039	(3 017)

NOTE 22 – OTHER ASSETS

	2009	2008
	MHUF	MHUF
Receivables from investment services	1 116	1 115
Prepayments	228	2 879
Trade receivables	1 078	843
Receivables from employees	36	34
Receivables from bankcard service	2 225	3 541
Items in transit due to payment services	163	2 931
Receivables from compensation (see Note 27)	17 300	16 399
Items in transit due to trading in securities	85	229
Income accruals and cost prepayments	6 011	8 615
Other inventories	2 330	1 201
Other receivables	633	1 815
	31 205	39 602

NOTE 23 – 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 2009:

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

For the year ended 31 December 2008:

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

Deferred income taxes are calculated on all temporary differences under the asset and liability method using a principal rate of 20.62% (19% corporate income tax and 1.62% local business tax).

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

From the total of HUF 4 068 million tax losses carried forward as at 31 December 2009 (HUF 2 100 million at 31 December 2008), HUF 198 million (HUF 540 million at 31 December 2008) 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 3 870 million as at 31 December 2009 (HUF 1 560 million as at 31 December 2008).

NOTE 24 – INVESTMENTS IN ASSOCIATED COMPANIES

	2009 MHUF	2008 MHUF
GIRO Elszámolásforgalmi Zrt.	1 583	1 572
Budatrend-III Zrt.	-	98
HAGE Zrt.	542	542
Total	2 125	2 212

	2009 MHUF	2008 MHUF
Opening balance	2 212	2 065
- Carrying value, transfers, liquidation	(98)	(42)
- Share in the result for the period	454	587
- Dividends paid	(443)	(398)
Closing balance	2 125	2 212

NOTE 25 – PROPERTY AND EQUIPMENT

	Land and buildings MHUF	IT equipment MHUF	Office equipment MHUF	Other MHUF	Total MHUF
At 1 January 2008					
Cost	19 503	12 655	12 238	6 665	51 061
Accumulated depreciation	(6 108)	(9 221)	(5 495)	(1 588)	(22 412)
Net book value	13 395	3 434	6 743	5 077	28 649
Movements in 2008					
Additions	2 412	540	2 681	2 623	8 256
Disposals - net	(121)	-	(895)	(18)	(1 034)
Impairment charge	-	-	-	(51)	(51)
Depreciation charge	(862)	(1 494)	(2 247)	(851)	(5 454)
Other	-	-	19	-	19
At 31 December 2008					
Cost	21 720	13 694	12 882	9 180	57 476
Accumulated depreciation	(6 896)	(11 214)	(6 581)	(2 400)	(27 091)
Net book value	14 824	2 480	6 301	6 780	30 385
Movements in 2009					
Additions	4 013	1 640	439	2 240	8 332
Disposals - net	(85)	-	(3)	(88)	(176)
Impairment charge	(166)	-	(7)	-	(173)
Depreciation charge	(1 254)	(1 619)	(1 517)	(475)	(4 865)
Other	466	911	(699)	(4 913)	(4 235)
At 31 December 2009					
Cost	26 562	19 427	10 868	4 375	61 232
Accumulated depreciation	(8 764)	(16 015)	(6 354)	(831)	(31 964)
Net book value	17 798	3 412	4 514	3 544	29 268

During 2009 the Group entered into a contract for the construction of a new headquarter building with completion expected in 2012. The net amount of the contractual commitment is EUR 69.15 million as at 31 December 2009 (HUF 18 730 million).

NOTE 26 – OTHER INTANGIBLE ASSETS

	Acquired software MHUF	Other intangible assets MHUF	Total MHUF
At 1 January 2008			
Cost	31 681	504	32 185
Accumulated depreciation	(27 168)	(2)	(27 170)
Net book value	4 513	502	5 015
Movements in 2008			
Additions	1 975	35	2 010
Depreciation charge	(2 588)	(1)	(2 589)
Other	-	1	1
At 31 December 2008			
Cost	32 843	539	33 382
Accumulated depreciation	(28 943)	(2)	(28 945)
Net book value	3 900	537	4 437
Movements in 2009			
Additions	4 098	-	4 098
Impairment charge	(4)	-	(4)
Depreciation charge	(1 555)	(1 560)	(3 115)
Other	(1 321)	3 701	2 380
At 31 December 2009			
Cost	35 155	4 308	39 463
Accumulated depreciation	(30 037)	(1 630)	(31 667)
Net book value	5 118	2 678	7 796

NOTE 27 – 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 2008	188	21 204	911	22 303
Amounts allocated	899	21 589	1 054	23 542
Amounts used	-	(815)	-	(815)
Unused amounts reversed	(84)	(694)	(306)	(1 084)
Discount effect	-	159	-	159
Other (foreign exchange revaluation)	-	627	(621)	6
Balance as at 31 December 2008	1 003	42 070	1 038	44 111
Amounts allocated	84	12 713	1 812	14 609
Amounts used	(103)	(12 992)	(155)	(13 250)
Unused amounts reversed	(899)	(5 132)	(820)	(6 851)
Discount effect	-	858	-	858
Other (foreign exchange revaluation)	(1)	(802)	-	(803)
Balance as at 31 December 2009	84	36 715	1 875	38 674

From the total of HUF 36 715 million provision for pending legal disputes the Group has a provision of HUF 25 529 million (HUF 23 864 million in 2008) 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 K&H Bank Rt. The Bank also issued a letter of commitment that it will maintain the legally required level of equity at K&H Equities.

For the majority of claims, criminal investigations were launched which are litigated in Court. Some contested claims have already been determined by the Courts. As a result K&H Equities has incurred and charged against the provision for pending legal disputes HUF 191 million in 2009 (HUF 815 million in 2008).

The Group has during 2009 further revised its previous estimate for the fraud case and increased the provision by HUF 999 million (HUF 3 641 million increase in 2008).

