Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

CONSOLIDATED ANNUAL REPORT

31 December 2011

CONTENT

Statement of the Issuer

K&H Bank Zrt., as the Issuer (represented by Hendrik Scheerlinck, CEO and Attila Gombás, CFO) hereby declare that the Year 2011 Annual Report and the Year 2011 Consolidated Annual Report of K&H Bank Zrt. have been prepared to the best of the Issuer's knowledge, in compliance with the applicable accounting laws and regulations, and the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profitability of K&H Bank Zrt. and the companies involved in the consolidation, and the Management Report and Consolidated Management Report show a true and fair picture of the position, development and performance of K&H Bank Zrt. and the companies involved in the consolidation, including the major risks and uncertainties factors.

Budapest, April 26, 2012

Hendrik Scheerlinck	**Attila Gombás**
Chief Executive Officer	Chief Financial Officer

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

Consolidated annual financial statements prepared in accordance with
International Financial Reporting Standard as adopted
by the European Union for the year ended 31 December 2011
with the Report of Independent Auditors

Ernst & Young

Ernst & Young Kft.
H-1132 Budapest, Váci út 20.
1399 Budapest 62 Pf. 632, Hungary

Tel: +36 1 451 8100, Fax: +36 1 451 8199
www.ey.com/hu
Cg. 01-09-267553

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 2011, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság as of 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Emphasis of matter

We draw attention to note 33 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 2011 the Group has a provision of HUF 28,968 million for its potential liability to clients as a result of the fraud, and an asset of HUF 20,921 million for expected reimbursements. The ultimate outcome of this matter cannot presently be determined and due to its fundamental uncertainty the actual loss incurred by the Group might be significantly different from the provision and the asset created. Our opinion is not modified in respect of this matter.

Ernst & Young Kft.
Budapest, Hungary
6 April 2012

CONTENTS OF THE CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

	Notes	2011 MHUF	After reclassification 2010 MHUF
Interest income (after reclassification)		198 470	197 065
Interest expense (after reclassification)		(95 866)	(91 201)
Net interest income	4	102 604	105 864
Fee and commission income		44 328	45 746
Fee and commission expense		(14 910)	(15 440)
Net fee and commission income	5	29 418	30 306
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange (after reclassification)	6	18 844	11 606
Net realised gains / (losses) from available-for-sale assets	7	192	1 514
Dividend income	8	5	4
Other net income	9	621	8 888
Total income		151 684	158 182
Operating expenses		(68 135)	(86 633)
Staff expenses	12	(29 308)	(32 823)
General administrative expenses	10	(31 881)	(31 713)
Depreciation and amortisation of tangible and intangible assets		(6 408)	(7 071)
Bank tax	11	(538)	(15 026)
Impairment:	13	(79 157)	(35 796)
Loans and receivables		(79 073)	(35 688)
Other		(84)	(108)
Share in results of associated companies	14	342	372
Profit before tax		4 734	36 125
Income tax expense	15	(4 148)	(8 902)
Profit after tax		586	27 223
Earnings per share (HUF)	16	0.0047551	0.3693307

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	2011 MHUF	After reclassification 2010 MHUF
Profit after tax	586	27 223
Other comprehensive income		
Available-for-sale equity instruments		
Net change in revaluation reserve	-	4
Transfer from available for sale reserve to net profit		
Losses on disposal	-	-
Deferred income tax	-	-
Available for sale debt instruments		
Net change in revaluation reserve	(2 007)	(4 339)
Transfer from available for sale reserve to net profit		
(Losses)/ gains on disposal	705	(1 514)
Amortisation of reclassified assets	(522)	(647)
Deferred income tax	(38)	185
Net change in cash flow hedge reserve (after reclassification)	(288)	(248)
Transfer from cash flow hedge reserve to net profit		
Ineffective part (after reclassification)	69	(313)
Gross amount	149	707
Deferred income tax	(45)	(146)
Changes in future tax rate	860	(278)
Total other comprehensive income	(1 117)	(6 589)
Total comprehensive income	(531)	20 634

For more details on changes in the future tax rate see Note 28.

Approved by the Board of Directors on 6 April 2012.

Hendrik Scheerlinck *Chief Executive Officer* *Member of the Board*	*Attila Gombás* *Chief Financial Officer*

CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	2011 MHUF	2010 MHUF
ASSETS			
Cash and cash balances with central banks		161 398	115 351
Financial assets	17	2 592 582	3 033 039
Held for trading	26	212 819	177 952
Designated at fair value through profit or loss	20	3 297	6 416
Available for sale	24	389 146	758 909
Loans and receivables	22	1 565 868	1 681 112
Held to maturity		421 452	408 601
Hedging derivatives	26	-	49
Tax assets		9 720	3 244
Current tax assets		7 283	2 312
Deferred tax assets	28	2 437	932
Investments in associated companies	29	2 106	2 104
Investment property	30	55	-
Property and equipment	31	48 344	35 333
Intangible assets	32	9 908	8 175
Other assets	27	46 630	31 694
Total assets		2 870 743	3 228 940
LIABILITIES AND EQUITY			
Financial liabilities	17	2 593 569	2 937 683
Held for trading	26	153 876	170 853
Designated at fair value through profit or loss	20	196 461	193 069
Measured at amortised cost		2 242 688	2 572 896
Hedging derivatives	26	545	865
Tax liabilities		556	285
Current tax liabilities		111	160
Deferred tax liabilities	28	445	125
Provisions for risks and charges	33	35 120	34 736
Other liabilities	34	46 821	34 992
Total liabilities		2 676 067	3 007 696
Total equity	35;44	194 676	221 244
Total liabilities and equity		2 870 743	3 228 940

Approved by the Board of Directors on 6 April 2012.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

For breakdown of assets and liabilities by remaining maturity see Note 23.

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
2010							
Balance at the beginning of the period	73 709	48 775	12 536	(2 695)	(294)	78 614	210 645
Net profit for the year	-	-	-	-	-	27 223	27 223
Other comprehensive income for the period	-	-	-	(6 590)	1	-	(6 589)
Total comprehensive income	-	-	-	(6 590)	1	27 223	20 634
Dividend	-	-	-	-	-	(10 035)	(10 035)
Transfer from retained earnings to statutory risk reserve	-	-	2 893	-	-	(2 893)	-
Total change	-	-	2 893	(6 590)	1	14 295	10 599
Balance at the end of the period	73 709	48 775	15 429	(9 285)	(293)	92 909	221 244
of which revaluation reserve for bonds	-	-	-	(9 285)	-	-	(9 285)
2011							
Balance at the beginning of the period	73 709	48 775	15 429	(9 285)	(293)	92 909	221 244
Net profit for the year	-	-	-	-	-	586	586
Other comprehensive income for the period	-	-	-	(1 001)	(116)	-	(1 117)
Total comprehensive income	-	-	-	(1 001)	(116)	586	(531)
Capital increase	67 269	-	-	-	-	-	67 269
Dividend	-	-	-	-	-	(93 306)	(93 306)
Transfer from retained earnings to statutory risk reserve	-	-	444	-	-	(444)	-
Total change	67 269	-	444	(1 001)	(116)	(93 164)	(26 568)
Balance at the end of the period	140 978	48 775	15 873	(10 286)	(409)	(255)	194 676
of which revaluation reserve for bonds	-	-	-	(10 286)	-	-	(10 286)

For information related to the capital increase in 2011 see Note 35.

The dividend paid on ordinary shares was HUF 93 306 million – 1.265870 HUF/share in 2011 (HUF 10 035 million – 0.136143 HUF/share in 2010). For dividend proposed on ordinary shares see Note 44.

Approved by the Board of Directors on 6 April 2012.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2011 MHUF	2010 MHUF
OPERATING ACTIVITIES			
Profit before tax		4 734	36 125
Adjustments for:			
Net transfer from available for sale reserve		183	(1 514)
Net transfer from cash flow hedge reserve		218	707
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	31;32	6 492	7 179
(Profit)/Loss on the disposal of property and equipment	9	19	45
(Profit)/Loss on the disposal of subsidiaries and associated companies	9	-	36
Change in impairment on loans and advances*	13;25	79 073	35 688
Change in other provisions	33	514	(7 033)
Unrealised valuation differences		(4 850)	93 647
Income from associated companies	14	(342)	(372)
Cash flows from operating profit before tax and before changes in operating assets and liabilities		86 041	164 508
Changes in financial assets held for trading		(24 041)	(163 801)
Changes in financial assets designated at fair value through profit or loss		1 201	2 934
Effect of reclassification from available for sale to held to maturity		20	(258 479)
Changes in financial assets held to maturity		(1 162)	-
Changes in financial assets available for sale		367 235	311 313
Changes in loans and receivables		(13 103)	2 317
Changes in other assets		(23 350)	8 189
Changes in operating assets		306 800	(97 527)
Changes in financial liabilities held for trading		(25 506)	119 596
Changes in financial liabilities designated at fair value through profit or loss		7 228	36 898
Changes in financial liabilities measured at amortised cost		(400 934)	42 133
Changes in other liabilities		12 375	(5 564)
Changes in operating liabilities		(406 837)	193 063
Income taxes paid		1 063	(15 374)
Net cash from/(used in) operating activities		(12 933)	244 670

* Including impairments on loans and receivables and loan commitments.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2011 MHUF	2010 MHUF
INVESTING ACTIVITIES			
Purchase of held-to-maturity securities		(39 286)	(166 022)
Proceeds from the repayment of held-to-maturity securities at maturity		27 577	15 900
Proceeds from the disposal of a subsidiary, net of cash disposed		-	17
Proceeds from the disposal of shares in associated companies		81	-
Dividends received from associated companies	8	348	415
Purchase of intangible fixed assets	32	(3 943)	(2 663)
Purchase of property, plant and equipment	31	(19 075)	(11 503)
Proceeds from the sale of property, plant and equipment		91	131
Net cash from/(used in) investing activities		(34 207)	(163 725)
FINANCING ACTIVITIES			
Proceeds from the issuance of share capital		67 269	-
Dividends paid		(93 306)	(10 035)
Net cash from/(used in) financing activities		(26 037)	(10 035)
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents		(73 177)	70 910
Cash and cash equivalents at beginning of the period		2 438	(68 472)
Cash and cash equivalents at end of the period		(70 739)	2 438

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2011 MHUF	After restatement 2010 MHUF
ADDITIONAL INFORMATION			
Interest received (after restatement)		197 842	198 283
Interest paid (after restatement)		(91 964)	(98 509)
Dividend received		354	419
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash and cash balances with central banks		161 398	115 351
Loans and advances to banks repayable on demand and term loans to banks < 3 months		51 402	99 899
Deposits from banks repayable on demand and redeemable at notice		(283 539)	(212 812)
Total cash and cash equivalents		(70 739)	2 438

The amounts of received and paid interests presented as additional information were changed for the comparative period, since the total interest income and expense reported in 2010 were decreased with the impact of accrued interests.

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

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

Approved by the Board of Directors on 6 April 2012.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – GENERAL

Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság ("K&H Bank Zrt." or "the Bank") is a limited liability company incorporated in Hungary. K&H Bank Zrt. and its subsidiaries ("the Group") provide a full range of banking services through a nation-wide network of 236 branches. As at 31 December 2011 K&H Bank Zrt.'s registered office was at Vigadó tér 1, Budapest. From 1 January 2012 on the new address of the office is at Lechner Ödön fasor 9, Budapest.

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

NOTE 2 – ACCOUNTING POLICIES

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

2.1 Basis of presentation

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

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

2.1.1 Statement of compliance

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

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

Certain accounting principles prescribed for statutory purposes are different from IFRS. In order to present the financial position and results of operations of the Group in accordance with IFRS certain adjustments have been made to the Group's Hungarian consolidated statutory accounts. Details on these adjustments are presented in note 42.

2.1.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and all entities it controlled as at 31 December 2010. The Bank and the entities which it controls are referred to collectively as "the Group". Control is presumed to exist where the Bank holds, directly or indirectly, more than 50% of the registered capital or where the Bank can exercise more than 50% of the voting rights or where the Bank can appoint or dismiss a majority of the members of the Board of Directors. The effects of all material intercompany balances and transactions are eliminated. Subsidiaries under liquidation are consolidated using the equity method (see below).

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

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 40.

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 33 for further details.

Allowance for impairment of available-for-sale investments

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

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 2011.

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

- *IAS 24 Related Party Disclosures (revised)*
- *IAS 32 Financial Instruments: Presentation - Classification of Rights Issues (amendment)*
- *IFRIC 14 IAS 19 - The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction - Prepayments of Minimum Funding Requirements (amendment)*
- *IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (new)*
- *Improvements to IFRSs (issued in May 2010)*

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:

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 amendments have no impact on the consolidated financial statement.

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

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

The amendments have no impact on the consolidated financial statement.

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.

The amendments have no impact on the consolidated financial statement.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (new)

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

The amendments have no impact on the consolidated financial statement.

Improvements to IFRSs (issued in May 2010)

The IASB issued Improvements to IFRSs, an omnibus of amendments to its IFRS standards. The amendments are listed below.

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

The improvements have no impact on the consolidated financial statement.

2.4 Summary of significant accounting policies

2.4.1 Foreign currency translation

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

2.4.2 Financial instruments

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

2.4.2.1 Trade and settlement date accounting

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2.2 Financial instruments at fair value through profit or loss

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

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

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

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

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

2.4.2.3 Derivatives

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

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

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

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

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

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

2.4.2.4 Financial assets and financial liabilities measured at amortized cost

2.4.2.4.1 Loans and receivables

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

2.4.2.4.2 Financial liabilities at amortised cost

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.2.4.3 Held-to-maturity instruments

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

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

- are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- occur after the Group has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or
- are attributable to an isolated event that is beyond the Group's control, is non-recurring and could not have been reasonably anticipated by the Group.

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.

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.3 Day 1 profit

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

2.4.4 Repo and reverse repo agreements

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

2.4.5 Securities lending and borrowing

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

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

2.4.6 Allowances for impairment of financial assets

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

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.6.1 Financial assets measured at amortized cost

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

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

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

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

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

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

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

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

2.4.6.2 Available-for-sale financial assets

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.6.3 Renegotiated loans

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

2.4.7 Offsetting

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

2.4.8 Derecognition of financial assets

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

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

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

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.10.1 Where the Group is the lessee

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

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

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

2.4.10.2 Where the Group is the lessor

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

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

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

2.4.11 Revenue recognition

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

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

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

2.4.13 Cash and cash equivalents

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

2.4.14 Investment property

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.15 Bank premises and equipment

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

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

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

2.4.16 Intangible assets

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

2.4.17 Commitments, contingent liabilities

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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

2.4.18 Provisions

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

2.4.19 Taxation

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

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

2.4.20 Fiduciary assets

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

2.4.21 Dividend on ordinary shares

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

2.4.22 Equity reserves

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

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

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.23 Share based payment transactions

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

2.5 Future changes in accounting policies

IFRSs and IFRIC interpretations not yet effective

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

IFRS 9 Financial Instruments (new)

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

IFRS 9 shall be applied for annual periods beginning on or after 1 January 2015. Early application is permitted. In subsequent phases the Board will address impairment and hedge accounting.

