Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

CONSOLIDATED ANNUAL REPORT

31 December 2012

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Statement of the Issuer

K&H Bank Zrt., as the Issuer (represented by Hendrik Scheerlinck, CEO and Attila Gombás, CFO) hereby declare that the Year 2012 Annual Report and the Year 2012 Consolidated Annual Report of K&H Bank Zrt. have been prepared to the best of the Issuer's knowledge, in compliance with the applicable accounting laws and regulations, and the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profitability of K&H Bank Zrt. and the companies involved in the consolidation, and the Management Report and Consolidated Management Report show a true and fair picture of the position, development and performance of K&H Bank Zrt. and the companies involved in the consolidation, including the major risks and uncertainties factors.

Budapest, April 29 2013

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 2012
with the Report of Independent Auditors

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Independent auditors' report

To the shareholder of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság

We have audited the accompanying consolidated financial statements of Kereskedelmi és Hitelbank Zártkörűen Működő Részvénytársaság and its subsidiaries, ("the Group") which comprise the consolidated statement of financial position as at 31 December 2012, 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 2012, 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 34 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 2012 the Group has a provision of HUF 30,024 million for its potential liability to clients as a result of the fraud, and an asset of HUF 21,768 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
9 April 2013

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CONSOLIDATED INCOME STATEMENT

	Notes	2012 MHUF	After reclassification 2011 MHUF
Interest income		161 804	198 470
Interest expense		(87 811)	(95 866)
Net interest income	4	73 993	102 604
Fee and commission income		42 807	44 328
Fee and commission expense		(14 097)	(14 910)
Net fee and commission income	5	28 710	29 418
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	6	22 944	18 844
Net realised gains / (losses) from available-for-sale assets	7	131	192
Dividend income	8	8	5
Other net income (after reclassification)	9	247	194
Total income		126 033	151 257
Operating expenses		(85 867)	(67 351)
Staff expenses	12	(31 570)	(29 308)
General administrative expenses (after reclassification)	10	(31 831)	(31 097)
Depreciation and amortisation of tangible and intangible assets	32;33	(7 515)	(6 408)
Bank tax	11	(14 951)	(538)
Impairment:	13	(13 629)	(79 514)
Loans and receivables		(12 861)	(79 073)
Other (after reclassification)		(768)	(441)
Share in results of associated companies	14	441	342
Profit before tax		26 978	4 734
Income tax expense	15	(6 521)	(4 148)
Profit after tax		20 457	586
Earnings per share (HUF)	16	0.1451077	0.0047551

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	2012 MHUF	After reclassification 2011 MHUF
Profit after tax		20 457	586
Other comprehensive income			
Available-for-sale equity instruments			
Net gain / (loss) from fair value changes	17	943	-
Deferred tax impact on fair value changes	29	(195)	-
Available for sale debt instruments			
Net gain / (loss) from fair value changes (after reclassification)	17	8 936	(2 528)
Deferred tax impact on fair value changes (after reclassification)	29	(1 843)	521
Transfer from available for sale reserve to net profit			
(Losses)/ gains on disposal	7	(131)	705
Amortisation of reclassified assets		38	(522)
Deferred income tax	29	19	(38)
Cash flow hedge			
Net gain / (loss) from fair value changes (after reclassification)		13 880	(364)
Deferred tax impact on fair value changes (after reclassification)	29	(2 862)	76
Transfer from cash flow hedge reserve to net profit			
Ineffective part	6;27	20	69
Gross amount	6;27	(17 724)	149
Deferred income tax	29	3 651	(45)
Changes in future tax rate	15	-	860
Total other comprehensive income		4 732	(1 117)
Total comprehensive income		25 189	(531)

Approved by the Board of Directors on 8 April 2013.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	2012 MHUF	2011 MHUF
ASSETS			
Cash and cash balances with central banks		78 784	161 398
Financial assets	17	2 279 367	2 592 582
Held for trading	27	159 634	212 819
Designated at fair value through profit or loss	21	3 022	3 297
Available for sale	25	293 014	389 146
Loans and receivables	23	1 315 946	1 565 868
Held to maturity	17	507 751	421 452
Tax assets		3 290	9 720
Current tax assets		3 223	7 283
Deferred tax assets	29	67	2 437
Investments in associated companies	30	2 201	2 106
Investment property	31	472	55
Property and equipment	32	45 634	48 344
Intangible assets	33	11 826	9 908
Other assets	28	40 620	46 630
Total assets		2 462 194	2 870 743
LIABILITIES AND EQUITY			
Financial liabilities	17	2 165 429	2 593 569
Held for trading	27	46 042	153 876
Designated at fair value through profit or loss	21	241 826	196 461
Measured at amortised cost	17	1 810 096	2 242 688
Hedging derivatives	27	67 465	545
Tax liabilities		368	556
Current tax liabilities		-	111
Deferred tax liabilities	29	368	445
Provisions for risks and charges	34	35 507	35 120
Other liabilities	35	45 020	46 821
Total liabilities		2 246 324	2 676 067
Total equity	36;45	215 870	194 676
Total liabilities and equity		2 462 194	2 870 743

Approved by the Board of Directors on 8 April 2013.