In 2006 the letter of commitment of ABN Amro Bank N.V. was replaced by an indemnity agreement between KBC Bank N.V., ABN Amro Bank N.V., K&H Bank and K&H Equities. Under this agreement ABN Amro Bank N.V. indemnifies 40% of the payments to clients based on finalised Court decisions. According to the insurance agreement which was subscribed in 2008, the insurance company partly reimburses the loss of the Group resulting from compensation payments to clients. In order to recognise the indemnity provided by ABN Amro N.V. and the insurance company the Group recorded an asset of HUF 17 300 million as at 31 December 2009 (HUF 1 079 million increase in 2009 and HUF 11 118 million increase in 2008) for amounts expected to be received as part of the indemnity agreement.

The change in provision and the asset itself are presented net in the consolidated income statement (HUF 80 million gain in 2009 and HUF 7 477 million gain in 2008). From 2007 the calculation of provision is based on an effective interest rate method which results in a HUF 858 million increase recorded as interest expense in the consolidated income statement (HUF 159 million increase in 2008).

NOTE 27 – PROVISIONS FOR RISK AND CHARGES (continued)

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

The K&H Equities is in a settlement dispute with the insurance company. In 2008 the insurer rejected the claim of K&H Equities in the amount of HUF 1 028 million and related penalty interest due to faulty settlement. The insurer also announced a counter claims toward K&H Equities in the amount of HUF 615 million and related penalty interest which were not accepted by K&H Equities. The outcome of the settlement dispute is uncertain. Based on the legal opinions it is only possible, but not probable, that the claims of insurer will succeed in its actions. The Group has therefore not made any provision for the claim of the insurer.

The K&H Group is also party to litigation and claims arising in the normal course of business. The majority of the provision of HUF 11 286 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2009 (HUF 18 206 million at 31 December 2008) has been created relating to commercial litigations as a consequence of the sale of investment products to clients in the past. In 2009 commercial compensation was offered to clients and in the majority of the cases a settlement has been reached for which the cost was recorded. For this reason Management believes that during 2009 uncertainty regarding the outcome of these commercial litigations reduced significantly and considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 3 137 million as at 31 December 2009 (HUF 3 533 million as at 31 December 2008) is presented in Note 20.

NOTE 28 – OTHER LIABILITIES

	2009 MHUF	2008 MHUF
Trade creditors	3 333	3 675
Lease liabilities	1	5
Items in transit due to payment services	19 131	19 813
Vostro accounts	515	769
Items in transit due to lending activity	673	3 176
Items in transit due to trading in securities	-	1 003
Liabilities from bankcard service	1 299	1 988
Liabilities from brokerage services	5 377	2 783
Other	11 257	13 827
Total other liabilities	41 586	47 039

NOTE 29 – SHARE CAPITAL

	2009 MHUF	2008 MHUF
Ordinary shares issued and outstanding	73 709	66 307

During 2009 KBC Bank N.V increased the Bank's share capital. The capital increase of HUF 7 402 million was effective as of 30 April 2009.

NOTE 29 - SHARE CAPITAL (continued)

The nominal value of the ordinary shares issued and outstanding at 31 December 2009 is HUF 1 per share (2008: HUF 1).

Shareholders of the Bank:

	2009 Shares held (millions)	2009 Shareholding %	2008 Shareholding %
KBC Bank N. V.	73 709	100.00%	100.00%
	73 709	100.00%	100.00%

NOTE 30 – 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 30 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

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

	2009 MHUF	2008 MHUF
Credit commitments – undrawn amount		
Received	7 944	2 241
Given		
Irrevocable	172 433	174 672
Revocable	120 337	149 095
Total given	292 770	323 767
Financial guarantees		
Given	117 971	143 941
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets	330 864	178 319
Financial assets	1 183	180
For assets that are not impaired or past due		
Non-financial assets	1 518 877	1 417 955
Financial assets	16 448	29 819
Total guarantees received/collateral	1 867 372	1 626 273

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 10 573 million (HUF 1 969 million as at 31 December 2008) 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 31 – FINANCE AND OPERATING LEASES

Lessor position

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

	2009	2008
	MHUF	MHUF
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	27 853	25 832
one to five years	25 339	37 705
more than five years	6 119	8 739
	59 311	72 276
The present value of minimum lease payments receivables*:		
less than one year	17 610	16 298
one to five years	22 583	32 206
more than five years	4 367	7 465
	44 560	55 969
Unearned finance income	10 267	13 009
Contingent rents recognized as income - gross	4 018	4 312
Non-guaranteed residual values	4 007	1 032

*Net of impairment.

The total impairment recorded on financial lease receivables amounted to HUF 4 474 million as at 31 December 2009 (HUF 3 577 million as at 31 December 2008).

The term of the new contracts is between 3 and 120 months. Interest rates are in BUBOR, EURO LIBOR or CHF LIBOR plus an average margin of 3.14% (2.70% in 2008). The CHF and the long terms contracts (120 month) are related to contracts in the Retail Car Financing business line, these contracts already having been agreed at the end of 2008. Without these Retail Car Financing contracts the term of new contracts are between 3 and 85 months with interest rates in either BUBOR or EURO LIBOR.

NOTE 31 – FINANCE AND OPERATING LEASES (continued)

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

	2009 MHUF	2008 MHUF
Total of futures minimum lease payments:		
less than one year	805	-
one to five years	1 004	-
more than five years	-	-
	1 809	-
Contingent rents recognised as income - gross	833	-

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

	2009 MHUF	2008 MHUF
Office equipment	35	-
Other	1 789	-
Total carrying amount	1 824	-
Accumulated depreciation	779	-

Lessee position

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

	2009 MHUF	2008 MHUF
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	2 390	1 535
one to five years	6 228	6 122
more than five years	3 033	2 582
	11 651	10 239

	2009 MHUF	2008 MHUF
Future minimum sublease payments expected to be received	-	42
Minimum lease payments recognized as expense	5 067	4 464

NOTE 32 – 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 (2008: 100.00%). The ultimate parent of the Group is KBC Group N.V.