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

IFRS 10 Consolidated Financial Statements (new)

IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. IFRS 10 replaces the consolidation requirements in SIC-12 Consolidation – Special Purpose Entities and IAS27 Consolidated and Separate Financial Statements and is effective for annual periods beginning on or after 1 January 2013. Early application is permitted. IFRS 10 builds on existing principles by identifying the concept of control as determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where it is difficult to assess.

IFRS 11 Joint Arrangements (new)

IFRS 11 provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interest in jointly controlled entities.
The standard is effective for annual periods beginning on or after 1 January 2013. Early application is permitted.

IFRS 12 Disclosure of Interests in Other Entities (new)

IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structure entities. IFRS 12 is effective for annual periods beginning on or after 1 January 2013. Early application is permitted.

The objective of IFRS 12 is to require the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities, the effects of those interests on its financial position, financial performance and cash flows.

NOTE 2 – ACCOUNTING POLICIES (continued)

IFRS 13 Fair Value Measurement (new)

IFRS 13 sets out a framework for defining "fair value" in a single IFRS. IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements.
IFRS 13 explains how to measure fair value for financial reporting. It does not require fair value measurements in addition to those already required or permitted by other IFRSs and is not intended to establish valuation standards or affect valuation practices outside financial reporting.
The standard is effective for annual periods beginning on or after 1 January 2013. Early application is permitted.

IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (amendment)

The objective of this IFRS is to ensure that an entity's first IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information which is transparent for users and comparable over all periods presented; provides a suitable starting point for accounting under IFRSs; and can be generated at a cost that does not exceed the benefits to users.

IFRS 1 amendment on December 2010 to provide relief for first-time adopters of IFRSs from having to reconstruct transactions that occurred before their date of transition to IFRSs and to provide guidance for entities emerging from severe hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time. Entities shall apply these amendments for annual periods beginning on or after 1 July 2011.

IFRS 7 IFRS Disclosures—Transfers of Financial Assets (amendment)

The objective of the IFRS 7 is to require entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks. The principles in the IFRS 7 complement the principles for recognising, measuring and presenting financial assets and financial liabilities in IAS 32 and IAS 39.

The amendment on 2010 October allows users of financial statements to improve their understanding of transfer transactions of financial assets, including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendment also requires additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period. Entities shall apply these amendments for annual periods beginning on or after 1 July 2011.

IFRS 7 Disclosures—Offsetting Financial Assets and Financial Liabilities (amendment)

The amendment on 2011 December applying IFRS 7 related to disclosures on transition to IFRS 9. Entities shall apply these amendments for annual periods beginning on or after 1 January 2013.

IAS 1 Presentation of Items of Other Comprehensive Income (amendment)

The objective of this standard is to prescribe the basis for presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this standard sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The recognition, measurement and disclosure of specific transactions and other events are dealt with in other standards and in interpretations.

NOTE 2 – ACCOUNTING POLICIES (continued)

On 16 June 2011, the IASB published amendments to IAS 1 Presentation of Financial Statements. The amendments to IAS 1 retain the 'one or two statement' approach at the option of the entity and only revise the way other comprehensive income is presented: requiring separate subtotals for those elements which may be 'recycled' (e.g. cash-flow hedging, foreign currency translation), and those elements that will not (e.g. fair value through OCI items under IFRS 9). Entities shall apply these amendments for annual periods beginning on or after 1 July 2012.

IAS 12 Deferred Tax: Recovery of Underlying Assets (amendment)

The objective of this standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences.
This standard requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity.

IAS 12 requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale. The amendment provides a practical solution to the problem by introducing a presumption that recovery of the carrying amount will, normally be, be through sale. Entities shall apply these amendments for annual periods beginning on or after 1 January 2012.

IAS 19 Employee Benefits (amendment)

The objective of this standard is to prescribe the accounting and disclosure for employee benefits. The standard requires an entity to recognise a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Prior to the amendment, IAS 19 permitted choices on how to account for actuarial gains and losses on pensions and similar items, which resulted the deferral of gains and losses. The final amendments make the changes in respect of pensions (and similar items) only, but all other long term benefits are required to be measured in the same way even though changes in the recognised amount are fully reflected in profit or loss. Entities shall apply these amendments for annual periods beginning on or after 1 January 2013.

IAS 27 Separate Financial Statements (amendment)

This standard shall be applied in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent. This standard does not deal with methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IFRS 3 Business combinations). This standard shall also be applied in accounting for investments in subsidiaries, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present separate financial statements.

The amendment on 2011 May applying IAS 27 related to disclosures on transition to IFRS 10. IAS 27 (as amended in 2011) is applicable to annual reporting periods beginning on or after 1 January 2013.

NOTE 2 – ACCOUNTING POLICIES (continued)

IAS 28 Investments in Associates and Joint Ventures (amendment)

This standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by: venture capital organisations; or mutual funds, unit trusts and similar entities, including investment-linked insurance funds; that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with IAS 39 Financial instruments shall be measured at fair value in accordance with IAS 39, with changes in fair value recognised in profit or loss in the period of the change.

The amendment on 2011 May applying IAS 28 related to disclosures on transition to IFRS 10 and IFRS 11. IAS 27 (as amended in 2011) is applicable to annual reporting periods beginning on or after 1 January 2013.

IAS 32 Offsetting Financial Assets and Financial Liabilities (amendment)

The objective of this standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.
The principles in this standard complement the principles for recognising and measuring financial assets and financial liabilities in IAS 39, and for disclosing information about them in IFRS 7 disclosures.

The amendments on December 2011 clarify the meaning of the "currently has a legally enforceable right of set-off" and that some gross settlement system may be considered equivalent to net settlement.
Entities shall apply these amendments for annual periods beginning on or after 1 January 2014 and are required to be applied retrospectively.

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine (new)

The costs of stripping activity to be accounted for in accordance with the principles of IAS 2 Inventories to the extent that the benefit from the stripping activity is realised in the form of inventory produced. The costs of stripping activity which provides a benefit in the form of improved access to ore is recognised as a non-current 'stripping activity asset' where it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity.
IFRIC 20 applies to annual periods beginning on or after 1 January 2013.

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

2.6 Tax payable by financial institutions

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

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

In December 2011 a new Act has been put in force by the Parliament, which permits credit institutions to reverse bank tax in the amount of 30% of the realised loss on early repaid foreign exchange mortgage loans (see Note 25). The Act is effective for reporting periods beginning on 1 January 2011.

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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

2.7 Reclassification

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

	As previously reported 2010	Reclassification	After reclassification 2010
	MHUF	MHUF	MHUF
Consolidated income statement			
Interest income	183 421	13 644	197 065
Interest expense	(80 122)	(11 079)	(91 201)
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	14 171	(2 565)	11 606
Other comprehensive income			
Net change in cash flow hedge reserve	(561)	313	(248)
Transfer from cash flow hedge reserve to net profit Ineffective part	-	(313)	(313)

The interest income and expenses of Asset/Liability Management (ALM) interest rate derivatives were reclassified from Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange to Interest income and Interest expenses due to the updated reporting definitions as introduced within the KBC Group as from the beginning of 2011.

In the presentation of other comprehensive income the ineffective part of cash flow hedges transferred to the consolidated income statement was separated from the net change in cash flow hedge reserve.

The reclassifications presented in the table above have no impact on the comparative data of the consolidated statement of financial position.

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

NOTE 2 – ACCOUNTING POLICIES (continued)

The reclassified and restated notes are the following:

- Consolidated statement of cash flows
- Note 3 – Segment information
- Note 4 – Net interest income
- Note 5 – Net fee and commission income
- Note 6 – Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange
- Note 10 – General administrative expenses
- Note 15 – Income taxes
- Note 19 – Fair value of financial assets and liabilities
- Note 36 – Commitments, contingent assets and contingent liabilities

Management believes the above reclassifications relating to 2010 are immaterial to the consolidated financial statements taken as a whole.

2.8 Change in estimate

In 2011 The Group has changed the valuation methodology of Hungarian government bonds denominated in JPY in two steps. The bonds are valued at fair value through profit or loss in accordance with the fair value option permitted by IAS 39. The Group has used Bloomberg Fair Value (model based) prices for valuation of the bonds. Since Bloomberg has stopped publishing these prices, the Group has switched to an internal valuation model based on the yield curves of HUF denominated Hungarian government bonds. The method change resulted in a HUF 68 million negative revaluation impact in 2011. As a second step the yield curves of HUF denominated Hungarian government bonds were switched to the yield curves of EUR bonds, which resulted in an additional one-off impact of HUF 329 million loss. Impacts are reported under the heading 'net gains from financial instruments at fair value through profit or loss'. This change in the estimate has no impact on the result of future periods.

The provisioning method of retail mortgage lending has been changed in the course of 2011. The essence of the method change was to align Basel II expected loss with provisions both for portfolio based and specific provisions. It caused a one-off impact of HUF 2 106 million loss in the consolidated income statement.

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 2 000 million. Services provided: loans and financing products, deposits and other savings products, transactional services, etc.

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

Treasury: proprietary trading activity.

Leasing: loans, financial and operational lease products provided by the Group.

NOTE 3 – SEGMENT INFORMATION (continued)

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 33), impact of FX mortgage repayment, bank tax, yield on real equity (result on the reinvestment on free equity) and fair value changes recognised under IFRS on derivatives used for hedging purposes that do not qualify for fair value hedge accounting for a portfolio hedge of interest rate risk.

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

The Group only operates in the Republic of Hungary.

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

Segment reporting information by customer segments for 2011:

	Retail MHUF	Corporate MHUF	Treasury MHUF	Leasing MHUF	General management MHUF	Total MHUF
Net interest income / (expense)	59 083	21 244	11 243	5 029	6 005	102 604
Net fee and commission income / (expense)	25 307	4 737	-	(279)	(347)	29 418
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	6 239	4 146	(6 732)	157	15 034	18 844
Net realised gains / (losses) from available-for-sale assets	53	16	(193)	-	316	192
Dividend income	-	-	-	-	5	5
Other net income / (expense)	6	44	(187)	575	183	621
Total income / (expense)	90 688	30 187	4 131	5 482	21 196	151 684
of which:						
external income / (expense)	90 645	30 229	4 133	5 481	21 503	151 991
internal income / (expense)	43	(43)	-	-	-	-
Operating expenses	(47 434)	(11 375)	(2 586)	(4 233)	(2 507)	(68 135)
Impairment	(19 147)	(6 857)	-	(5 845)	(47 308)	(79 157)
Share in results of associated companies	-	-	-	-	342	342
Profit / (loss) before tax	24 107	11 955	1 545	(4 596)	(28 277)	4 734
Income tax benefit / (expense)	(3 286)	(1 264)	(169)	(371)	942	(4 148)
Segment profit / (loss)	20 821	10 691	1 376	(4 967)	(27 335)	586
Total assets	846 084	702 935	184 847	73 288	1 063 589	2 870 743
Total liabilities and equity	1 436 120	643 300	5 401	86	785 836	2 870 743

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2010 after reclassification:

	Retail MHUF	Corporate MHUF	Treasury MHUF	Leasing MHUF	General management MHUF	Total MHUF
Net interest income / (expense) (after reclassification)	58 627	20 140	1 339	4 800	20 959	105 865
Net fee and commission income / (expense)	26 439	4 796	-	253	(1 182)	30 306
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange (after reclassification)	6 812	5 814	3 144	(100)	(4 064)	11 606
Net realised gains / (losses) from available-for-sale assets	581	322	-	-	611	1 514
Dividend income	-	-	-	-	4	4
Other net income / (expense)	5	44	-	698	8 141	8 888
Total income / (expense)	92 464	31 116	4 483	5 651	24 468	158 182
of which:						
external income / (expense)	92 061	31 518	4 482	5 652	24 649	158 182
internal income / (expense)	402	(402)	-	-	-	-
Operating expenses	(50 902)	(12 421)	(2 616)	(4 069)	(16 625)	(86 633)
Impairment	(20 852)	(8 835)	-	(6 109)	-	(35 796)
Share in results of associated companies	-	-	-	-	372	372
Profit / (loss) before tax	20 710	9 860	1 867	(4 527)	8 215	36 125
Income tax benefit / (expense)	(5 284)	(2 046)	(358)	(371)	(843)	(8 902)
Segment profit / (loss)	15 426	7 814	1 509	(4 898)	7 372	27 223
Total assets	912 499	702 354	161 415	108 723	1 343 949	3 228 940
Total liabilities and equity	1 383 391	589 764	11 488	1 159	1 243 138	3 228 940

NOTE 4 – NET INTEREST INCOME

	2011 MHUF	After reclassification 2010 MHUF
Loans and receivables	108 338	108 391
Held to maturity	26 948	12 092
Available-for-sale assets	34 049	53 409
Subtotal, interest income from financial assets not measured at fair value through profit or loss	169 335	173 892
of which: impaired financial assets	-	*2 422*
Financial assets held for trading	12 388	8 315
Asset/liability management derivatives (after reclassification)	16 372	13 644
Other financial assets at fair value through profit or loss	375	1 214
Total interest income	198 470	197 065
Financial liabilities measured at amortised cost	(70 948)	(65 370)
Other liabilities not measured at fair value through profit or loss	(514)	(883)
Subtotal, interest income from financial assets not measured at fair value through profit or loss	(71 462)	(66 253)
Financial liabilities held for trading	(221)	(751)
Asset/liability management derivatives (after reclassification)	(10 257)	(11 079)
Other financial liabilities at fair value through profit or loss	(13 926)	(13 118)
Total interest expenses	(95 866)	(91 201)
Net interest income	102 604	105 864

NOTE 5 – NET FEE AND COMMISSION INCOME

	2011	After reclassification 2010
	MHUF	MHUF
Brokerage services (after reclassification)	6 242	7 199
Trust and fiduciary activities (after reclassification)	3 597	4 063
Credit and guarantee fee income	3 704	3 954
Structured finance	555	379
Payment services	19 585	19 509
Card services	9 369	9 713
Other	1 276	929
Fee and commission income	44 328	45 746
Brokerage services	(1 024)	(972)
Credit and guarantee fee expense	(2 430)	(2 048)
Commissions to agents (after reclassification)	(141)	(693)
Structured finance	(22)	-
Payment transactions	(4 388)	(4 743)
Card services	(4 798)	(4 634)
Insurance services	(2 006)	(2 121)
Other (after reclassification)	(101)	(229)
Fee and commission expense	(14 910)	(15 440)
Net fee and commission income	29 418	30 306

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

	2011 MHUF	After reclassification 2010 MHUF
Trading securities	(194)	390
Interest rate derivatives (including interest and fair value changes in trading derivatives) (after reclassification)	1 752	(447)
Other financial instruments initially recognised at fair value through profit or loss	1 779	(410)
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	15 725	12 467
Fair value adjustments in hedge accounting*	(218)	(394)
Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange	18 844	11 606

* Realised results of micro cash flow hedge derivatives amounted to HUF 149 million loss in 2011 (HUF 707 million loss in 2010), and HUF 69 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 313 million gain in 2010).