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 24.

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
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 (Note 6;7)	-	-	-	(1 001)	(116)	-	(1 117)
Total comprehensive income	-	-	-	(1 001)	(116)	586	(531)
Capital increase (Note 36)	67 269	-	-	-	-	-	67 269
Dividend	-	-	-	-	-	(93 306)	(93 306)
Transfer from retained earnings to statutory risk reserve (Note 45)	-	-	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 (Note 17)	-	-	-	(10 286)	-	-	(10 286)
2012							
Balance at the beginning of the period	140 978	48 775	15 873	(10 286)	(409)	(255)	194 676
Net profit for the year	-	-	-	-	-	20 457	20 457
Other comprehensive income for the period (Note 6;7)	-	-	-	7 767	(3 035)	-	4 732
Total comprehensive income	-	-	-	7 767	(3 035)	20 457	25 189
Dividend (Note 45)	-	-	-	-	-	(3 995)	(3 995)
Transfer from retained earnings to statutory risk reserve (Note 45)	-	-	2 644	-	-	(2 644)	-
Total change	-	-	2 644	7 767	(3 035)	13 818	21 194
Balance at the end of the period	140 978	48 775	18 517	(2 519)	(3 444)	13 563	215 870
of which revaluation reserve for shares (Note 17)	-	-	-	748	-	-	748
of which revaluation reserve for bonds (Note 17)	-	-	-	(3 267)	-	-	(3 267)

The dividend paid on ordinary shares was HUF 3 995 million – 0.028338 HUF/share in 2012 (HUF 93 306 million – 1.265870 HUF/share in 2011). For dividend proposed on ordinary shares see Note 45.

Approved by the Board of Directors on 8 April 2013.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2012 MHUF	After reclassification 2011 MHUF
OPERATING ACTIVITIES			
Profit before tax		26 978	4 734
Adjustments for:			
Net transfer from available for sale reserve	7	(93)	183
Net transfer from cash flow hedge reserve	6	(17 704)	218
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	32;33	8 294	6 492
(Profit)/Loss on the disposal of property and equipment	9	175	19
(Profit)/Loss on the disposal of investment property	9	(1)	-
Change in impairment on loans and advances*	13;26	12 861	79 073
Change in other provisions	34	(736)	514
Unrealised valuation differences (after reclassification)	6	49 572	22 685
Income from associated companies	14	(441)	(342)
Cash flows from operating profit before tax and before changes in operating assets and liabilities (after reclassification)		78 905	113 576
Changes in financial assets held for trading		80 645	(24 041)
Changes in financial assets designated at fair value through profit or loss		704	1 201
Effect of reclassification from available for sale to held to maturity		(63 929)	20
Changes in financial assets held to maturity		(4 112)	(1 162)
Changes in financial assets available for sale		106 011	367 235
Changes in loans and receivables		241 440	(13 103)
Changes in other assets		15 520	(23 350)
Changes in operating assets		376 279	306 800
Changes in financial liabilities held for trading		(95 859)	(25 506)
Changes in financial liabilities designated at fair value through profit or loss		40 342	7 228
Changes in financial liabilities measured at amortised cost		(296 558)	(400 934)
Changes in other liabilities		(1 410)	12 375
Changes in operating liabilities		(353 485)	(406 837)
Income taxes paid		(9 347)	1 063
Net cash from/(used in) operating activities (after reclassification)		92 352	14 602

* Including impairments on loans and receivables and loan commitments.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2012 MHUF	After reclassification 2011 MHUF
INVESTING ACTIVITIES			
Purchase of held-to-maturity securities		(66 734)	(39 286)
Proceeds from the repayment of held-to-maturity securities at maturity		48 476	27 577
Proceeds from the disposal of shares in associated companies	14	-	81
Dividends received from associated companies	8	346	348
Purchase of intangible fixed assets	33	(5 225)	(3 943)
Purchase of property, plant and equipment	32	(4 952)	(19 075)
Proceeds from the sale of property, plant and equipment	32	698	91
Net cash from/(used in) investing activities		(27 391)	(34 207)
FINANCING ACTIVITIES			
Proceeds from the issuance of share capital	36	-	67 269
Dividends paid*		(3 995)	(93 306)
Net cash from/(used in) financing activities		(3 995)	(26 037)
CHANGE IN CASH AND CASH EQUIVALENTS			
Net increase/(decrease) in cash and cash equivalents (after reclassification)		60 966	(45 642)
Net foreign exchange difference (after reclassification)		(3 615)	(27 535)
Cash and cash equivalents at beginning of the period		(70 739)	2 438
Cash and cash equivalents at end of the period		(13 388)	(70 739)