Subsidiaries:

See list of subsidiaries in Note 34.

Associates:

See list of associates in Note 34.

Other related parties, members of KBC Group:

Baker Street Finance Ltd
CBC Banque SA
Československa Obchodni Banka a.s.
Dorset Street Finance Ltd
Fin-Force N.V.
Hanover Street Ltd
KBC Bank Ireland Plc. (formerly Irish Intercontinental Bank)
KBC Asset Management Ltd
KBC Asset Management N.V.
KBC Bank Deutschland AG.
KBC Global Services N.V. (formerly KBC Exploitatie N.V.)
KBC Internationale Financieringsmij N.V.
KBC Lease Holding N.V.
KBC Securities N.V.
K&H Biztosító Zrt.
Kredyt Bank SA
KBL European Private Bankers SA (formerly Kredietbank SA Luxembourgeoise)
Pembridge Square Ltd
Regent Street Ltd
Sydney Finance Street Ltd

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 32 - RELATED PARTY TRANSACTIONS (continued)

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

	Parent MHUF	Subsidiaries MHUF	Associates MHUF	Other related parties MHUF	Total MHUF
As at 31 December 2009					
Assets					
Loans and advances	1 812	-	205	1 335	3 352
Current accounts	1 072	-	-	669	1 741
Term loans	740	-	205	549	1 494
Finance leases	-	-	-	117	117
Other receivables	2	-	-	247	249
Total assets	1 814	-	205	1 582	3 601
Liabilities					
Deposits	723 906	-	661	28 835	753 402
Current accounts	220 694	-	661	5 614	226 969
Term deposits (with agreed maturity)	503 212	-	-	23 221	526 433
Subordinated liabilities	16 204	-	-	-	16 204
Other liabilities	330	-	28	1 016	1 374
Total liabilities	740 440	-	689	29 851	770 980
Income statement					
Net interest income	(11 457)	-	13	(6 659)	(18 103)
Interest income	62	-	38	776	876
Interest expense	(11 519)	-	(25)	(7 435)	(18 979)
Net fee and commission income	(638)	-	(322)	206	(754)
Fee and commission income	468	-	7	1 363	1 838
Fee and commission expense	(1 106)	-	(329)	(1 157)	(2 592)
Other net income	34	-	(1)	(5 025)	(4 992)
Other income	49	-	-	932	981
Other expense	(15)	-	(1)	(5 957)	(5 973)
Total income statement	(12 061)	-	(310)	(11 478)	(23 849)
Off-statement of financial position items					
Commitments and contingent liabilities	10 822	-	-	27 093	37 915
Guarantees received	3 343	-	-	-	3 343
Notional amount of derivatives	1 587 488	-	-	37 263	1 624 751

NOTE 32 - RELATED PARTY TRANSACTIONS (continued)

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

NOTE 32 - RELATED PARTY TRANSACTIONS (continued)

Transactions with key management

Loans

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

The outstanding amount of such housing loans at 31 December 2009 was HUF 24 million (HUF 26 million at 31 December 2008), with the long-term maturity obligations ranging from 15-20 years.

Deposits

In accordance with the Group's internal policy, all the employees of the Group, including key management staff are entitled to have a bank account and a securities/bond account with condition of K&H 4000+ account package offered for companies with number of employees over 4 000. According to this package the interest paid on deposit is the maximum interest rate for the K&H Savings Deposit Account + 1.50%, with a maximum of the basic interest rate of the Hungarian National Bank less 0.5%.

At 31 December 2009 the outstanding amount of deposits was HUF 155 million (HUF 58 million at 31 December 2008). In 2009 the Bank paid HUF 7 million interest on these deposits (HUF 4 million in 2008).

The following amounts have been granted to key management personnel:

Type of benefit	**2009**	**2008**
	MHUF	**MHUF**
Short-term employee benefits	489	396

NOTE 33 – AUDITOR'S REMUNERATION

The remuneration recognised due to the audit of statutory annual accounts performed by Ernst & Young Audit Kft. amounted to HUF 170 million in 2009 (HUF 152 million in 2008). In 2009 an additional remuneration of HUF 30 million was either accrued or paid to the auditor for other services, such as data custody and delivery of tax service in relation to the Equities fraud (HUF 106 million in 2008).

NOTE 34 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2009	Effective Shareholding 2008
Fully consolidated subsidiaries		%	%
K&H Pannonlízing Zrt.	Finance lease	100	100
K&H Autópark Kft.	Operative lease	100	100
K&H Autófinanszírozó Zrt.	Finance lease	100	100
K&H Eszközfinanszírozó Zrt.	Finance lease	100	100
K&H Eszközlízing Kft.	Operative lease	100	100
K&H Alkusz Kft.	Insurance broker	100	100
K&H Lízingház Zrt.	Operative lease	100	100
K&H Lízing Zrt.	Finance lease	100	100
K&H Lízingadminisztrációs Zrt. “v.a.”	Dormant	100	100
K&H Ingatlanlízing Zrt.	Finance lease	100	100
K&H Befektetési Alapkezelő Zrt.	Fund manager	100	100
K&H Csoportszolgáltató Kft.	Group service center	100	100
K&H Equities Zrt.	Business and management consultancy	100	100
Kvantum KK Rt. "v.a."	Under liquidation	100	100
K&H Faktor Zrt.	Other financial services	100	-
Associates consolidated using the equity method			
Giro Elszámolásforgalmi Zrt.	Clearing house	21	21
HAGE Zrt.	Meat processing	25	25
Budatrend-III. Zrt.	Real estate management	-	34
Immaterial, non consolidated investment			
Risk Kft. „f.a.”	Under liquidation	100	100

During 2009, Budatrend III. Zrt. was liquidated. The carrying amount of the Bank’s participation was HUF 151 million, the Group didn’t realise any result on the liquidation.

NOTE 35 – SUBSEQUENT EVENTS

There were no material subsequent events.