Net gains / (losses) from financial instruments at fair value through profit or loss and foreign exchange include the interest result on non-Asset/Liability Management (ALM)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 20),

The change in the fair value of financial instruments at fair value through profit or loss, where the fair value calculation is based on non-observable parameters was HUF 65 million gain in 2011 (no impact in 2010).

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

	2011 MHUF	2010 MHUF
Fixed-income securities	192	1 514
Net realised gains from available for sale	192	1 514

NOTE 8 – DIVIDEND INCOME

	2011 MHUF	2010 MHUF
Available-for-sale shares	5	4

Dividends in 2011 and 2010 are paid by VISA Inc..

NOTE 9 – OTHER NET INCOME

	2011 MHUF	2010 MHUF
Gain on property, plant and equipment	12	(11)
Sale of goods	924	687
Gain / (loss) on disposal of investments	-	(36)
Revenue on other services	824	686
Gain / (loss) due to operational risks	(1 779)	7 329
Other	640	233
Other net income	621	8 888

The income of HUF 824 million reported as revenue on other services in the table (HUF 686 million 2010) results from finance and accounting, business management, technical, logistics and bank security services granted by the Group to other KBC Group entities operating in Hungary but not included in the consolidation. In 2011 gain / (loss) due to operational risks contains HUF 454 million compensation income (HUF 6 818 million in 2010) for covering the losses resulting from operational risk (see Note 33).

NOTE 10 – GENERAL ADMINISTRATIVE EXPENSES

	2011 MHUF	After reclassification 2010 MHUF
IT expenses	(9 742)	(10 608)
Rental expenses (after reclassification)	(4 475)	(4 532)
Repair and maintenance	(1 952)	(1 508)
Marketing expenses	(1 677)	(2 083)
Professional fees	(2 457)	(2 322)
Other facilities expenses (after reclassification)	(5 710)	(5 556)
Communication expenses	(224)	(292)
Travel expenses	(95)	(82)
Training expenses	(572)	(586)
Personnel related expenses	(232)	(356)
Other administrative expenses	(4 698)	(3 636)
Other provision	(47)	(152)
Total general administrative expenses	(31 881)	(31 713)

NOTE 11 – BANK TAX

The Group paid a bank tax of HUF 15 878 million in 2011 (HUF 15 026 million in 2010). The basis and the tax rate of the tax payable by financial institutions can differ per group members, dependent on their activities. The tax base and the tax rates applicable for the Bank have changed in 2011. The change of the bank tax at K&H Eszközfinanszírozó Zrt. results from self revision. In 2011 the credit institutions can reclaim 30% of losses from the early repayment from the bank tax (see Note 25).The Group reversed a bank tax expense of HUF 15 340 million in 2011.

The tables below present the details of the bank tax paid by the group members in 2011 and 2010.

2011	Activity	Tax base MHUF	Tax rate %	Tax MHUF
Group members:				
K&H Bank Zrt.	Credit institution	2 879 214	0.523*	15 070
K&H Pannonlízing Zrt.	Finance leasing	7 462	6.500	485
K&H Autófinanszírozó Zrt.	Finance leasing	1 846	6.500	120
K&H Eszközfinanszírozó Zrt.	Finance leasing	154	6.500	10
K&H Lízing Zrt.	Finance leasing	11	6.500	1
K&H Befektetési Alapkezelő Zrt.	Asset management	685 070	0.028	192
Total		3 573 757	0.444	15 878

2010	Activity	Tax base MHUF	Tax rate %	Tax MHUF
Group members:				
K&H Bank Zrt.	Credit institution	2 879 214	0.494*	14 221
K&H Pannonlízing Zrt.	Finance leasing	7 462	6.500	485
K&H Autófinanszírozó Zrt.	Finance leasing	1 846	6.500	120
K&H Eszközfinanszírozó Zrt.	Finance leasing	109	6.500	7
K&H Lízing Zrt.	Finance leasing	11	6.500	1
K&H Befektetési Alapkezelő Zrt.	Asset management	685 070	0.028	192
Total		3 573 712	0.420	15 026

*Effective rate

The bank tax payable by the Group members for the year 2011 is calculated as follows.

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

- Hungarian interbank loan receivables, including bank deposits and repo transactions
- bonds and shares issued by Hungarian credit institutions, financial enterprises and investment enterprises
- loan receivables, subordinated and supplementary subordinated loan receivables with respect to capital provided to Hungarian financial enterprises and investment enterprises (including receivables under repos, collateralized repos, repos settled in kind).
- receivables deriving from EU inter-bank credits, bonds and shares issued by other credit institutions (new element in 2011).

The bank tax for credit institutions is payable at 0.15% on tax base below HUF 50 000 million and 0.53% on tax base above HUF 50 000 million (0,5% in 2010).

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

NOTE 11 – BANK TAX (continued)

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

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

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

The Bank tax for the Group is expected to be HUF 15 840 million in 2012, which liability is established on January 1, 2012 and from which HUF 3 919 million is expected to be reclaimed (see Note 25).

NOTE 12 – AVERAGE NUMBER OF PERSONNEL

	2011	2010
White-collar staff	3 289	3 486
Blue-collar staff	25	33
Management	187	186
Total average number of persons employed	3 501	3 706

NOTE 13 – IMPAIRMENT (income statement)

	2011 MHUF	2010 MHUF
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for loans and receivables	(54 174)	(35 502)
Specific provisions on credit commitments	758	791
Portfolio-based impairments and provisions	(25 657)	(977)
Total impairments and provisions on loans and receivables and credit commitments	(79 073)	(35 688)

For more detailed information on changes in the impairment loss see Note 25.

	2011 MHUF	2010 MHUF
Impairment on other		
Intangible assets	-	(2)
Property and equipment	-	(133)
Other	(84)	27
Total impairment on other	(84)	(108)

NOTE 14 – SHARE IN THE RESULTS OF ASSOCIATED COMPANIES

	2011 MHUF	2010 MHUF
Giro Elszámolásforgalmi Zrt.	349	345
HAGE Zrt.	-	34
K&H Lízingház Zrt. "v.a"	(7)	(7)
Share of the results of associates	342	372

The impairment made on HAGE Zrt. was a HUF 33 million loss in 2011 (HUF 173 million gain in 2010). 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 15 – INCOME TAXES

The components of income tax expense for the year ended 31 December 2011 and 2010 are:

	2011 MHUF	After reclassification 2010 MHUF
Statutory income tax expense (after reclassification)	(112)	(7 534)
Statutory income tax from self revision of prior years (after reclassification)	417	881
Local business tax expense	(4 263)	(4 293)
Deferred taxes on income	(190)	2 044
Income tax expense	(4 148)	(8 902)

Statutory income tax expense

In 2011, corporate income tax is payable at 10% on yearly profits below a limit of HUF 500 million and 19% on profits above the limit. The same rule was effective in 2010 for the second half of the year, while 19% was payable for the first half of the year. (The Group considered the limit on a proportional basis during the income tax calculation.)

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

There is no procedure for final agreement of tax assessments in Hungary. The tax authorities may examine the accounting records and revise assessments for up to five years after the period to which they relate. Consequently, the Group may be subject to further assessments in the event of an audit by the tax authorities. The corporate tax returns for the Bank have been reviewed and closed off by the taxation authorities for the years up to 2007. Management is not aware of any additional significant unaccrued potential tax liability which might arise relating to years not audited by the tax authorities.

NOTE 15 – INCOME TAXES (continued)

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

	2011 MHUF	2010 MHUF
Profit before tax	4 734	36 125
Income tax rate*	20.62%	20.62%
Income tax calculated	(976)	(7 449)
Plus/minus tax effects attributable to:		
Tax base decreasing items	1 658	925
Adjustments related to prior years	510	720
Adjustments, opening balance of deferred taxes due to change in tax rate	(1 387)	1 080
Unused tax losses to reduce current tax expense	63	-
Unused tax losses to reduce deferred tax expense	1 251	167
Reversal of previously recognised deferred tax on unused tax losses and tax credits	(398)	(46)
Tax base increasing items	(5 041)	(4 298)
Other	172	(1)
Total tax effects	(3 172)	(1 453)
Income tax expense (income tax calculated + total tax effects)	(4 148)	(8 902)

*The 19% of statutory income tax rate was modified, because local business taxes are presented as income taxes in the consolidated income statement. This creates an increase of about 1.62% in the statutory income tax rate in 2011 and 2010. The effective income tax rate for 2011 is 82.29% (2010: 24.64%).

For more information on adjustments, opening balance of deferred taxes due to change in tax rate see Note 28.

NOTE 16 – EARNINGS PER SHARE

Earnings per share is the profit attributable to shareholders of the Group divided by the weighted average number of shares outstanding during the period, excluding treasury shares. There were no other potentially dilutive securities in existence at 31 December 2011 and 2010. The following amounts were used in the calculation of earnings per share:

	2011	2010
Net profit attributable to shareholders (MHUF)	586	27 223
Weighted average shares outstanding (in millions)	123 237	73 709
Earnings per share (HUF)	0.0047551	0.3693307

NOTE 17 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND PRODUCT

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets as at 31 December 2011							
Loans and advances to credit institutions and investment firms*	-	-	-	74 855	-	-	74 855
Loans and advances to customers	-	-	-	1 428 580	-	-	1 428 580
Consumer credit	-	-	-	61 726	-	-	61 726
Mortgage loans	-	-	-	611 554	-	-	611 554
Term loans	-	-	-	609 499	-	-	609 499
Finance leasing	-	-	-	34 259	-	-	34 259
Current account advances	-	-	-	94 336	-	-	94 336
Other	-	-	-	17 206	-	-	17 206
Equity instruments	12 338	-	952	-	-	-	13 290
Debts instruments issued by public bodies	154 317	3 297	388 194	62 433	421 452	-	1 029 693
Derivatives	46 164	-	-	-	-	-	46 164
Total carrying value	212 819	3 297	389 146	1 565 868	421 452	-	2 592 582

Debt instruments issued by public bodies include Hungarian government and Hungarian municipality bonds.

*From the total balance of loans and advances to credit institutions and investment firms HUF 51 402 million is either repayable on demand or is maturing in less than 90 days. Loans and advances to credit institutions, investment firms and customers include reverse repo transactions of HUF 25 732 million.

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

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

Debt instruments issued by public bodies include Hungarian government and Hungarian municipality bonds.

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

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

	Held for trading	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2011					
Deposits from credit institutions and investment firms*	-	-	-	639 408	639 408
Deposits from customers and debt certificates	-	196 461	-	1 602 027	1 798 488
Deposits from customers	-	191 102	-	1 565 262	1 756 364
Demand deposits	-	-	-	443 279	443 279
Time deposits	-	191 102	-	913 466	1 104 568
Savings deposits	-	-	-	208 517	208 517
Debt certificates	-	5 359	-	36 765	42 124
Certificates of deposits	-	-	-	261	261
Non-convertible bonds	-	5 359	-	13 147	18 506
Non-convertible subordinated liabilities	-	-	-	23 357	23 357
Derivatives	147 367	-	545	-	147 912
Short positions	6 509	-	-	-	6 509
In debt instruments	6 509	-	-	-	6 509
Other	-	-	-	1 253	1 253
Total carrying value	153 876	196 461	545	2 242 688	2 593 570

*Of which HUF 283 539 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 30 752 million.

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

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

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

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

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 2011 was HUF 24 925 million, of which HUF 6 494 million (reported as short positions in the consolidated statement of financial position) has been sold (31 December 2010 HUF 48 476 million and HUF 35 266 million respectively).

The carrying amount of Hungarian government bonds pledged as collateral for repo liabilities amounted to HUF 34 767 million as at 31 December 2011 (HUF 69 782 million as at 31 December 2010).

NOTE 17 – 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 equity and debt instruments is presented in the tables below.

	2011 MHUF	2010 MHUF
Held for trading		
Treasury bills	41 455	103 497
Government bonds issued in HUF	111 496	27 291
Government bonds issued in foreign currency	1 366	7 890
Listed equity instruments	6 290	5 994
Unlisted equity instruments	6 048	3 645
Total held for trading securities	166 655	148 317

	2011 MHUF	2010 MHUF
Available for sale		
Treasury bills	1 288	118 552
Other government bonds issued in HUF	386 906	592 130
Bonds issued by municipality - issued in foreign currency	-	47 317
Unlisted equity instruments	952	910
Total available for sale	389 146	758 909

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

	2011 MHUF	2010 MHUF
Loans and receivables		
Bonds issued by municipality - issued in HUF	-	4 987
Bonds issued by municipality - issued in foreign currency	62 433	20 862
Total loans and receivables debt instruments	62 433	25 849

	2011 MHUF	2010 MHUF
Held to maturity		
Treasury bills	-	6 251
Consolidation bonds issued in HUF	112 017	112 025
Government bonds issued in HUF	309 435	290 325
Total held to maturity	421 452	408 601

The Group reclassified the foreign currency denominated municipality bonds from available-for-sale to the loans and receivables portfolio (see Note 18).

Consolidation bonds were acquired as part of the 1992-1994 consolidation programs. These bonds expire in 2013 and 2014, bear a market rate of interest equivalent to the State of Hungary's treasury bill rates and reprice annually or semi-annually. As there is not yet a liquid market for these instruments in Hungary they are carried at amortized historical cost both in 2011 and 2010. 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 2011 unlisted equity instruments in a value of HUF 952 million (HUF 910 million at the end of 2010) for which a fair value cannot be measured reliably. These investments are not traded on active markets. Management believes that the carrying value of these investments approximates their fair value.