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

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Notes	2012 MHUF	2011 MHUF
OPERATING CASH FLOWS FROM INTEREST AND DIVIDENDS			
Interest received	4	161 355	197 842
Interest paid	4	(79 912)	(91 964)
Dividend received*	8	354	354
COMPONENTS OF CASH AND CASH EQUIVALENTS			
Cash and cash balances with central banks		78 784	161 398
Loans and advances to banks repayable on demand and term loans to banks < 3 months	17	55 332	51 402
Deposits from banks repayable on demand and redeemable at notice	17	(147 504)	(283 539)
Total cash and cash equivalents		(13 388)	(70 739)

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

*Dividends received also includes dividends received from associated companies.

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 8 April 2013.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

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 226 branches. As at 31 December 2012 K&H Bank Zrt.'s registered office was at Lechner Ödön Fasor 9, Budapest.

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

NOTE 2 – ACCOUNTING POLICIES

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

2.1 Basis of presentation

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

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

2.1.1 Statement of compliance

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

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

Certain accounting principles prescribed for statutory purposes are different from IFRS. In order to present the financial position and results of operations of the Group in accordance with IFRS certain adjustments have been made to the Group's Hungarian consolidated statutory accounts. Details on these adjustments are presented in note 43.

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 2012. 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 41.

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 34 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 2012.

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

- *IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (amendment)*
- *IFRS 7 IFRS Disclosures—Transfers of Financial Assets (amendment)*
- *IAS 12 Deferred Tax: Recovery of Underlying Assets (amendment)*

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

The principal effects of these changes are as follows:

IFRS 1 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.

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

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

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

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.

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

2.4 Summary of significant accounting policies

2.4.1 Foreign currency translation

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

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 from foreign exchange. The interest component is recognized as interest income using the effective interest rate method.

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

2.4.2.3 Derivatives

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

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

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 from foreign exchange.

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

2.4.2.4 Financial assets and financial liabilities measured at amortized cost

2.4.2.4.1 Loans and receivables

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

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 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)

2.4.2.6 Fair value hierarchy of financial instruments

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

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

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

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

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

2.4.3 Day 1 profit

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

2.4.4 Repo and reverse repo agreements

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

2.4.5 Securities lending and borrowing

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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.

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

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.

2.4.6.3 Renegotiated loans

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

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

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

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

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

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

Derecognition of renegotiated loans

For the derecognition of the renegotiated loans the Group applies the criteria of the derecognition of financial liabilities defined in IAS39 (point 40. and AG62) which are commonly applied for financial assets, as well.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.7 Offsetting

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

2.4.8 Derecognition of financial assets

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

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

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

2.4.9 Derecognition of financial liabilities

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

2.4.10 Leases

Determination of whether an arrangement contains a lease

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

2.4.10.1 Where the Group is the lessee

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

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

NOTE 2 – ACCOUNTING POLICIES (continued)

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.

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

2.4.11 Revenue recognition

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

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

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

2.4.13 Cash and cash equivalents

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

2.4.14 Investment property

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.4.15 Bank premises and equipment

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

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

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

2.4.16 Intangible assets

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 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.

2.4.23 Share based payment transactions

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

NOTE 2 – ACCOUNTING POLICIES (continued)

2.5 Future changes in accounting policies

IFRSs and IFRIC interpretations not yet effective

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

IFRS 1 First-time adoption of International Financial Reporting Standard *(Amendments to Government Loans)*

Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards address how a first-time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRSs. The amendments mirror the requirements for existing IFRS preparers in relation to the application of amendments made to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance in relation to accounting for government loans.

First-time adopters of IFRSs are permitted to apply the requirements of IAS 20 only to new loans entered into after the date of transition to IFRSs. The first-time adopter is required to apply IAS 32 Financial Instruments: Presentation to classify the loan as a financial liability or an equity instrument at the transition date. Entities shall apply these amendments for annual periods beginning on or after 1 January 2013.

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 IASB's 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 2014. 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 2014. 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 2014. Early application is permitted.

NOTE 2 – ACCOUNTING POLICIES (continued)

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.

IFRS 13 Fair Value Measurement (new)

IFRS 13 defines fair value sets out in a single IFRS a framework for measuring fair value requires disclosures about fair value measurements. 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 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.

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 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.

NOTE 2 – ACCOUNTING POLICIES (continued)

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 2014.

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 28 (as amended in 2011) is applicable to annual reporting periods beginning on or after 1 January 2014.