NOTE 36 – 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	18 323	173 297	3 048 418	2 856 798
Adjustments for IFRS accounts				
Capitalization of VAT, financial leases and revaluation of real estates	19	695	898	184
Portfolio-based allowance for loan losses	(8 455)	16 850	(8 165)	(16 560)
Specific allowance for loan losses	3 177	192	2 789	(580)
Adjustment on delivery repos	(6 291)	15 990	9 805	106
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	(1 500)	582	(12 108)	(11 190)
Fair valuation of AFS portfolio	60	(3 391)	8 470	11 801
Cash flow hedge on FX options	(786)	786	-	-
Holiday accruals	468	(523)	-	55
Amortisation of loan origination fees	1 306	(277)	983	(46)
Deferred tax	3 098	(5 740)	-	2 642
Bank standalone IFRS	9 419	198 461	3 051 090	2 843 210
Subsidiaries accounts prepared under Hungarian Accounting Standards	1 960	8 619	165 427	154 848
Adjustments for IFRS accounts				
Portfolio-based allowance for loan losses	334	(1 232)	(898)	-
Financial leases	(162)	620	789	331
Specific allowance for loan losses	(78)	312	17 534	17 300
Cash flow hedge on FX options	-	-	851	851
Deferred tax	429	197	626	-
Subsidiaries standalone IFRS	2 483	8 516	184 329	173 330
Adjustments for consolidation	(1 867)	(6 367)	(170 922)	(162 688)
Balance per IFRS report	10 035	200 610	3 064 497	2 853 852

[1] Excluding the current year profit

NOTE 37 – RISK MANAGEMENT

37.1 General

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

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

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

Risk Management governance model

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

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

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

Risk measurement and – monitoring

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

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

NOTE 37 – RISK MANAGEMENT (continued)

- Measurement of risks; qualitative and quantitative assessment of exposure to risk. The Group uses the following risk measures for the following significant risk types:
  - Credit risk: nominal positions (outstanding/exposure), LGD/EL (loss given default/expected loss), stress test results. In the future the Group will more intensively use an economic capital approach to credit risk measurement.
  - 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, net present value.
  - Operational risk: KRI (key risk indicator), results of risk self assessment, level of compliance with Group Standards.
  - Liquidity risk: Operational unsecured liquidity gap, loan-to-deposit ratio, liquidity stress test results.

- Setting limits; is a way of authorizing specific forms of risk taking. A limit indicates how much risk the Group considers 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 (mainly local risk committees) in a structured format. The main types of reports used in the Group:
  - exposures to key risk types,
  - limit breaches,
  - losses and near misses,
  - advice from risk management department regarding the risk response.

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

- Monitoring and response to shortcomings; the purpose of responding to risks is to 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.

37.2 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. In 2009 the Group completely renewed its liquidity policy and built up a comprehensive Liquidity Risk Management Framework.

NOTE 37 – 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 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 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 their 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:

- Building up and maintenance of a sound and diversified liability structure;
- Attracting significant client funds (both corporate and retail);
- Keeping the cost of funding to a minimum, while maintaining competitiveness (prices should be in line with the rates of other key players in the market);
- Avoiding reliance on volatile deposits that can be attracted by aggressive pricing;
- Offering full service to clients with the widest possible array of financial products.

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

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

Operational liquidity is measured by the unsecured liquidity gap limit. The operational liquidity gap is the difference between the cash in and outflows in different time horizons (5 day, 30-day and 90-days) and an internal limit was set for the gap to be covered by National Bank of Hungary eligible collaterals. The Group had no uncovered operational liquidity gap in 2009, its operational liquidity situation being both sound and stable during 2009 despite the international financial crisis.

NOTE 37 – RISK MANAGEMENT (continued)

Structural liquidity is managed via the loan-to-deposit (LTD) ratio, being an overall liquidity benchmark. LTD is calculated as the amount of a bank's loans to customers divided by the amount of its customer deposits at any given time. The higher the ratio, the more reliant the Bank is on borrowed wholesale funds. The loan to deposit ratio was 104.3% in 2008 and 91.1% in 2009.

Liquidity stress tests

Contingency liquidity risk is assessed in the Group on the basis of several liquidity stress scenarios. The aim of the stress tests is to measure how the liquidity buffer of the Group evolves under stressed scenarios. For each scenario the evolution of the liquidity buffer is calculated: this is the amount of excess liquidity per time bucket. Excess liquidity is the amount of cash that is available which is not required to cover immediately maturing liabilities. The simulated liquidity buffer is the sum of two components: the expected cash evolution under stressed scenarios and the expected liquidity increasing actions under stressed scenarios. In essence, there are two different types of stress tests: General market and KBC / K&H specific scenarios. Under both scenarios the Group would achieve the internally set survival period.

NOTE 37 – RISK MANAGEMENT (continued)

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

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

NOTE 37 – RISK MANAGEMENT (continued)

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

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

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

NOTE 37 – RISK MANAGEMENT (continued)

37.3 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. The market risk for the trading portfolio is managed and monitored based on a historical VaR (hVaR) methodology. Market risks of non-trading positions (banking book) are managed and monitored using other risk measures.

Market risk – trading

The Group is exposed to market risk via the trading books of the Bank'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 ensure that the Group would withstand market shocks.

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

The hVaR approach uses the actual historic market performance to simulate possible future market evolutions. The hVaR methodology does not rely on assumptions regarding the distribution of price fluctuations or correlations, but is based on patterns of experience over the previous two years (500 scenario dates). The hVaR that the Group applies is an estimate - using a confidence level of 99% and ten-day holding period. The use of the 99% confidence level means that, within a one day horizon, losses exceeding the VaR figure should occur, on average, once every hundred days. However, the VaR method will not tell us how much we will lose on that day, only that it will 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.