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

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

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

	2011 MHUF	2010 MHUF
Hitelgarancia Zrt.	640	640
VISA Inc.	306	265
SWIFT S.C.	6	5
	952	910

The table does not contain Risk Kft., as it is fully impaired as at the end of 2011 and 2010.

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 2011, 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.

	2011 MHUF	2010 MHUF
Refinancing credits	173 790	170 462

Non-convertible subordinated liabilities

	2011 MHUF	2010 MHUF
Subordinated loan from KBC Group	18 630	16 684
Bonds issued to the State	4 714	4 714
	23 344	21 398

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 18 – RECLASSIFICATION OF FINANCIAL ASSETS

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

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

The following table presents the bonds' bookvalue as at 31 December 2011 and their impact before income tax on the comprehensive income in 2011 as they are recognised after reclassification in the Consolidated Financial Statements and as they would be recognised, if no reclassification had been done.

	After reclassification	Without reclassification
	MHUF	MHUF
Bookvalue as at 31 December 2011	49 804	39 267
Available for sale reserve (before tax)	(6 337)	(16 914)
Income statement (before tax)	156	-

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

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

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

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

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

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The table below presents information concerning the fair value of financial assets and liabilities for year 2011:

	At fair value							
	Quoted market price MHUF	Valuation techniques - market observable inputs MHUF	Valuation techniques - non market observable inputs MHUF	At amortised cost MHUF	Total carrying amount MHUF	Recognised in profit or loss - non market observable inputs MHUF	Fair value MHUF	Unrecognised gain/(loss) MHUF
Financial assets								
Held for trading	51 387	157 509	3 923	-	212 819	2 720	212 819	-
Designated at fair value through profit or loss	-	-	3 297	-	3 297	56	3 297	-
Available for sale	112 204	275 990	-	952	389 146	-	389 146	-
Loans and receivables	-	-	-	1 565 868	1 565 868	-	1 542 679	(23 189)
Held to maturity	-	-	-	421 452	421 452	-	399 047	(22 405)
Hedging derivatives	-	-	-	-	-	-	-	-
Total financial assets	163 591	433 499	7 220	1 988 272	2 592 582	2 776	2 546 988	(45 594)
Financial liabilities								
Held for trading	6 509	143 453	3 914	-	153 876	(2 711)	153 876	-
Designated at fair value through profit or loss	-	196 461	-	-	196 461	-	196 461	-
Measured at amortised cost	-	-	-	2 242 688	2 242 688	-	2 231 632	11 056
Hedging derivatives	-	545	-	-	545	-	545	-
Total financial liabilities	6 509	340 459	3 914	2 242 688	2 593 570	(2 711)	2 582 514	11 056

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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

	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	After restatement Fair value	After restatement Unrecognised gain/(loss)
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Held for trading	138 656	37 193	2 103	-	177 952	536	177 952	-
Designated at fair value through profit or loss	-	6 416	-	-	6 416	-	6 416	-
Available for sale	710 682	-	47 317	910	758 909	-	758 909	-
Loans and receivables (after restatement)	-	-	-	1 681 112	1 681 112	-	1 672 429	(8 683)
Held to maturity	-	-	-	408 601	408 601	-	398 427	(10 174)
Hedging derivatives	-	49	-	-	49	-	49	-
Total financial assets	849 338	43 658	49 420	2 090 623	3 033 039	536	3 014 182	(18 857)
Financial liabilities								
Held for trading	35 266	133 484	2 103	-	170 853	(536)	170 853	-
Designated at fair value through profit or loss	-	193 069	-	-	193 069	-	193 069	-
Measured at amortised cost (after restatement)	-	-	-	2 572 896	2 572 896	-	2 560 246	(12 650)
Hedging derivatives	-	865	-	-	865	-	865	-
Total financial liabilities	35 266	327 418	2 103	2 572 896	2 937 683	(536)	2 925 033	(12 650)

NOTE 19 – 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 2010	2 103	-	47 317	49 420
Net gains / (losses)				
In profit or loss	2 354	(879)	(973)	502
In other comprehensive income	-	-	4 127	4 127
Acquisitions	-	978	-	978
Settlement	(534)	(1 815)	(844)	(3 193)
Switch to valuation technique	-	5 013	-	5 013
Reclassification to loans and receivables	-	-	(49 627)	(49 627)
Balance as at 31 December 2011	3 923	3 297	-	7 220

The Group has changed the valuation method of JPY denominated Hungarian government bonds valued at fair value through profit or loss in 2011 (see Note 2.8).

Foreign currency denominated municipality bonds classified as available for sale in the previous periods were reclassified to loans and receivables in 2011 (see Note 18).

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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 2009	2 488	294	45 879	48 661
Net gains / (losses)				
In profit or loss	285	(7 595)	8 337	1 027
In other comprehensive income	-	-	(6 526)	(6 526)
Acquisitions	-	7 301	-	7 301
Settlement	(670)	-	(373)	(1 043)
Balance as at 31 December 2010	2 103	-	47 317	49 420

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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 2010	2 103	-	2 103
Net (gains) / losses			
In profit or loss	2 359	12	2 371
In other comprehensive income	-	-	-
Acquisitions	-	-	-
Settlement	(548)	(12)	(560)
Balance as at 31 December 2011	3 914	-	3 914

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 2009	2 488	36	2 524
Net (gains) / losses			
In profit or loss	285	985	1 270
In other comprehensive income	-	-	-
Acquisitions	-	-	-
Settlement	(670)	(1 021)	(1 691)
Balance as at 31 December 2010	2 103	-	2 103

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Fair value of financial instruments

Financial instruments at fair value

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

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

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

When market parameters are not available, the Group uses its best estimations and assumptions to determine the relevant circumstances which have to be taken into account during the model valuation. Valuation techniques based on unobservable market parameters are used in case of held-for-trading exotic derivatives, fixed rate corporate bonds at fair value through profit or loss, issued bonds at fair value through profit or loss linked to these instruments, and available-for-sale debt instruments issued by public bodies (municipality bonds).

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

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

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

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

The Group has changed the valuation method of JPY denominated Hungarian government bonds valued at fair value through profit or loss in 2011. Before changing the valuation method the Group valued the bond based on Bloomberg Fair Value (model based) prices and presented as financial assets for which fair value is determined based on market observable inputs. Since Bloomberg has stopped publishing Bloomberg Fair Value prices the Group uses internal valuation model for pricing this specific Hungarian government bond where base curves are derived from the yield curves of EUR denominated Hungarian government bonds.

For impact of the method change on the Consolidated Income Statement see in Note 2.8.
Shifting the yield curves of EUR denominated Hungarian government bonds with +10 basis points would reduce the current carrying value by HUF 10 million.

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

The difference between the fair value and the transaction price of financial instruments not recognised in profit or loss as at the beginning and the end of the period was immaterial in 2011 and 2010.

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

Available-for-sale equity instruments held at cost

Available-for-sale equity instruments contain as at 31 December 2011 equity instruments in a value of HUF 952 million (HUF 910 million at the end of 2010) which fair value cannot be measured reliably. Management believes that the carrying value of these investments approximates their fair value (for more information see Note 17).

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

Held-to-maturity instruments

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

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

Loans and receivables and financial liabilities measured at amortized cost

The decrease of HUF 13 000 million between the fair values of loans and receivables as at 31 December 2011 and as at 31 December 2010 is caused by the decrease in the fair value of municipality bonds reclassified from the available-for-sale portfolio to loans and receivables.

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

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

NOTE 19 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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.

In case of refinancing loans and refinancing liabilities the fair value adjustment was based on a netting approach in 2010, since it was assumed that any difference in the fair values from the carrying value for refinanced loans is largely offset by a corresponding difference between carrying value and fair value for refinancing liabilities (the net fair value of refinanced loans and liabilities was assumed to be zero). In order to better reflect the different valuation characteristics of assets from liabilities, the Group has changed the valuation methodology for these deals and included separate valuation using the above described valuation technique from 2011. For comparability reasons, the Group has restated the related fair value adjustments applying the same separate valuation methodology for refinancing loans and liabilities as for other loans and deposits in 2010 (fair value adjustments on loans and receivables and liabilities measured at amortised cost are primarily the consequence of this restatement).

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

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

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

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

NOTE 20 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2011 MHUF	2010 MHUF
Financial assets designated at fair value through profit or loss		
Government bonds issued in foreign currencies	3 297	5 094
Loans to customers	-	1 322
	3 297	6 416

	2011 MHUF	2010 MHUF
Financial liabilities designated at fair value through profit or loss		
Term deposits:		
- retail	7 874	9 812
- corporate	4 161	5 977
- investment funds	179 067	176 006
Other issued bonds	5 359	1 274
	196 461	193 069

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

The changes in the fair value of loans designated at fair value through profit or loss recognised due to credit risk in the consolidated income statement amounted to HUF 1 509 million loss in 2011 (HUF 871 million loss in 2010).

The loan designated at fair value through profit or loss has no credit risk exposure as at 31 December 2011 (the maximum credit risk exposure of the loan was its fair value before any collateral, which was HUF 1 322 million as at 31 December 2010).

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 derivatives which do not achieve the criteria for hedge accounting.

The fair value changes of issued bonds recognised in the consolidated income statement due to credit risk was immaterial in 2011 and cumulatively (immaterial in 2010 and cumulatively).

NOTE 20 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

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 2011 and 2010.

The amount that the Group would contractually be required to pay at maturity is HUF 1 977 million higher than the fair value of the deposits and issued bonds (HUF 1 868 million less in 2010).

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND GEOGRAPHIC LOCATION

The Group's financial assets, and financial liabilities before taking into account any collateral held or other credit enhancements as at 31 December 2011 can be analysed by the following geographical regions.

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Hungary	187 844	3 297	388 835	1 498 962	421 452	-	-	2 500 390
EMU countries	20 087	-	6	9 844	-	-	-	29 947
East-European countries	14	-	-	15 354	-	-	-	15 368
Russia	-	-	-	13 999	-	-	-	13 999
Other European countries	4 793	-	-	25 800	-	-	-	30 593
Non-European countries	71	-	305	1 909	-	-	-	2 285
Total	212 819	3 297	389 146	1 565 868	421 452	-	-	2 592 582
Financial liabilities								
Hungary	14 245	192 701	-	-	-	-	1 566 097	1 773 043
EMU countries	113 880	631	-	-	-	545	627 915	742 971
East-European countries	167	-	-	-	-	-	5 212	5 379
Russia	-	2 795	-	-	-	-	6 629	9 424
Other European countries	25 407	253	-	-	-	-	26 810	52 470
Non-European countries	177	81	-	-	-	-	10 025	10 283
Total	153 876	196 461	-	-	-	545	2 242 688	2 593 570

NOTE 21 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND GEOGRAPHIC LOCATION (continued)

The geographical breakdown of financial assets and financial liabilities as at 31 December 2010 is presented below:

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

NOTE 22 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY

Credit quality per class of financial assets

The table below presents the credit quality by asset classes as at 31 December 2011:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Hedging derivatives	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Unimpaired assets	212 819	3 297	389 146	1 471 604	421 452	-	2 498 318
Impaired assets	-	-	513	237 310	-	-	237 823
Impairment	-	-	(513)	(143 046)	-	-	(143 559)
Total carrying value	212 819	3 297	389 146	1 565 868	421 452	-	2 592 582

The credit quality of assets as at 31 December 2010 can be presented as follows:

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

NOTE 22 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

The balance of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2011 are shown in the following table.

	Available-for-sale equity Instruments	Loans and receivables	Commitments and contingent liabilities	Total
	MHUF	MHUF	MHUF	MHUF
Individually impaired assets	513	108 499	6 068	115 080
Individually assessed impairment	(513)	(54 570)	(1 415)	(56 498)
Total	-	53 929	4 653	58 582

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

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

NOTE 22 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

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

Aging analysis of past due but not impaired financial assets as at 31 December 2011 is as follows:

	Less than 30 days MHUF	30 days or more, but less than 90 days MHUF	Total MHUF
Loans to customers			
- Corporate	5 494	3 530	9 024
- Retail	130 212	46 635	176 847
Total	135 706	50 165	185 871

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

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

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

Collaterals behind impaired or past due financial assets amounted to HUF 456 023 million as at 31 December 2011 (HUF 459 782 million as at 31 December 2010).

NOTE 22 – FINANCIAL ASSETS AND LIABILITIES, BREAKDOWN BY PORTFOLIO AND QUALITY (continued)

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

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

	2011 MHUF	2010 MHUF
Equity instruments*	13 290	10 549
Debt instruments*	1 029 744	1 336 221
Loans and advances	1 646 312	1 754 230
of which designated at fair value through profit or loss*	-	1 322
Derivatives*	46 164	29 684
Other assets	46 630	31 694
Total assets	2 782 140	3 163 700
Commitments to extend credit	283 676	286 626
Guarantees	136 003	132 030
Letters of credit	3 178	8 533
Total commitments and contingent liabilities	422 857	427 189
Total credit exposure	3 204 997	3 590 889

*For more information see Note 17.

The amounts shown above represent the current credit risk exposure, which may change over time as a result of changes in values (derivative financial instruments, financial investments, etc.) and changes in FX rates (due to FCY lending). The effect of collateral and other risk mitigation techniques is shown in Note 43.4.

Risk concentration of the maximum exposure to credit risk

Concentration of risk is managed by client/client group and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2011 was HUF 29 334 million (HUF 29 317 million as of 31 December 2010) before taking account of any collateral or other credit enhancements.