NOTE 37 – RISK MANAGEMENT (continued)

VaR results can be presented as follows:

	Foreign exchange	Interest rate	Global VAR
	MHUF	MHUF	MHUF
2009 – 31 December	95	311	374
2009 – Average daily	215	739	772
2009 – Highest	543	1 684	1 591
2009 – Lowest	4	311	374
2008 – 31 December	202	1 315	1 147
2008 – Average daily	186	851	816
2008 – Highest	1 041	2 718	2 785
2008 – Lowest	13	288	321

The Group's hVaR exposure decreased significantly in 2009 compared to the year 2008, characterised by the market turmoil in Hungary and in the entire global financial system. In the beginning of the year 2009 positions were built down resulting in a moderate limit utilisation for the rest of the year. The average limit utilization was well below the hVaR limit of the Group.

Market risk – Non-trading

The Asset and Liability Committee (ALCO) is responsible for controlling the value creation, the maturity transformation and the market risks of the banking book. In 2009 the Group introduced both a new Asset and Liability Management (ALM) Policy, and Investment Policy, and built up a comprehensive Banking Book Interest Rate Risk Management Framework. The Group applies the KBC ALM risk management methodology. Risk tolerance levels are allocated by KBC Group ALCO and approved by the K&H Board of Directors.

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

The BPV tables below presents the results of reasonable possible changes of the economic value of the banking book on 31 December 2009 and 2008. Possible alternatives were calculated based on the scenarios of 10, 100, and 200 basis point parallel shifts in yield curves. The banking book is limited in BPV by an internally set limit; the Group performed within the imposed limit during 2009.

NOTE 37 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2009	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up	CHF	(86)	(3)	(89)
	EUR	-	66	66
	HUF	(843)	651	(192)
	USD	-	(28)	(28)
10 bp parallel up total		(969)	727	(242)
100 bp parallel up	CHF	(841)	(33)	(875)
	EUR	-	609	609
	HUF	(8 283)	6 287	(1 996)
	USD	-	(282)	(282)
100 bp parallel up total		(9 478)	6 934	(2 544)
200 bp parallel up	CHF	(1 545)	(179)	(1 725)
	EUR	-	1 160	1 160
	HUF	(16 130)	12 218	(3 912)
	USD	-	(557)	(557)
200 bp parallel up total		(18 377)	13 344	(5 033)

DOWN Scenarios, 31 December 2009	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down	CHF	85	4	89
	EUR	-	(60)	(60)
	HUF	862	(642)	220
	USD	-	29	29
10 bp parallel down Total		991	(713)	278
100 bp parallel down	CHF	987	(202)	785
	EUR	-	(910)	(910)
	HUF	8 780	(6 654)	2 126
	USD	-	286	286
100 bp parallel down total		10 128	(7 841)	2 287
200 bp parallel down	CHF	2 169	(1 391)	778
	EUR	-	(2 137)	(2 137)
	HUF	18 083	(13 731)	4 351
	USD	-	346	346
200 bp parallel down total		20 978	(17 640)	3 338

NOTE 37 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2008	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up	CHF	-	(11)	(11)
	EUR	-	(10)	(10)
	HUF	(384)	(147)	(532)
	USD	-	(1)	(1)
10 bp parallel up total		(419)	(135)	(554)
100 bp parallel up	CHF	-	(112)	(112)
	EUR	-	(74)	(74)
	HUF	(3 718)	(1 430)	(5 148)
	USD	-	(8)	(8)
100 bp parallel up total		(4 063)	(1 279)	(5 342)
200 bp parallel up	CHF	-	(220)	(220)
	EUR	-	(96)	(96)
	HUF	(7 173)	(2 766)	(9 940)
	USD	-	(12)	(12)
200 bp parallel up total		(7 858)	(2 410)	(10 268)

DOWN Scenarios, 31 December 2008	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down	CHF	-	11	11
	EUR	-	11	11
	HUF	387	149	536
	USD	-	1	1
10 bp parallel down Total		422	137	559
100 bp parallel down	CHF	-	203	203
	EUR	-	134	134
	HUF	4 002	1 535	5 537
	USD	-	9	9
100 bp parallel down total		4 354	1 529	5 883
200 bp parallel down	CHF	-	206	206
	EUR	-	455	455
	HUF	8 316	3 184	11 500
	USD	-	4	4
200 bp parallel down total		9 025	3 140	12 165

NOTE 37 – RISK MANAGEMENT (continued)

Currency risk

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

Fair valuation

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

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

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

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

37.4 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 37 – 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. Risk ratings are assessed and updated regularly. Bank's assets have been distributed among classes based on the Basel II PD rating for Corporate and SME counterparties, and based on the facility rating for Leasing and Consumer exposures according to the table below. Unimpaired Leasing and Consumer exposures are presented in 'Standard grade'.

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

Credit risk management at transactional level

Acceptance

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

Supervision and monitoring

How the credit is monitored is determined primarily by the risk class, determined based on the Probability of Default (PD) classification of the client. The 'normal' loan portfolio is split up into internal rating classes ranging from 1 (lowest risk) to 9 (highest 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, 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 37 – RISK MANAGEMENT (continued)

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

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

Classes 11 and 12 are for 'non-performing' borrowers. Class 11 groups borrowers that have any material amount payable by the client to any member of the KBC Group and that has been overdue for more than 90 days. For overdrafts days past due commence, once an obligor has breached an advised limit or has drawn credit without authorisation and the underlying amount is material. For credit cards the start date of days past due is the due date of the minimum repayment obligation. An amount is considered material if it exceeds

- HUF 250.000, or
- 2% of the total contracted obligations of the client. At calculating the total contracted obligation, off-statement of financial position liabilities have to be taken into account by using the loan conversion factor.

Class 12 comprises borrowers if:

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

Credit risk management at portfolio level

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

NOTE 37 – 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.

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.

	2009 MHUF	2008 MHUF
Equity instruments*	8 266	8 625
Debt instruments*	1 150 977	1 024 403
Loans and advances	1 769 559	1 961 060
of which designated at fair value through profit or loss*	2 329	2 430
Derivatives*	41 536	87 585
Other assets	31 205	39 602
Total assets	3 003 892	3 123 705
Commitments to extend credit	292 752	323 719
Guarantees	112 594	134 740
Letters of credit	2 259	5 717
Total commitments and contingent liabilities	407 605	464 176
Total credit exposure	3 411 497	3 587 881

*For more information see Note 16.

NOTE 37 – RISK MANAGEMENT (continued)

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

Risk concentration of the maximum exposure to credit risk

Concentration of risk is managed by client/client group and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2009 was HUF 36 055 million (HUF 34 634 million as of 31 December 2008) before taking account of any collateral or other credit enhancements.

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

	2009	2008
	MHUF	MHUF
Industry sector		
Service industry	335 615	294 822
Agriculture	75 095	89 717
Manufacturing and building	235 499	301 186
Food processing	48 467	59 512
Wholesale and retail	114 072	171 361
Power industry	42 871	37 874
Other	3 231	36 954
Individuals	808 979	810 538
Gross loans	1 663 829	1 801 964
Portfolio-based impairment for loan losses	(9 063)	(5 348)
Specific impairment for loan losses	(64 844)	(41 647)
Impairment on loans and receivables (see Note 20)	(73 907)	(46 995)
Loans to customers	1 589 922	1 754 969

NOTE 37 – RISK MANAGEMENT (continued)

The Group's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2009 can be analysed by the following geographical regions.

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets							
Hungary	89 663	9 145	1 075 734	1 586 343	132	-	2 761 017
EMU countries	20 240	-	-	22 666	194	-	43 105
East-European countries	1 104	-	-	13 295	-	-	14 399
Russia	-	-	-	4 727	-	-	4 727
Other European countries	6 448	-	-	5 470	21	-	11 939
Non-European countries	203	-	-	4 113	-	-	4 555
Total	117 658	9 145	1 075 734	1 636 614	347	-	2 839 742
Financial liabilities							
Hungary	13 761	155 580	-	-	721	1 596 277	1 766 339
EMU countries	37 909	-	-	-	499	908 625	947 033
East-European countries	170	37	-	-	-	17 934	18 141
Russia	-	-	-	-	-	5 952	5 952
Other European countries	7 250	-	-	-	257	6 218	13 725
Non-European countries	1 310	46	-	-	-	15 131	16 487
Total	60 400	155 663	-	-	1 477	2 550 137	2 767 677

NOTE 37 – RISK MANAGEMENT (continued)

The geographical breakdown of financial assets and financial liabilities as at 31 December 2008 is presented below:

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

Collateral and other credit enhancements

In compliance with its business policy the Group normally does not grant collateral-based financing (i.e. financing that is not based on the loan repayment capacity of the client), however, there may be exceptions to this rule. The Group grants credits to advance resources that may be repaid from the borrower's cash flow, and assumes active lending commitments only if they may be returned from cash flow. The borrower's cash flow represents the primary – direct – source of loan repayment to the Group.

NOTE 37 – RISK MANAGEMENT (continued)

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

The main types of collateral applied are as follows:

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

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

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

Credit quality per class of financial assets

The table below presents the credit quality by asset classes as at 31 December 2009:

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

NOTE 37 – RISK MANAGEMENT (continued)

The credit quality of assets as at 31 December 2008 can be presented as follows:

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

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 2009 is as follows:

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

Aging analysis of past due but not impaired financial assets as at 31 December 2008 is as follows:

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

NOTE 37 – RISK MANAGEMENT (continued)

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

Credit quality of not impaired nor past due assets

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

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	69 068	6 816	1 028 673	13 454	-	1 118 011
Standard grade	48 590	-	47 305	882 131	347	978 373
Sub-standard grade	-	2 329	-	479 392	-	481 721
Total carrying value	117 658	9 145	1 075 978	1 374 977	347	2 578 105

The credit quality of unimpaired and not past due assets as at 31 December 2008 is presented in the table below:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	134 408	6 903	840 069	145 190	-	1 126 570
Standard grade	93 859	-	44 257	1 046 490	1 039	1 185 645
Sub-standard grade	-	2 508	-	508 953	-	511 461
Total carrying value	228 267	9 411	884 326	1 700 633	1 039	2 823 676

NOTE 37 – RISK MANAGEMENT (continued)

Credit risk exposure for each internal risk rating

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

	Historical default rates	Average unsecured share of exposure 2009	Total 2009	Average unsecured share of exposure 2008	Total 2008
	%	%	MHUF	%	MHUF
High grade	0.00	80.86	66 481	81.49	237 450
Standard grade	4.84	34.26	1 121 929	33.85	1 184 757
Sub-standard grade	10.46	66.92	656 975	46.52	719 692
Impaired	100.00	46.38	248 047	49.88	151 368
Total			2 093 432		2 293 267

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

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

	2009	2008
	MHUF	MHUF
Loans to customers		
- Corporate lending	7 815	3 636
- Small business lending	191	6 314
- Consumer lending	43 026	4 047
Total	51 032	13 997

NOTE 37 – 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). For such loans and receivables impairment losses are recorded on a ‘portfolio basis’, using a formula based on the IRB Foundation models intended to be used for calculating capital requirements. This formula was introduced in the fourth quarter of 2007 in order to better comply with IFRS requirements for Incurred But Not Reported provisions.

Statistical impairment

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

Individually assessed impairments

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

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 and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. The Group records such impairments based on an estimate of the net present value of the recoverable amount.

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

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

NOTE 37 – RISK MANAGEMENT (continued)

Internal credit risk models and Basel II

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

Starting from 2011, these models are also planned to form the building blocks for calculating the regulatory capital requirements for credit risk. The Bank is in other words opting to use the Internal Rating Based (IRB) Approach. Initially, the Bank will use the IRB 'Foundation' Approach, but a switch to the 'Advanced' approach is envisaged in 2013 (both are subject to regulatory approval).

The switch to the Basel II IRB Foundation approach is taking place in stages, with the Bank planning to switch over in 2011, while main subsidiary (K&H Leasing Group) is planning to adopt the IRB Advanced approach in 2013 directly from being under Standardised approach since 2008 (subject to regulatory approval).