NOTE 23 – REMAINING MATURITY OF ASSETS AND LIABILITIES

The following table shows a breakdown of the financial assets and financial liabilities by expected maturity at 31 December 2011:

	Held for trading MHUF	Designated at fair value through profit or loss MHUF	Available for sale MHUF	Loans and receivables MHUF	Held to maturity MHUF	Hedging derivatives MHUF	Measured at amortised cost MHUF	Total MHUF
Financial assets								
Not more than one year	153 286	-	286 140	504 362	34 677	-	-	978 465
More than one but not more than five years	35 033	3 297	62 472	481 914	275 605	-	-	858 321
More than five years	12 163	-	39 582	579 592	111 170	-	-	742 507
Without maturity	12 337	-	952	-	-	-	-	13 289
Total	212 819	3 297	389 146	1 565 868	421 452	-	-	2 592 582
Financial liabilities								
Not more than one year	57 892	56 846	-	-	-	-	2 010 699	2 125 437
More than one but not more than five years	89 932	136 613	-	-	-	545	161 635	388 725
More than five years	6 052	3 002	-	-	-	-	70 354	79 408
Without maturity	-	-	-	-	-	-	-	-
Total	153 876	196 461	-	-	-	545	2 242 688	2 593 570

NOTE 23 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

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

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

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

NOTE 23 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The remaining maturity of non-financial assets and liabilities held as at 31 December 2011 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	7 283	2 437	9 720
Investments in associated companies	-	2 106	2 106
Investment property	55	-	55
Property and equipment	4 926	43 418	48 344
Intangible assets	2 276	7 632	9 908
Other assets	25 709	20 921	46 630
Total assets	40 249	76 514	116 763
Tax liabilities	111	445	556
Provisions for risks and charges	5 533	29 587	35 120
Other liabilities	46 821	-	46 821
Total liabilities	52 465	30 032	82 497

The remaining maturity of non-financial assets and liabilities held as at 31 December 2010 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	2 312	932	3 244
Investments in associated companies	-	2 104	2 104
Investment property	-	-	-
Property and equipment	4 410	30 923	35 333
Intangible assets	2 346	5 829	8 175
Other assets	11 868	19 826	31 694
Total assets	20 936	59 614	80 550
Tax liabilities	160	125	285
Provisions for risks and charges	2 518	32 218	34 736
Other liabilities	34 992	-	34 992
Total liabilities	37 670	32 343	70 013

NOTE 24 – IMPAIRMENT ON AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2011 MHUF	2010 MHUF
Opening balance	513	513
Impairment reversed	-	-
Closing balance	513	513

Risk Kft. (see Note 17 and Note 40) is fully impaired as at the end of 2011 and 2010.

NOTE 25 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position)

	2011 MHUF	2010 MHUF
Breakdown by type		
Specific impairment for loans and receivables	104 372	94 326
Specific provision on credit commitments	1 415	2 027
Portfolio-based impairment and provision	39 022	11 731
Total impairment and provision on loans and receivables and credit commitments	144 809	108 084

	2011 MHUF	2010 MHUF
Breakdown by counterparty		
Impairments on loans and advances to banks	-	248
Impairment for loans and advances to customers (excluding banks)	141 812	105 456
Impairment for debt instruments issued by municipalities	1 235	-
Specific and portfolio based provision, credit commitments	1 762	2 380
Total impairment and provision on loans and receivables and credit commitments	144 809	108 084

NOTE 25 – 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 2011	94 326	2 027	11 731	108 084
Movements with an impact on results				
Loan loss expenses	112 779	866	70 584	184 229
Loan loss recoveries	(58 605)	(1 624)	(44 927)	(105 156)
Interest accrued on impaired loans	(4 261)	-	-	(4 261)
Discount effect	(1 312)	94	-	(1 218)
Movements without an impact on results				
Write-offs	(43 621)	-	-	(43 621)
Other	5 066	52	1 634	6 752
Closing balance as at 31 December 2011	104 372	1 415	39 022	144 809

The Group has written down the interest accrual on impaired loans due to uncollectibility. The utilization of the related allowances are presented as a decrease of HUF 4 261 million on interest accrued on impaired loans in the table.

In the course of 2011 the following debtor relief programs were initiated by the government:

1. Implementation of a special ('buffer') account to provide temporary foreign exchange protection until year-end 2014 for voluntarily participating qualifying debtors: foreign exchange rate used for monthly instalments are fixed at preferential foreign exchange rates (CHF/HUF: 180, EUR/HUF: 250, JPY/HUF: 2). The difference between the actual spot rate and the preferential fixed rate will be accrued on a special ('buffer') account denominated in HUF bearing 3 month BUBOR rate representing a below market interest rate until 2014. Repayment of the buffer account is due from 1 January 2015. The participation rate in this program was low. The related law (act LXXV of 2011) was enacted on the 26th of June 2011.
2. Debt repayment at preferential foreign exchange rates for foreign currency mortgage debtors. The scheme was enacted and introduced in the third quarter of 2011. (See further details on the program below.)
3. Following the above measures (as described under point 1. and point 2 above.), based on the results of negotiations between the Hungarian Banking Association and the Hungarian Government an agreement was formulated and put into a written document ("Minutes of Understanding") over foreign exchange debtor relief programs on 15 December, 2011. The agreement has three main sections, dealing separately with the treatment of "performing", "non-performing" debtors and with the recoverability of 2011 banking tax already declared and paid (see note 11 for further details on this last point). The judicial procedure concerning performing and non-performing debtors, as agreed according to 'Minutes of Understanding', is in progress and the related laws were enacted or are expected to be enacted in 2012.

The following paragraphs include an overview of the measures as described above under point 2 and 3.

NOTE 25 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

Debt repayment possibility at preferential foreign exchange rates for foreign currency mortgage debtors (point 2 above)

The foreign exchange repayment scheme at preferential rates for foreign exchange mortgage debtors was introduced by the government in the third quarter of 2011 providing a possibility for a full repayment of foreign exchange mortgage loans at a fixed (preferential) exchange rate for qualifying customers. Preferential rates were: 180 HUF/CHF, 250 HUF/EUR and 2 HUF/JPY. The possibility was open until year-end 2011 for customers to announce their intention to repay with an ultimate repayment date set at 28 February 2012, but by 30 January 2012 the borrowers had to either provide for coverage on an account or present a promissory note of a financial institution for the repayment amount.

As at 31 December 2011 the Group recognised a HUF 48 886 million impairment loss for realized (until 31 December 2011) and for expected (to be realized between 31 December 2011 and 28 February 2012) losses in relation to this legislation. Out of the total HUF 48 886 million losses HUF 22 135 million impairment loss was provided as a portfolio based impairment at December 31, 2011 for the expected losses to be realized by the Group between 31 December 2011 and 28 February 2012.

As detailed under note 11 and above under point 3., the Group became entitled to claim 30% of the losses suffered in connection with the above mortgage repayment program at preferential rate for foreign exchange mortgage debtors. The total amount of the claim recognised is HUF 15 340 million in 2011 (see Note 11). This amount is recoverable as a reduction in 2011 bank tax in accordance with legislation passed in December 2011.

The total pre-tax effect of the repayment scheme amounted to HUF 33 546 million in 2011, including the above mentioned 2011 bank tax reclaim.

Debtor relief program based on the "Minutes of Understanding" (point 3. above)

Measures to assist performing retail foreign exchange mortgage debtors

The already existing scheme (as presented under point 1. above) under which loan instalments are paid based on a fixed foreign exchange rates was modified and is accessible on a voluntary basis for qualifying customers, until the end of 2012 (where the original loan value at disbursement does not exceed HUF 20 million and the debtor did not participate in any other payment easement programme before and has not been overdue for more than 90 days as of 30 September 2011).

Under the proposal, the difference between the current spot rate and the preferential fixed foreign exchange rate (180 HUF/CHF, 250 HUF/EUR, 2.5 HUF/JPY) for the principal part of the monthly instalment is recorded in a "buffer" account and may be deferred for repayment until June 2017 (until which date the buffer account is bearing 3 month BUBOR rate representing a below market interest rate).

Further to the deferral of the above difference on the principal part of the loan repayments, the interest part of the monthly instalment above the preferential foreign exchange rates is borne by the Hungarian government and by the banks on a 50/50 basis. Should the foreign exchange rate exceed the levels of CHF/HUF 270 and EUR/HUF 340, the excess amounts will be borne by the Hungarian state.

Based on an estimation of management, assuming a client participation rate of 50% in the program, the total pre-tax present value impact on the consolidated income statement of this measure until 2017 is estimated to be HUF 4 100 million over the 5 year period (and HUF 500 million before tax impact on the "buffer" account bearing below market interest) based on K&H's budget rate. This amount has not been recognised in the 2011 accounts.

The Hungarian Parliament approved the legislation relating to this part of the agreement on 19 March 2012.

NOTE 25 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

Measures to assist defaulted retail foreign exchange mortgage debtors

Retail foreign exchange mortgage debtors whose loans were overdue by more than 90 days on 30 September 2011 and the market value of the collateral was less than HUF 20 million can request to have their foreign exchange mortgage loans converted into HUF mortgage loans. For all loans converted, the Group is required to waive 25% of the converted total obligations at the date of conversion. Further as part of this proposal, 30% of the obligation waived by the Group can be deducted from the bank tax due for 2012 (see Note 11).

It was also decided that the National Asset Management Company (NAMC) shall purchase residential properties of eligible mortgages debtors, the so called social cases. The NAMC is expected to purchase 25 000 properties by the end of 2014.

The measures to assist defaulted foreign exchange mortgage debtors are estimated not to have further substantial impact on the consolidated income statement considered the average impairment level existing at year end 2011 for eligible clients and the banking tax benefits associated to the program.

This part of the legislation has not been approved by Parliament at the date of this report.

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

NOTE 26 – DERIVATIVE FINANCIAL INSTRUMENTS

	Year ended 31 December 2011				Year ended 31 December 2010			
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	90 748	89 653	5 078	(949)	76 622	80 626	416	(1 850)
Currency futures	7 683	7 647	6	(6)	4 628	4 634	11	(11)
Currency swaps	587 588	584 694	10 607	(8 798)	307 925	315 806	2 229	(7 326)
Currency options	149 465	148 754	9 972	(9 938)	297 848	297 810	6 343	(6 360)
Total foreign exchange derivatives	835 484	830 748	25 663	(19 691)	687 023	698 876	8 999	(15 547)
Interest rate derivatives								
Interest rate swaps	738 220	738 220	14 667	(13 106)	1 301 642	1 301 642	19 514	(17 607)
Cross currency interest rate swaps	652 044	764 085	4 372	(111 758)	598 258	701 439	616	(100 571)
Interest rate options	178 607	178 607	639	(639)	71 787	71 787	394	(394)
Forward rate agreements	308 000	205 129	749	(1 285)	325 000	158 286	61	(386)
Total interest rate derivatives	1 876 871	1 886 041	20 427	(126 788)	2 296 687	2 233 154	20 585	(118 958)
Equity options	482	9 958	35	(849)	465	8 215	47	(1 078)
Commodity swaps	442	442	10	(10)	79	79	4	(4)
Commodity options	197	197	29	(29)				
Total derivatives held for trading	2 713 476	2 727 386	46 164	(147 367)	2 984 254	2 940 324	29 635	(135 587)
Derivatives designated as cash flow hedges								
Currency options	-	-	-	-	29 579	33 938	49	(865)
Cross currency interest rate swaps	3 990	6 852	-	(545)				
Total derivatives held for hedging	3 990	6 852	-	(545)	29 579	33 938	49	(865)
Total derivative financial instruments	2 717 466	2 734 238	46 164	(147 912)	3 013 833	2 974 262	29 684	(136 452)

NOTE 26 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Options

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

Currency options designated as cash flow hedges

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

Currency options designated as cash flow hedges have expired in 2011.

Cash flow hedge of reclassified assets

In 2011 the Group reclassified municipality bonds from the available-for-sale to the loans and receivables portfolio (see Note 18). The fair value adjustment as at the date of reclassification is recognised in the original currency of the reclassified asset as part of the new carrying amount while unrealised changes in the fair value up to the date of reclassification are recorded in HUF in other comprehensive income. The amortisation of the fair value adjustment included in the asset's carrying amount is compensated by the amortisation of the fair value changes recorded in other comprehensive income, but the regular foreign exchange revaluation of the asset's carrying amount opens a foreign currency position in the consolidated statement of financial position which can cause volatility in the consolidated income statement. That Group mitigates this volatility with deposits and CCIRS deals. Deals are taken into account from the Group's portfolio of available instruments, by having the appropriate ratio of them to avoid overhedge, prescribed by IAS 39.

Realised results of micro cash flow hedge derivatives amounted to HUF 149 million loss in 2011 (HUF 707 million loss in 2010), and HUF 69 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 313 million gain in 2010).

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

	2011		2010	
	Expected cash flows		Expected cash flows	
	Inflow	Outflow	Inflow	Outflow
	MHUF	MHUF	MHUF	MHUF
< 3 months	-	(11)	15	(191)
3-6 months	-	(11)	11	(313)
6 months - 1 year	-	(23)	25	(376)
1-2 years	-	(45)	-	-
2-5 years	-	(134)	-	-
> 5 years	-	(360)	-	-
Total	-	(584)	51	(880)

Forecast transactions for which hedge accounting had previously been used but which is no longer expected to occur amounted to HUF 892 million as at 31 December 2011 (HUF 420 million as at 31 December 2010).

NOTE 27 – OTHER ASSETS

	2011 MHUF	2010 MHUF
Receivables from investment services	-	291
Prepayments	15 878	266
Trade receivables	1 020	1 308
Receivables from employees	16	23
Receivables from bankcard service	4 401	2 085
Items in transit due to payment services	350	122
Receivables from compensation (see Note 33)	20 921	19 826
Items in transit due to trading in securities	11	21
Income accruals and cost prepayments	3 062	5 536
Inventories	637	809
Other receivables	333	1 407
	46 630	31 694

As at 31 December 2011 prepayments include HUF 15 340 million asset recorded due to the reclaim of the bank tax (see Note 11).

NOTE 28 – 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 2011:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	-	(172)	-
Losses carry forward	2 286	-	1 374	-
Tangibles and intangibles assets	789	310	339	-
Provisions for risk and charges	203	-	199	-
Impairment for losses on loans and advances	(1 764)	-	(895)	-
Financial instruments at fair value	(336)	-	(629)	-
Fair value adjustments AFS	2 671	-	-	1 345
Cash flow hedge	106	-	-	30
Other	(1 518)	135	(406)	-
Total	2 437	445	(190)	1 375

NOTE 28 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (continued)

For the period ended 31 December 2010:

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

In 2010, based on the actual corporate income tax law income taxes were calculated on all temporary differences under the asset and liability method using a tax rate of 20.62% (19% corporate income tax and 1.62% local business tax) on temporary differences expected to be realised before the end of 2012. (For details of the corporate income tax law see Note 15.) Deferred tax of temporary differences to be realised on or after 1 January 2013 were calculated at 10% or 11.8% (10% effected by local business tax, if applicable). In 2011 the Group applied a principal rate of 20.62%, since the previously introduced 10% income tax rate applicable from 1 January 2013 on has been cancelled in 2011.

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

From the total of HUF 14 192 million tax losses carried forward as at 31 December 2011 (HUF 14 748 million at 31 December 2010), HUF 2 181 million (HUF 5 631 million at 31 December 2010) 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 12 011 million as at 31 December 2011 (HUF 9 116 million as at 31 December 2010).