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

37.5 Operational risk

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

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

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

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

NOTE 37 – RISK MANAGEMENT (continued)

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

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

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

NOTE 38 – SOLVENCY AND CAPITAL

In accordance with Act CXII of 1996 on Credit Institutions and Financial Enterprises, the Bank must have a minimum capital amount higher than 8% of risk weighted assets. According to the Act, the capital adequacy ratio calculation is prepared based on Hungarian accounting standards. The main differences between statutory and IFRS accounts are presented in Note 36. The Bank takes this regulation into account when preparing its detailed budget and creates further reserves in order to have sufficient guarantee capital in case of the depreciation of the HUF or other unexpected events. The Bank reports its level of capital adequacy situation to the Hungarian Financial Supervisory Authority (HFSA) each month and also prepares monthly forecasts to the Asset-Liability Committee (ALCO) of the Bank. When needed, the Bank's Executive Committee decides and proposes to KBC Group any necessary steps that the Committee believes need to be taken (such as capital increase, dividend payment etc).

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

According to Hungarian capital adequacy regulations, the Bank's capital adequacy ratio at 31 December 2009 was 12.82% (9.87% at 31 December 2008). The Bank fulfilled the capital requirements set by HFSA continuously during years 2009 and 2008 and at 31 December 2009 (and at 31 December 2008).

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 2009 was HUF 12 536 million (HUF 10 704 million as at 31 December 2008).

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

Accordingly, the Bank had distributable reserves of HUF 77 304 million as at 31 December 2009 (HUF 68 215 million as at 31 December 2008).

The dividend proposed on ordinary shares for approval by the shareholder (not recognized as a liability as at 31 December 2009) is HUF 10 035 million – 0.136143 HUF/share (HUF 7 402 million – 0.111632 HUF/share in 2008).

K&H Bank Zrt.

Consolidated business report

December 31, 2009

On December 31, 2009, the Group's consolidated balance sheet total stood at 3 064 billion HUF. As a financial institution offering banking and insurance products alike, K&H offers the whole range of financial services to clients via its 241 branches.

INTRODUCTION OF STRATEGIC SUBSIDIARIES

Leasing Group

Currently, the Leasing Group consists of 9 legal entities.

Name	Key profile
K&H Pannonlízing Zrt	Lending
K&H Autófinanszírozó Zrt.	Financial leasing
K&H Autópark Kft.	Operative leasing, fleet management (lease)
K&H Eszközfinanszírozó Zrt.	Financial leasing
K&H Eszközlízing Kft.	Operative leasing (lease)
K&H Ingatlanlízing Zrt.	Financial leasing
K&H Alkusz Kft.	Insurance mediation

K&H Lízing Zrt. and K&H Lízingház Zrt. play a passive role in the operation of the Leasing Group. The company doesn't conclude new contracts any more. In the future they will either become part of an active company, or, being companies without an active portfolio, they will be wound up. As a step in the company consolidation process, the voluntary liquidation of Lízingadminisztrációs Zrt. was completed in 2009. The company consolidation process will also carry on in 2010, in order to ensure the optimum distribution of legal entities versus activities.

The largest company in the Group is K&H Pannonlízing Zrt., which has a weighting of 63% in the portfolio.

At the end of 2009, the portfolio of **K&H Leasing Group** stood at approximately 127 billion HUF, which represents a 25% drop compared to the end of the previous year. The discontinuation of retail car financing at the end of 2008 resulted in the gradual reduction of the retail car financing and dealer financing portfolios. Preliminary half-year figures about financing provided on the leasing market show that the Leasing Group obtained a 3% market share overall, with 9.8% achieved in the fleet business line and 5.1% in the TME business line, and with new production amounting to 14 billion HUF.
Since the beginning of 2009 the company has been focusing on corporate and SME clients, offering corporate finance products in the asset financing and fleet financing business lines. In 2009 they developed and adjusted their systems and processes accordingly. In the field of fleet financing they introduced the Advise Soft system.

K&H Befektetési Alapkezelő Zrt.

Year 2009 was characterised by continuous improving market conditions, but, despite some encouraging signs, it was still not clear by the end of the year if the crisis was over. Savings started to grow in the 4th quarter of the year, but they still did not reach their pre-crisis value.
Assets managed both in investment funds and in portfolios slightly grew, and the company's operating income exceeded targets, largely due to tight cost management. They also carried on with the innovation strategy launched in previous years, and not only on the market of closed-end funds, as a number of new open-ended products were also launched.

During the year, the asset management company launched 8 new, public closed-end and 2 exclusive, closed-end funds. The major challenge last year was the conversion of certain maturing funds into new, open-ended funds and the retention of savings in the bank. The majority of maturing savings (amounting to approximately 120 billion HUF) remained in investment funds, also owing to the sales campaigns linked to maturing funds.
As for discretionary portfolios, our co-operation with existing partners strengthened further, even though the loss-in-value of share markets significantly affected the asset managed portfolios as well. At the end of 2009 the fund management company was managing assets worth 685 billion HUF (compared to 624 at the beginning of the year), of which investment funds amounted to 529 billion HUF (509 billion HUF at the beginning of the year), which still makes it the second largest player on the investment funds market, with a market share of 20.2%. The company is successfully safeguarding its market leading position in the guaranteed funds segment, where our market share could grow due to the outstandingly high retention rate of maturing funds, compared to our competitors.