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

NOTE 29 – INVESTMENTS IN ASSOCIATED COMPANIES

	2011 MHUF	2010 MHUF
GIRO Elszámolásforgalmi Zrt.	1 547	1 547
HAGE Zrt.	542	542
Kvantum KK Rt. "v.a."	-	81
Lízingház Zrt. "v.a."	17	(66)
Total	2 106	2 104

	2011 MHUF	2010 MHUF
Opening balance	2 104	2 125
- Carrying value, transfers, liquidation	(81)	15
- Share in the result for the period	431	379
- Dividends paid	(348)	(415)
Closing balance	2 106	2 104

The liquidation procedure of Kvantum KK Rt. was completed on 15 February 2011.

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

The table below includes the financial information of the associates as at 31 December 2011.

	Total assets MHUF	Revenue MHUF	Profit or loss MHUF
GIRO Elszámolásforgalmi Zrt.	7 844	5 529	1 262
HAGE Zrt.	8 923	5 462	190
Kvantum KK Rt. "v.a."	-	-	-
Lízingház Zrt. "v.a."	17	-	86

The table below includes the financial information of the associates as at 31 December 2010.

	Total assets MHUF	Revenue MHUF	Profit or loss MHUF
GIRO Elszámolásforgalmi Zrt.	7 856	5 405	1 344
HAGE Zrt.	8 243	4 711	194
Kvantum KK Rt. "v.a."	81	-	-
Lízingház Zrt. "v.a."	23	-	(7)

NOTE 30 – INVESTMENT PROPERTIES

	Investment properties MHUF
At 31 December 2010	
Cost	-
Accumulated depreciation	-
Net book value	-
Movements in 2011	
Additions	56
Disposals - net	-
Impairment charge	-
Depreciation charge	(1)
Other	-
At 31 December 2011	
Cost	56
Accumulated depreciation	(1)
Net book value	55

Investment properties include collaterals obtained by taking in possession.

The difference between the fair value and the carrying amount of the assets is immaterial as at 31 December 2011.

NOTE 31 – PROPERTY AND EQUIPMENT

	Land and buildings	IT equipment	Office equipment	Other	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
At 1 January 2010					
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
Movements in 2010					
Additions (acquired separately)	8 146	1 194	451	1 712	11 503
Disposals - net	(60)	-	(1)	(263)	(324)
Impairment charge	(130)	-	(3)	-	(133)
Depreciation charge	(1 190)	(1 850)	(1 304)	(287)	(4 631)
Other	120	(243)	108	(335)	(350)
At 31 December 2010					
Cost	34 403	18 153	11 123	5 601	69 280
Accumulated depreciation	(9 719)	(15 640)	(7 358)	(1 230)	(33 947)
Net book value	24 684	2 513	3 765	4 371	35 333
Movements in 2011					
Additions (acquired separately)	14 905	2 170	1 748	196	19 019
Disposals - net	(69)	(249)	(1)	(167)	(486)
Impairment charge	-	-	-	-	-
Depreciation charge	(1 470)	(1 278)	(978)	(336)	(4 062)
Other	(300)	(165)	(683)	(312)	(1 460)
At 31 December 2011					
Cost	48 865	18 870	10 913	6 060	84 708
Accumulated depreciation	(11 115)	(15 879)	(7 062)	(2 308)	(36 364)
Net book value	37 750	2 991	3 851	3 752	48 344

Expenditure on items in the course of construction amounted to HUF 4 861 million as at 31 December 2011 (HUF 12 306 million as at 31 December 2010).

During 2009 the Group entered into a contract for the construction of a new headquarter building. The net amount of the contractual commitment was EUR 38.89 million (HUF 10 841 million) as at 31 December 2010. In 2011 the new headquarter building has been capitalized. The bookvalue of the building amounted to HUF 23 029 million as at the date of capitalization.

NOTE 32 – INTANGIBLE ASSETS

	Acquired software MHUF	Other intangible assets MHUF	Total MHUF
At 1 January 2010			
Cost	35 155	4 308	39 463
Accumulated depreciation	(30 037)	(1 630)	(31 667)
Net book value	5 118	2 678	7 796
Movements in 2010			
Additions (acquired separately)	2 663	-	2 663
Impairment charge	(2)	-	(2)
Depreciation charge	(1 551)	(889)	(2 440)
Other	(2 140)	2 298	158
At 31 December 2010			
Cost	27 779	6 436	34 215
Accumulated depreciation	(23 691)	(2 349)	(26 040)
Net book value	4 088	4 087	8 175
Movements in 2011			
Additions (acquired separately)	3 943	-	3 943
Depreciation charge	(1 266)	(1 080)	(2 346)
Other	(802)	938	136
At 31 December 2011			
Cost	30 812	7 440	38 252
Accumulated depreciation	(24 849)	(3 495)	(28 344)
Net book value	5 963	3 945	9 908

Fully amortised intangible assets which were still in use amounted to HUF 24 353 million as at 31 December 2011 (HUF 17 538 million as at 31 December 2010).

NOTE 33 – 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 2010	84	36 715	1 875	38 674
Amounts allocated	653	2 963	428	4 044
Amounts used	(67)	(9 635)	-	(9 702)
Unused amounts reversed	(17)	(1 258)	(99)	(1 374)
Discount effect	-	644	-	644
Other (foreign exchange revaluation)	-	1 900	(1 830)	70
Balance as at 31 December 2010	653	31 329	374	32 356
Amounts allocated	-	3 286	348	3 634
Amounts used	(624)	(1 607)	(287)	(2 518)
Unused amounts reversed	(29)	(558)	(14)	(601)
Discount effect	-	420	-	420
Other (foreign exchange revaluation)	-	49	18	67
Balance as at 31 December 2011	-	32 919	439	33 358

From the total of HUF 32 919 million provision for pending legal disputes the Group has a provision of HUF 28 968 million (HUF 27 484 million in 2010) for its liability to clients as a result of the fraud that occurred at K&H Equities during and prior to 2003. In 2003, the two shareholders of the Bank, KBC Bank N.V. and ABN Amro Bank N.V., issued a letter of commitment that they will maintain the legally required level of equity in the Bank. The Bank also issued a letter of commitment that it will maintain the legally required level of equity at K&H Equities.

For the majority of claims, criminal investigations were launched which are litigated in Court. Most of the contested claims have already been determined by the Courts. As a result K&H Equities has incurred and charged against the provision for pending legal disputes HUF 250 million in 2010 (no charge in 2011).

The Group has during 2011 further revised its previous estimate for the fraud case and increased the provision by HUF 1 063 million (HUF 1 560 million increase in 2010).

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 20 921 million as at 31 December 2011 (HUF 19 826 million as at 31 December 2010) for amounts expected to be received as part of the indemnity agreement. Income received from insurance companies is presented in other net income (see Note 9).

The change in provision and the asset itself are presented net in the consolidated income statement (HUF 32 million gain in 2011 and HUF 1 066 million gain in 2010). From 2007 the calculation of provision is based on an effective interest rate method which results in a HUF 420 million increase recorded as interest expense in the consolidated income statement (HUF 644 million increase in 2010).

NOTE 33 – 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 Group is also party to litigation and claims arising in the normal course of business. The majority of the provision of HUF 4 155 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2011 (HUF 3 845 million at 31 December 2010) has been created relating to commercial litigations as a consequence of the sale of investment products to clients in the past. In 2010 commercial compensation was offered to clients and in the majority of the cases a settlement has been reached for which the cost was recorded. In 2011 the Group continued to offer compensation to the clients and reached further settlements. Management considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 1 762 million as at 31 December 2011 (HUF 2 380 million as at 31 December 2010) is presented in Note 25.

NOTE 34 – OTHER LIABILITIES

	2011 MHUF	2010 MHUF
Trade creditors	5 567	4 703
Lease liabilities	528	1
Items in transit due to payment services	26 866	12 468
Vostro accounts	-	157
Items in transit due to lending activity	544	385
Liabilities from bankcard service	1 893	1 243
Liabilities from brokerage services	-	2 835
Other	11 423	13 200
Total other liabilities	46 821	34 992

NOTE 35 – SHARE CAPITAL

	2011 MHUF	2010 MHUF
Ordinary shares issued and outstanding	140 978	73 709

The nominal value of the ordinary shares issued and outstanding at 31 December 2011 is HUF 1 per share (2010: HUF 1).

During 2011 KBC Bank N.V increased the Bank's share capital. The capital increase of HUF 67 269 million was effective as of 7 April 2011.

NOTE 35 - SHARE CAPITAL (continued)

Shareholders of the Bank:

	2011 Shareholding %	2010 Shareholding %
KBC Bank N. V.	100.00%	100.00%
	100.00%	100.00%

NOTE 36 – 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 36 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

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

	2011 MHUF	Restated 2010 MHUF
Credit commitments – undrawn amount		
Received	6 431	5 512
Given		
Irrevocable	170 980	158 594
Revocable	112 988	128 135
Total given	283 968	286 729
Collaterals		
Given	140 651	142 839
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets (after restatement)	426 737	451 230
Financial assets (after restatement)	29 285	29 887
For assets that are not impaired or past due		
Non-financial assets (after restatement)	1 094 376	1 511 808
Financial assets (after restatement)	372 876	290 431
Total guarantees received/collateral	1 923 274	2 283 356

Due to the changes in the presentation the total amount of received guarantees and collateral has been changed for the comparative period. In the consolidated financial statements of the previous year the amount of the received guarantees and collaterals were limited to the maximum credit exposure, instead of the total collateral value, as currently presented.

The total of collateral received to mitigate the maximum exposure to credit risk amounts to HUF 1 470 872 million as at 31 December 2011 (HUF 1 557 928 million as at 31 December 2010).

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 10 314 million (HUF 11 358 million as at 31 December 2010) 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 37 – FINANCE AND OPERATING LEASES

Lessor position

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:

	2011 MHUF	2010 MHUF
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	13 418	19 115
one to five years	22 278	22 602
more than five years	1 416	3 715
	37 112	45 432
The present value of minimum lease payments receivables*:		
less than one year	12 773	13 181
one to five years	19 924	20 518
more than five years	1 257	2 706
	33 954	36 405
Unearned finance income	2 845	3 583
Contingent rents recognized as income - gross	2 383	2 637
Non-guaranteed residual values	1 987	2 607

*Net of impairment.

The total impairment recorded on financial lease receivables amounted to HUF 3 312 million as at 31 December 2011 (HUF 3 483 million as at 31 December 2010).

The term of the new contracts is between 3 and 73 months. Interest rates are in BUBOR and in EURO LIBOR plus an average margin of 2.84% (3.04% in 2010).

NOTE 37 – FINANCE AND OPERATING LEASES (continued)

The Group has car 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:

	2011 MHUF	2010 MHUF
Total of futures minimum lease payments:		
less than one year	1 436	529
one to five years	1 226	2 566
	2 662	3 095

Contingent rents recognised as income - gross	60	481

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

	2011 MHUF	2010 MHUF
Other equipment	2 439	2 780
Accumulated depreciation	750	458

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:

	2011 MHUF	2010 MHUF
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	811	1 292
one to five years	6 936	6 799
more than five years	5 060	5 426
	12 807	13 517

	2011 MHUF	2010 MHUF
Minimum lease payments recognized as expense	4 738	5 129

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

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

NOTE 38 – 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 (2010: 100.00%). The ultimate parent of the Group is KBC Group N.V.

Subsidiaries:

See list of subsidiaries in Note 40.

Associates:

See list of associates in Note 40.

Other related parties, members of KBC Group:

Baker Street Finance Ltd (no transactions in 2011)
CBC Banque SA
Československa Obchodni Banka a.s.
Dorset Street Finance Ltd
Garantiqua Hitelgarancia Kft.
Gulliver Kft. (no transactions in 2011)
Hanover Street Ltd (no transactions in 2011)
KBC Bank Ireland Plc.
KBC Asset Management Ltd
KBC Asset Management N.V.
KBC Bank Deutschland AG.
KBC Global Services N.V.
KBC EQUITAS Bróker Zrt. (merged into KBC Securities N.V.)
KBC Internationale Financieringsmij N.V. (no transactions in 2011)
KBC Lease Holding N.V.
KBC Private Equity Tanácsadó Kft. (no transactions in 2011)
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
RTI Invest Kft.
Sydney Finance Street Ltd
VIV Docu Kft.
VIV Server I. Kft.

Other related parties through key management

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

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

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

	Parent MHUF	Associ-ates MHUF	Other related parties (KBC Group) MHUF	Other related parties (through key management) MHUF	Total MHUF
As at 31 December 2011					
Assets					
Loans and advances	557	204	1 401	9 938	12 100
Current accounts	557	-	987	468	2 012
Term loans	-	204	398	9 470	10 072
Finance leases	-	-	16	-	16
Other receivables	1	-	567	-	568
Total assets	558	204	1 968	9 938	12 668
Liabilities					
Deposits	441 659	116	19 659	9 723	471 157
Current accounts	230 863	116	2 496	359	233 834
Term deposits (with agreed maturity)	210 796	-	17 163	9 364	237 323
Subordinated liabilities	18 630	-	-	-	18 630
Other liabilities	220	55	1 764	-	2 039
Total liabilities	460 509	171	21 423	9 723	491 826
Income statement					
Net interest income	(8 469)	16	(658)	(134)	(9 244)
Interest income	124	21	165	407	717
Interest expense	(8 593)	(5)	(823)	(541)	(9 961)
Net fee and commission income	(1 014)	(308)	1 249	93	21
Fee and commission income	268	2	2 250	101	2 621
Fee and commission expense	(1 282)	(310)	(1 001)	(8)	(2 601)
Other net income	39	(4)	(4 461)	-	(4 426)
Other income	49	-	1 512	-	1 561
Other expense	(10)	(4)	(5 973)	-	(5 987)
Total income statement	(9 444)	(295)	(3 896)	(41)	(13 650)
Off-statement of financial position items					
Commitments and contingent liabilities	17 458	-	6 736	1 658	25 852
Guarantees received	29 191	-	185	-	29 376
Notional amount of derivatives	1 314 598	-	10 364	-	1 324 962

The table excludes the fair value of derivatives.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

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

The table excludes the fair value of derivatives.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

Transactions with key management

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

Loans

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

The outstanding amount of such housing loans at 31 December 2011 was HUF 276 million (HUF 412 million at 31 December 2010), 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 2011 the outstanding amount of deposits was HUF 1 549 million (HUF 838 million at 31 December 2010). In 2011 the Bank paid HUF 43 million interest on these deposits (HUF 44 million in 2010).

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

Type of benefit	**2011**	**2010**
	MHUF	**MHUF**
Short-term employee benefits	2 142	2 219
Other long-term benefits	145	142
Termination benefits	-	7
Share based payment (cash settled)	108	-
Total benefits	2 395	2 368

The liability of HUF 108 million resulting from the carrying amount of share based payment is recorded as other liability in the consolidated statement of financial position.

Share based payment

For compensation of the key identified employees the Group has launched a share based payment program in 2011. Due to the program a part of the premium earned by key identified employees is settled in KBC shares in four portions on the grant dates in April every year, first for the performance of 2011. Upon each anniversary of the grant date it is determined if the beneficiaries are eligible for the grant. Vested shares are paid out in cash one year after they have vested. Options for the shares or for the pay out of the shares lapse in case of misbehaviour, serious error, downturn of the financial performance of the Group or if there is significant reduction in the group's regulatory capital base.

NOTE 38 - RELATED PARTY TRANSACTIONS (continued)

As at 31 December 2011 the information related to the number and weighted average exercise prices of share options is not available, since the first grant date is in April 2012. From the grant date in April 2012 on share options are valued at fair value based on the quoted market prices of KBC shares. No intrinsic value is recorded.

NOTE 39 – AUDITOR'S REMUNERATION

The remuneration recognised due to the audit of annual accounts performed by Ernst & Young Audit Kft. amounted to HUF 272 million in 2011 (HUF 191 million in 2010). In 2011 an additional remuneration of HUF 5 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 15 million in 2010).

NOTE 40 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2011	Effective Shareholding 2010
Fully consolidated subsidiaries		%	%
K&H Pannonlízing Zrt.	Finance lease	-	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 Lízing Zrt.	Finance lease	100	100
K&H Ingatlanlízing Zrt.	Finance lease	100	100
K&H Befektetési Alapkezelő Zrt.	Fund manager	100	100
K&H Csoportszolgáltató Kft.	Group service center	100	100
K&H Equities Zrt.	Business and management consultancy	100	100
K&H Faktor Zrt.	Other financial services	100	100
Associates consolidated using the equity method			
Giro Elszámolásforgalmi Zrt.	Clearing house	21	21
HAGE Zrt.	Meat processing	25	25
K&H Lízingház Zrt. "v.a."	Under liquidation	100	100
Kvantum KK Rt. "v.a."	Under liquidation	-	100
Immaterial, non consolidated investment			
Risk Kft. "f.a."	Under liquidation	100	100

K&H Pannonlízing Zrt. merged into the Bank as at 30 November 2011. The merger had no impact on the Consolidated Financial Statements.

During 2011, Kvantum KK Rt. "v.a." was liquidated with no profit or loss realized on final liquidation.

NOTE 41 – SUBSEQUENT EVENTS

For subsequent event related to the early repayment of retail foreign exchange mortgage loans see Note 25. There was no material difference between the impairment recognised in the consolidated financial statements and losses incurred until the closing date of the early repayment program.

For dividend proposed on ordinary shares see Note 44.

NOTE 42 – 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	4 439	180 327	2 895 685	2 710 919
Adjustments for IFRS accounts				
Capitalization of VAT, financial leases and revaluation of real estates	(27)	694	1 227	560
Portfolio-based allowance for loan losses	(1 296)	9 646	(3 224)	(11 574)
Specific allowance for loan losses	1 114	569	725	(958)
Adjustment on repos	(2 508)	7 297	3 687	(1 102)
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	2 979	(1 232)	(2 787)	(4 534)
Fair valuation of AFS portfolio	(819)	(12 770)	(13 588)	1
Cash flow hedge	515	(515)	-	-
Amortisation of loan origination fees	213	1 162	1 337	(38)
Income tax	(1 068)	2 049	981	-
Bank standalone IFRS	3 542	187 227	2 883 658	2 692 889
Subsidiaries accounts prepared under Hungarian Accounting Standards	(3 530)	5 531	88 979	86 978
Adjustments for IFRS accounts				
Portfolio-based allowance for loan losses	(374)	(971)	(1 345)	-
Financial leases	(154)	812	663	5
Specific allowance for loan losses	(49)	964	916	1
Provisions for risk and charges	(512)	512	20 921	20 921
Deferred tax	655	55	1 155	445
Subsidiaries standalone IFRS				
Adjustments for consolidation	1 008	(40)	(124 589)	(125 557)
Balance per IFRS report	586	194 090	2 870 743	2 676 067

[1] Excluding the current year profit

NOTE 43 – RISK MANAGEMENT

43.1 General

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

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

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

Risk management governance model

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

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

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

NOTE 43 – RISK MANAGEMENT (continued)

Risk measurement and – monitoring

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

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

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

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

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

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

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

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

43.2 Liquidity risk and funding management

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

NOTE 43 – RISK MANAGEMENT (continued)

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

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

The Group assesses the following liquidity risk aspects:

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

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

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

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

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

NOTE 43 – RISK MANAGEMENT (continued)

The following tables present the future undiscounted cash flows of financial liabilities and commitments and contingent liabilities by remaining contractual maturity as at 31 December 2011.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	-	-	944 710	944 710
Less than three months	9 196	6 287	23 223	-	959 487	998 193
More than three months but not more than one year	42 187	-	35 313	-	123 625	201 125
More than one but not more than five years	89 932	-	155 997	545	178 067	424 541
More than five years	6 052	-	4 217	-	72 946	83 215
Total	147 367	6 287	218 750	545	2 278 835	2 651 784

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	283 968	137 027	509	421 504
Less than three months	-	441	2 669	3 110
More than three months but not more than one year	-	-	-	-
More than one but not more than five years	-	5	-	5
More than five years	-	-	-	-
Total	283 968	137 473	3 178	424 619

NOTE 43 – RISK MANAGEMENT (continued)

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

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

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

NOTE 43 – RISK MANAGEMENT (continued)

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

Operational liquidity is measured by the unsecured liquidity gap limit. The operational liquidity gap is the difference between the cash in and outflows in different time horizons (5 day, 30-day and 90-days) and an internal limit was set for the gap to be covered by National Bank of Hungary eligible collaterals. The Group had no uncovered operational liquidity gap in 2011 and 2010, its operational liquidity situation being both sound and stable during 2011 despite the persistence of global economic crisis and FX mortgage prepayment.

Structural liquidity is measured via the loan-to-deposit (LTD) ratio, being a secondary key performance indicator (KPI) until the net stable funding ratio (NSFR) definition has been agreed upon with the banking sector supervisor. LTD is calculated as the amount of a bank's loans to customers divided by the amount of its customer deposits at any given time. The higher the ratio, the more reliant the Bank is on borrowed wholesale funds. The loan to deposit ratio was 93.7% in 2010 and 82.0% in 2011 meaning very prudent operation.

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 three different types of stress tests: General market, Central Europe specific and Institution specific scenarios. Under all scenarios the Group would achieve the internally set survival period of one month.

Basel III and regulatory ratios

LCR and NSFR ratios prescribed in consultative document of Basel III on liquidity measurement are calculated and reported regularly as key liquidity risk measure even until the method comes into law (expected in 2015 and 2018 respectively). New regulatory liquidity limits on Balance Sheet Coverage, Deposit Coverage and FX funding adequacy ratios came into force in 2012 which are measured and monitored on a monthly basis to achieve full compliance.

43.3 Market Risk

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

NOTE 43 – RISK MANAGEMENT (continued)

Market risk – trading

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

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

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

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

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

VaR results can be presented as follows:

	Foreign exchange	Interest rate	Total VAR
	MHUF	MHUF	MHUF
2011 – 31 December	64	326	320
2011 – Average daily	98	350	363
2011 – Highest	381	574	578
2011 – Lowest	2	160	152
2010 – 31 December	186	401	415
2010 – Average daily	173	630	666
2010 – Highest	873	1 044	1 222
2010 – Lowest	12	320	357

NOTE 43 – RISK MANAGEMENT (continued)

The Group's hVaR exposure decreased significantly in 2011 compared to the year 2010, characterised by reduced risk appetite. The average limit utilization was well below the hVaR limit of the Group.

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

Market risk – Non-trading

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

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

The BPV tables below present the results of reasonable possible changes of the economic value of the banking book on 31 December 2011 and 2010. 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 2011.

NOTE 43 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2011	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel up	CHF	-	-	-
	EUR	-	(0)	(0)
	HUF	(373)	(13)	(386)
	USD	-	(0)	(0)
10 bp parallel up total		(373)	(13)	(386)
100 bp parallel up	CHF	-	-	-
	EUR	-	(0)	(0)
	HUF	(3 732)	(129)	(3 861)
	USD	-	(2)	(2)
100 bp parallel up total		(3 732)	(131)	(3 863)
200 bp parallel up	CHF	-	-	-
	EUR	-	(0)	(0)
	HUF	(7 461)	(257)	(7 718)
	USD	-	(3)	(3)
200 bp parallel up total		(7 461)	(261)	(7 722)

DOWN Scenarios, 31 December 2011	denomination	Sensitivity of equity	Sensitivity of profit or loss	Total sensitivity
		MHUF	MHUF	MHUF
10 bp parallel down	CHF	-	-	-
	EUR	-	0	0
	HUF	373	13	386
	USD	-	0	0
10 bp parallel down Total		373	13	387
100 bp parallel down	CHF	-	-	-
	EUR	-	0	0
	HUF	3 734	131	3 865
	USD	-	2	2
100 bp parallel down total		3 734	133	3 867
200 bp parallel down	CHF	-	-	-
	EUR	-	0	0
	HUF	7 471	264	7 735
	USD	-	2	2
200 bp parallel down total		7 471	265	7 736

NOTE 43 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2010	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel up	CHF	(7)	5	(2)
	EUR	(1)	18	17
	HUF	(400)	(243)	(643)
	USD	-	2	2
10 bp parallel up total		(408)	(218)	(626)
100 bp parallel up	CHF	(67)	48	(19)
	EUR	(8)	168	160
	HUF	(3 912)	(2 371)	(6 283)
	USD	-	24	24
100 bp parallel up total		(3 987)	(2 131)	(6 118)
200 bp parallel up	CHF	(134)	96	(38)
	EUR	(17)	310	293
	HUF	(7 620)	(4 591)	(12 211)
	USD	-	48	48
200 bp parallel up total		(7 771)	(4 137)	(11 908)

DOWN Scenarios, 31 December 2010	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel down	CHF	7	(5)	2
	EUR	-	(18)	(18)
	HUF	404	247	651
	USD	-	(2)	(2)
10 bp parallel down Total		411	222	633
100 bp parallel down	CHF	22	(7)	15
	EUR	7	(228)	(221)
	HUF	4 137	2 539	6 676
	USD	-	(26)	(26)
100 bp parallel down total		4 166	2 278	6 444
200 bp parallel down	CHF	22	(7)	15
	EUR	8	(466)	(458)
	HUF	8 513	5 259	13 772
	USD	-	(26)	(26)
200 bp parallel down total		8 543	4 761	13 303

NOTE 43 – RISK MANAGEMENT (continued)

Currency risk

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

Fair valuation

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

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

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

43.4 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 43 – RISK MANAGEMENT (continued)

Credit quality per class of financial assets

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

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

Credit risk management at transactional level

Acceptance

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

Supervision and monitoring

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

NOTE 43 – RISK MANAGEMENT (continued)

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

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

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

Class 12 comprises borrowers if:

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

Credit risk management at portfolio level

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

NOTE 43 – RISK MANAGEMENT (continued)

Country risk, banking

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

The following risks are included:

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

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

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

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

	2011 MHUF	2010 MHUF
Industry sector		
Service industry	279 769	333 010
Agriculture	62 890	60 165
Manufacturing and building	171 521	185 757
Food processing	48 771	48 939
Wholesale and retail	107 725	102 569
Power industry	35 473	41 411
Other	408	352
Individuals	863 833	870 777
Credit institutions	74 855	117 913
Gross loans	1 645 245	1 760 893
Portfolio-based impairment for loan losses	(38 435)	(11 378)
Specific impairment for loan losses	(103 376)	(94 326)
Impairment on loans and advances (see Note 25)	(141 811)	(105 704)
Loans to customers	1 503 434	1 655 189

NOTE 43 – RISK MANAGEMENT (continued)

Collateral and other credit enhancements

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

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

The main types of collateral applied are as follows:

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

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

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

The carrying amount of investment properties and other assets, which were obtained by the Group by taking possession, amounted to HUF 462 million as at 31 December 2011 (HUF 554 million in 2010).

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

Credit quality of not impaired nor past due assets

The credit quality of unimpaired and not past due assets as at 31 December 2011 is presented in the table below:

	Held for trading	Designated at fair value through profit or loss	Available for sale	Loans and receivables	Held to maturity	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade	154 318	3 297	388 195	7 977	421 452	975 239
Standard grade	58 501	-	952	902 370	-	961 823
Sub-standard grade	-	-	-	375 386	-	375 386
Total carrying value	212 819	3 297	389 147	1 285 733	421 452	2 312 448

NOTE 43 – RISK MANAGEMENT (continued)

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

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

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 2011	Total 2011	Average unsecured share of exposure 2010	Total 2010
	%	%	MHUF	%	MHUF
High grade	0.00	97.87	42 870	89.35	85 947
Standard grade	0.27	36.59	1 353 129	31.83	1 199 485
Sub-standard grade	0.30	31.17	508 026	24.19	550 293
Impaired	100.00	30.53	86 971	29.96	313 178
Total			1 990 996		2 148 902

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

NOTE 43 – RISK MANAGEMENT (continued)

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

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

	2011	2010
	MHUF	MHUF
Loans to customers		
- Corporate lending	127 823	102 850
- Small business lending	11 404	8 861
- Consumer lending	123 851	80 479
Total	263 078	192 190

Impairment assessment

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

- individually assessed impairments
- collectively assessed impairments

Collectively assessed impairments

Portfolio-based impairment

Impairments are assessed collectively and on a portfolio basis for losses on loans and advances and on loan commitments if there is no objective evidence that an impairment loss has incurred individually (PD1-9). For such loans and receivables impairment losses are recorded on a 'portfolio basis', using a formula based on the IRB Foundation models intended to be used for calculating capital requirements. This methodology is reviewed regularly.

Statistical impairment

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

Individually assessed impairments

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

NOTE 43 – RISK MANAGEMENT (continued)

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

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

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

Internal credit risk models and Basel II

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

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

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

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

43.5 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.