K&H Csoportszolgáltató Kft

In 2005, K&H Group decided to set up a group services company, under the leadership of K&H Bank, the 100% owner of K&H Csoportszolgáltató Kft. (KHCSK). The purpose of this company was to centralise and efficiently organise all service and supplementary service activities performed in individual groups and closely linked to the core activities. [1]

The Company takes out service level agreements with individual group members for each service. Since 2007, services offered by KHCSK have also been used by the entities of K&H Insurance and the K&H Leasing Group as well. Currently KHCSK acts as the service centre for 12 entities (including the bank). As of May 1, 2008, KHCSK has also been performing financial and accounting, as well as operating tasks for the Hungarian branch office of KBC Global Services N.V. (KBC GSC), using KBC's SAP system. The EU Tender Consulting Directorate was set up on January 1, 2008. It is responsible for advisory and support services for EU applications. Since 2009, the company has also been responsible for the provision of financial and accounting services to RTI Invest Kft., a company constructing the buildings that will house the regional server centre of KBC Group; and K&H Factoring, a 100% K&H-owned subsidiary.

In addition to the services extended to the Group, the company also performs business administration activities for Supershop Kft.

KEY CONSOLIDATED FIGURES OF THE BANK GROUP

In 2009 the Bank Group's total assets decreased by appr. 4% primarily due to customer related loan and deposit volumes. The consolidated assets of the subsidiaries decreased by 21% compared to previous year. Subsidiaries with significant volume of total assets include: Pannonlízing Zrt (HUF 90 billion), K&H Autófinanszírozó Zrt (HUF 34 billion).

billion HUF	2008	2009	change
Balance sheet total	3,182.5	3,064.5	-3.7%
Loan portfolio	1,854.8	1,636.6	-11.8%
Of this: retail lending	705.6	708.7	+0.4%
Client deposits and deposit certificates	2,014.0	1,810.4	-10.1%
Of this: retail deposits	543.8	563.3	3.6%
Shareholders' equity	193.5	210.6	8.9%

[1] Comprehensive service activities performed by the company for the bank group include real estate management, logistics and bank security tasks, business management tasks (trade receivables, trade payables, fixed assets etc.; accounting, tax issues, payroll management). Supplementary business activities include the provision of comprehensive IT facilities for the SuperShop store loyalty programme, the sale of loyalty programmes and the provision of IT facilities for the General Loyalty Settlement System developed; as well as assistance with the issuing of cards for loyalty programmes in place at client sites. The company is a representative of K&H Group's VAT Group.

The operations, risk management practice, balance sheet and profit and loss statement of K&H Bank Zrt. are presented in detail in the Business Report for 2009.

Key items in the consolidated balance sheet:

- During the year *Loans and receivables* decreased by 12% primarily due to corporate and leasing portfolio; while the retail loan portfolio remained practically at the same level as of previous year.
- The total *deposit portfolio* decreased by 10% compared to the closing balance of 2008 in connection with the deposits of the funds managed by KBC Asset Management, an institution belonging to the interest of the owner KBC Bank, while there was a favourable evolution in business related deposits (both retail and corporate deposit portfolio increased in 2009).
- The 17.1 bln growth in *equity* is the balance of the following items: accounting for the dividends paid to the owner concerning 2008 and a capital increase in the amount corresponding to the first (- HUF 7.4 billion in accumulated profits, + HUF 7.4 in subscribed capital), current year's profit (+ HUF 10.0 billion), increase in cash flow hedge reserve and the revaluation reserve related to marketable financial instrument (HUF 7.1 billion).

The Bank Group's operating profit increased by 17% in 2009 (2009: HUF 56.8 billion, 2008: HUF 48.7 billion). Development of the main P&L components:

- The *net interest income* rose by almost 35% in 2009. Although, compared to the previous period there was an increase in credit margins, the increase is partially of technical nature (and connected to the changing financing structure of the bank as a result of the crisis)[2].
- *Net fee and commission income* (2009: HUF 28,2 billion, 2008: HUF 26.8 billion) increased by 5% primarily due to the bankcard and investment services related fee income.
- The significant decrease of *the net gains from financial instruments at fair value* (2009: HUF 20.0 billion, 2008: HUF 38.5 billion) is attributable to the already mentioned technical type decrease of interest rate swaps (which at the same time is offset by the increase of *"net interest and interest-type income"*, see above). The impact of the decreasing swap portfolio (on this P&L line) is mitigated by the rise of Treasury income compared to the reference period.

There was 7% decrease in the operating expenses of the Bank Group in 2009 (2009: HUF 80.9 billion, 2008: HUF 86.6 billion):

- *Personnel costs* increased by HUF 0.9 billion (2.8%) compared to previous year,
- The significant increase in *other costs* is primarily caused by operational type costs, which was offset by the adverse change in 'provisions for risks and charges'.

[2] the Bank acquires a significant part of the funds required for the foreign currency lending from EUR interbank deposits and EUR/CHF FX swaps instead of the previously typical HUF/CHF FX swaps. As a result of this the interest-type income connected to swaps decreased (in the books it is stated under the heading of "*net gains from financial instruments at fair value")*, which at the same time is offset by the interest income related to the securities portfolio – increased due to the surplus liquidity – under the interest profit & loss heading.

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

	2008	2009	change
Costs/ income	64.0%	58.7%	-5.3%
Non-interest type income/ total income	44.1%	35.2%	-8.9%
Commission income / total income	19.8%	20.4%	+0.6%
Operating income / average headcount	35.0	37.9	+8.3%
Operating costs / average headcount	22.4	22.3	-0.7%
Operating P&L / average headcount	12.6	15.6	+24.2%
Loan / deposit	104.3%	91.1%	-13.2%
Capital*/total liabilities	6.7%	7.6%	+0.9%
Solvency ratio (Basel II)**	9.87%	12.82%	+2.9%
ROE (calculated with the opening balance of equity)	12.5%	5.2%	-7.3%
ROA (calculated with average balance sheet total)	0.9%	0.3%	-0.6%

* in addition to equity it also includes subordinated debt capital

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

Although K&H Bank's performance has further improved in respect of operating profit and financial ratios, the significant increase of impairments connected to lending, similarly to our competitors, resulted in a decreasing profit in 2009. On top of that the Bank succeeded to achieve further improvement in its liquidity and capital adequacy positions during the year and preserved its favourable position in the bank sector in these areas as well.

Done at: Budapest, on 26 March 2010

Marko Voljč
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial and
Risk Officer