NOTE 43 – RISK MANAGEMENT (continued)

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

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

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

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

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

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

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

NOTE 44 – SOLVENCY AND CAPITAL

In accordance with Act CXII of 1996 on Credit Institutions and Financial Enterprises (banking law), the Bank must have a minimum capital amount higher than 8% of risk weighted assets. According to the Act, the capital adequacy ratio calculation is prepared based on Hungarian accounting standards. The main differences between statutory and IFRS accounts are presented in Note 42. The Bank takes this regulation into account when preparing its detailed budget and creates further reserves in order to have sufficient guarantee capital in case of the depreciation of the HUF or other unexpected events. The Bank reports its level of capital adequacy situation to the Hungarian Financial Supervisory Authority (HFSA) each month and also prepares monthly forecasts to the Capital and Risk Oversight Committee (CROC) of the Bank. When needed, the Bank's Executive Committee decides and proposes to KBC Group any necessary steps that the Committee believes need to be taken (such as capital increase, dividend payment etc).

As from January 2011, the Bank has applied the Basel II IRB Foundation approach in its capital adequacy calculations, having previously reported its capital situation according to Standardized methodology.

NOTE 44 – SOLVENCY AND CAPITAL (continued)

The table below presents what the Group manages as capital.

	2011 MHUF	2010[1] MHUF
Tier 1 capital elements	181 043	119 643
Deductions	(2 719)	(4 072)
Tier 1 total	178 324	115 571
Tier 2 capital elements	21 496	20 496
Deductions	(324)	(541)
Tier 2 total	21 172	19 955
Guarantee capital	199 496	135 526

[1] Based on standardized methodology

According to Hungarian capital adequacy regulations, the Bank's capital adequacy ratio (tier 1 + tier 2; the latter includes subordinated debts) at 31 December 2011 was 11.36% (8.38% at 31 December 2010). The Bank fulfilled the capital requirements set by HFSA continuously during years 2011 and 2010 and at 31 December 2011 (and at 31 December 2010).

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 2011 was HUF 15 873 million (HUF 15 429 million as at 31 December 2010).

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

Accordingly, the Bank had distributable reserves of HUF 3 995 million as at 31 December 2011 (HUF 93 305 million as at 31 December 2010).

The dividend proposed on ordinary shares for approval by the shareholder (not recognized as a liability as at 31 December 2011) is HUF 3 995 million – 0.028338 HUF/share (HUF 93 305 million – 1.265856 HUF/share in 2010).

Approved by the Board of Directors on 6 April 2012.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

K&H Bank Zrt.

Management Report (consolidated)

December 31, 2011

On December 31, 2011, the Group's consolidated balance sheet total stood at 2 871 billion HUF. As a financial institution that offers banking and insurance products alike and has a nation-wide branch network of 236 branches, it offers the full range of financial services to clients.

1. The Strategic Objectives of the Bank

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

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

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

<u>Customer strategy:</u>
Retail: customers are served based on the different segments' special needs.
Corporate clients: focus on cross-sales, intensify new client acquisition in selected areas.

<u>Product strategy:</u>

Retail:

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

SME:

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

Corporate:

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

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

Key differentiators of the Bank Group:

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

2. Characteristics of the Group's consolidated activities

In 2011 the Bank Group's balance sheet total decreased by 11% (following the merger of Pannonlízing Zrt as of 30 November, the share of subsidiaries within the group's total assets significantly decreased to 3.9% from 5.6% in 2010).

Billion HUF	December 31, 2010	December 31, 2011	Variance
Balance sheet total	3,228.9	2,870.7	-11.1%
Loans and receivables	1,681.1	1,565.9	-6.9%
Customer deposits	1,623.2	1,756.4	+8.2%
Equity	221.2	194.7	-12.0%

The activities, balance sheet and profit and loss statement of K&H Bank Zrt, as well as its risk management practices are presented in detail in the relevant 2011 business report. The most important elements of the consolidated balance sheet are as follows:

- In the course of the year the amount of *loans and receivables* decreased by 7%: both the retail and corporate loan portfolio shrunk as compared to 2011. In the case of retail loans the decrease is primarily related to the repayment scheme for FX mortgage loans (which was partly offset by the exchange rate effect of the continued weakening of the HUF against the CHF), while – similarly to the previous year – only moderate demand was experienced by the corporate sector as well.
- *Deposits from customers* increased by 133 bln (8.2%) during the year, as the growth exceeded the average rate of the bank sector in both business segments (retail, corporate) owing to the successful savings campaign.
- *Shareholders' equity* decreased by 26.5 bln by the end of 2011, primarily as a net balance of dividend payment and capital increase (during the year the bank has paid out 26.0 bln dividend from the 2010 profit and 67.3 bln dividend from retained earnings, whereas the owner executed a capital increased at an amount identical to the dividends paid out from retained earnings in 2011).

The bank's group profit significantly decreased compared to previous year (2011: 0.6 bln, 2010: 27.2 bln) primarily due to the FX mortgage repayment[1].

- The 3% decrease in *net interest and interest-type income* is partly of technical nature (structural change in EUR funding from KBC[2]), and partly driven by business related item (lower loan volume).

[1] During 2011, the most significant impact on the Hungarian financial sector was the Act on repayments on foreign currency mortgage loans (Hungarian parliament passed the related amendment of the Act on credit institutions and financial enterprises on 19 September 2011). Those clients eligible according to the law were able to take advantage of repaying their FX mortgage debt at preferential rates (in the case of Euro HUF 250, in the case of Swiss Frank HUF 180, in the case of Japanese yen HUF 2). The clients had to meet the financial obligations associated with the repayment until the 60th day after the submission of their applications. By 30 January 2012 the borrowers had to either provide for coverage on an account or present a promissory note of a financial institution for the repayment amount. Considering the timetable set by the law the ultimate deadline for repayment at these preferable conditions has expired at 28 February 2012.
Accounting treatment of repayment: in the report, realised and expected losses are shown under the heading "impairment on loans and receivables", while the bank tax reclaim related to FX mortgage repayment is shown as a bank tax decreasing item under "general administrative expenses".

[2] In the new financing structure KBC ensures the majority of EUR financing via HUF/EUR swap instead of interbank sources from 2011. The structural changes in the balance sheet (lower interbank financing was accompanied by a similar decrease in the securities portfolio on the asset side, while the volume of EUR/HUF swaps increased among off-balance sheet items) also modified the composition of the profit and loss account (lower interest income resulting from the net balance of the decreased securities portfolio and EUR interbank financing costs, which was partially compensated by the increased interest-type incomes from FX swaps among "net gains from financial instruments at fair value").

- Similarly to net interest income, there was 3% decrease in *net fee and commission income* as well (201: 29.4 bln, 2010: 30.3 bln) primarily related to *investment services* (less capital protected funds were sold than in 2010 which was closed with an outstanding result).
- The increase in *net gains from financial instruments at fair value* (2011: 18.8 bln, 2010: 11.6 bln) is driven by ALM result.
- In 2010 *other income* included HUF 6.8 billion compensation income, to serve as coverage for losses from operational risks (the Bank accounted for HUF 0.5 billion compensation income in 2011).

In 2011, the Bank Group's *operating costs* came to HUF 68.1 bln, from which 0.5 bln represents the banktax[3]. Without the extra tax, the amount of operating costs is HUF 4.2 bln lower than in the previous year (2011: HUF 67.4 bln; 2010: HUF 71.6 bln). Within this:

- Staff expenses are by HUF 3.5 bln lower (10.7%), as a result of changes in headcount and bonus amounts
- there is a HUF -0.7 bln change in depreciation
- other costs remained at the level of the previous year's.

Impairment amounted to 79.2 bln in 2011 (2010: 35.8 bln), the considerable increase is due to the 48.9 bln loss on FX mortgage repayment. At the end of 2011 the share of non-performing loans within the total loan portfolio was 10.3% (2010: 8.6%).

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

million HUF	**2010**	**2011**	**variance**
Cost / income	54.8%	44.9%	-9.9%
Non-interest type income/ total income	33.1%	32.4%	-0.7%
Commission income / total income	19.2%	19.4%	+0.2%
Operating income / average headcount	42.7	43.3	+1.4%
Operating costs* / average headcount	19.3	19.3	0.0%
Operating profit* / average headcount	23.4	24.0	+2.6%
Credit cost ratio	1.98%	1.70%	-0.28%
Loan / deposit	93.7%	82.0%	-11.7%
Capital**/total liabilities	7.5%	7.6%	+0.1%
Solvency ratio (Basel II)***	8.38%	11.36%	+3.0%
ROE (based on average balance of equity)	12.8%	0.3%	-12.5%
ROA (based on average balance sheet total)	0.9%	0.0%	-0.9%

* excluding bank tax
** in addition to equity it also includes subordinated debt capital
*** according to the rules prescribed by the Hungarian supervisory authority

As a consequence of the FX mortgage repayment's financial settlement there was a significant deterioration in the profitability indicators compared to previous year. Considering liquidity type ratios K&H Bank preserved its position as one of the banks with the most favourable liquidity situation in the Banking Sector.

[3] In 2011 credit institutions can reclaim from the bank tax 30% of their losses incurred due to FX mortgage repayment; in connection with this measure in 2011 the Group reversed a bank tax expense of 15.3 bln.

3. Introduction of strategically important subsidiaries

Leasing Group

In the course of 2011, the Leasing Group was made up of 9 legal entities[4].

Name	Main profile	Comment
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.	Brokerage of insurance products	
K&H Lízing Zrt.	Not active	
K&H Lízingház Zrt.	Not active	
K&H Pannonlízing Zrt	Lending	on 30 November it has merged with K&H Bank Zrt

At the end of 2011, **K&H Leasing Group's** portfolio stood at 116 billion HUF, which represents a 1% increase compared to the end of the previous year. Out of the 116 billion HUF portfolio, 24 billion HUF represents the exposure linked to the office building leased by K&H Bank Zrt. from K&H Ingatlanlízing Zrt since December, 2011. The discontinuation of retail car financing activities at the end of 2008 resulted in a gradual drop in the retail car and dealer financing portfolio (by 17 billion in 2011, 21% decrease vs 2010). The Leasing Group's year 2011 leasing market production figures show that the Group obtained a 2.6% share on the market in overall terms, controlling 6.4% of the fleet financing market and 2.8% of the Truck, Machinery and Equipment (TME), with a total new production figure of 9 billion HUF (net of K&H Ingatlanlízing Zrt.'s placements within K&H Group).
Since 2009, the company has been serving clients via its corporate and SME business lines. Since 2010, they have also been offering a car leasing product to retail clients via the branch network. In 2011, the Leasing Group launched a corporate real estate financing product on the market. In 2011, the sales strategy focused on the strengthening of sales via K&H Bank's sales network, and this continues into 2012 as well. 2011 saw the launching of the LEAN efficiency development culture.

K&H Alapkezelő Zrt.

The part of the savings portfolio held in mutual funds dropped compared to the end of the previous year. The size of the portfolio at the end of 2011 falls 4% short of the previous year's closing figure. Assets managed for institutional clients also dropped by 4%.
The company's after-tax profits exceeded the target, owing to one-off items. The innovation strategy introduced in previous years continued, and, in addition to the launching of a number of closed-end funds and the conversion of a few into open-ended ones, the offering of classical open-ended funds was also extended.

[4] K&H Lízing Zrt. and K&H Lízingház Zrt. play a passive role in Leasing Group's life; they don't conclude any new contracts and they do not have a live portfolio any more. Under the company integration process, K&H Lízingház Zrt.'s voluntary liquidation started in 2010, and it's expected to be completed in 2012. On November 30, 2011 K&H Pannonlízing Zrt. (which has a 50% weighting in the portfolio of Leasing Group) merged into K&H Bank Zrt. For 2012 we plan the merger of K&H Autófinanszírozó Zrt. and K&H Eszközfinanszírozó Zrt. into K&H Bank Zrt. These organisational changes enable the realisation of the owner's leasing related strategic objectives, and the merge of these companies will also provide a long term solution for the capital position of the merged companies. The above analysis relates to the whole leasing business line including Pannonleasing Zrt. merged with K&H Bank Zrt. on 30 November as well.

During the year, 1 open-ended and 10 new capital and yield-protected funds were issued. The restructuring of maturing funds continued last year, as well as the re-launching of maturing capital and yield-protected periods, with a view to retaining savings. In 2011, capital and yield-protected periods expired in the case of 18 funds. We managed a total sum of 55 billion HUF at the start of the re-launched protected period.
In case of asset-managed institutional portfolios, co-operation with existing partners strengthened further. At the end of 2011, Alapkezelő [the Fund Management Company] managed assets worth 740 billion HUF (as opposed to 796 billion HUF at the beginning of the year). Of this, the portfolio of investment funds stood at 618 billion HUF (as opposed to 642 billion HUF at the beginning of the year), which makes it the second largest player on the investment funds market, with a market share of 20.3%. The Company is still defending its market leader position in the capital protected funds segment, where its market share increased to 51.9% compared to the previous year (50,0%).

K&H Csoportszolgáltató [Group Services] Kft

In 2005, K&H Group decided to set up a group services centre under the management of K&H Bank, which is the 100% owner of K&H Csoportszolgáltató Kft. (KHCSK). The purpose of this unit was the centralisation and efficient organisation of service and supplementary service activities closely linked to the core activities of individual group members. Comprehensive service activities performed for the group include the management of the real estate portfolio, logistical and bank security tasks, operative business responsibilities (the booking of trade receivables and payables, fixed assets etc.; tax accounting and payroll management). The company is part of K&H Group’s VAT group.

The company takes out service level agreements and contracts with individual group members for each individual service. Since 2007, services offered by KHCSK have also been used by K&H Insurance’s and K&H Leasing Group’s member companies as well. At present, KHCSK acts as a group services centre for 12 companies, including the Bank. Since May 1, 2008, KHCSK has also been performing the financial and accounting responsibilities and operative services of the Hungarian branch of KBC Global Services N.V. (KBC GSC). On January 1, 2008 the Tendering Directorate was set up, which is responsible for advisory and support services related to EU tenders. In 2009, the scope of the company’s activities was extended by financial and accounting services provided to RTI Invest Kft., a company constructing the buildings of KBC Group’s Central-European regional server centre, and K&H Factoring, a company 100% owned by K&H.

Additional business activities include the following: In mid-November, 2011, the company joined the SZÉP card issuing programme. The SZÉP card is a so-called cafeteria benefit in the Hungarian taxation system. It is an electronic voucher card which the employees of clients may use for purchasing certain services set out in a dedicated Government decree, such as accommodation, entertainment and recreational services.

Date: Budapest, 18th April 2012

Hendrik Scheerlinck	Attila Gombás
Chief Executive Officer	Chief Financial Officer