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.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

The amendments to IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities and IAS 27 Separate Financial Statements provide 'investment entities' an exemption from the consolidation of particular subsidiaries and instead require that an investment entity measure the investment in each eligible subsidiary at fair value through profit or loss in accordance with IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement. The amendment require additional disclosure about why the entity is considered an investment entity, details of the entity's unconsolidated subsidiaries, and the nature of relationship and certain transactions between the investment entity and its subsidiaries and require an investment entity to account for its investment in a relevant subsidiary in the same way in its consolidated and separate financial statements. Entities shall apply these amendments for annual periods beginning on or after 1 January 2014.

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 impact on the Group’s consolidated financial statements in the period of initial application.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.6 Tax payable by financial institutions

In August 2010 the Hungarian Parliament approved an 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 an Act had been put in force by the Parliament, which permitted credit institutions to reclaim bank tax in the amount of 30% of the realised loss on early repaid foreign exchange mortgage loans (see Note 26). The Act was effective for reporting periods beginning on 1 January 2011. The base of the reclaimable bank tax has changed for the reporting periods beginning on 1 January 2012. Due to the debtor relief program 30% of the obligation waived by the Group (in case of retail foreign exchange mortgage debtors who fulfil the conditions required to convert their overdue loans into HUF mortgage loans) can be deducted from the bank tax in 2012.

In 2012 a new act has been approved which extends the bank tax payment obligation of the credit institutions to 2013.

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.

NOTE 2 – ACCOUNTING POLICIES (continued)

2.7 Reclassification

The following comparative information has been reclassified in the Consolidated income statement, in Other comprehensive income and in the Consolidated statement of cash flows for presentation purposes.

	As previously reported 2011	Reclassification	After reclassification 2011
	MHUF	MHUF	MHUF
Consolidated income statement			
Other net income	621	(427)	194
General administrative expenses	(31 881)	784	(31 097)
Impairment on other	(84)	(357)	(441)
Consolidated other comprehensive income			
Available-for-sale debt instruments			
Net gain / (loss) from fair value changes	(2 007)	(521)	(2 528)
Deferred tax impact on fair value changes	-	521	521
Cash flow hedge			
Net gain / (loss) from fair value changes	(288)	(76)	(364)
Deferred tax impact on fair value changes	-	76	76
Consolidated statement of cash flows			
Adjustments for profit before tax:			
Unrealised valuation differences	(4 850)	27 535	22 685
Net foreign exchange difference (cash and cash equivalents)	-	(27 535)	(27 535)

The income resulting from the rental of the Group's headquarter building was reclassified from other net income to general administrative expenses. The write down of property, plant and equipment, intangible assets and inventories was reclassified from Other net income to Impairment on other. Both reclassifications were performed due to the updated reporting definitions as introduced within the Group as from the beginning of 2012.

Net gain / (loss) from fair value changes of available-for-sale bonds and cash flow hedge instruments and the deferred tax impact on fair value changes were separated according to IAS12.81.

In the Consolidated statement of cash flows the foreign exchange revaluation of cash and cash equivalents was separated from cash flows resulting from operating, financing and investing activities according to IAS 7.28.

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:

- Note 3 Segment information (due to changes in the segmentation practice in 2012)
- Note 9 Other net income
- Note 10 General administrative expenses
- Note 13 Impairment (Income statement)
- Note 17 Financial assets and liabilities, breakdown by portfolio and product (separation of trade receivables)
- Note 21 Financial assets and financial liabilities designated at fair value through profit or loss (the difference between the fair value and the amount contractually paid at maturity includes future interest cash flows in this Consolidated Financial Statement compared to previous years when interest cash flows were excluded)
- Note 32 Property and equipment (write down of property and equipment)
- Note 33 Intangible assets (write down of intangible assets)
- Note 37 Commitments, contingent assets and contingent liabilities (introducing the use of indexed property value)
- Note 38 Finance and operating leases (review of the calculation of non-guaranteed residual value)
- Note 44 Risk management; credit quality of unimpaired and non past due assets (changes in the Group's internal rating practice)
- Note 44 Risk management; industrial breakdown of loans and advances (separation of central governments and municipalities and allocation of finance lease receivables to the corresponding industry sector)

Management believes the above reclassifications relating to 2011 are immaterial to the consolidated financial statements taken as a whole.

2.8 Change in estimate

In 2012 the Group has modified the formerly applied fair value calculation methodology of the liabilities measured at fair value. The method takes into account a new component, the own credit risk of the Group, in order to provide a more accurate fair value. In the new methodology the current discounting yield curves are shifted by the maturity-related liquidity premium being the best estimation of the own credit risk. The method change resulted in a HUF 1 235 million revaluation gain in 2012.

In retail mortgage lending the annual review of parameters of collective and statistical provisioning models resulted in a HUF 1 538 million provision release in the second half of 2012, and a HUF 6 036 million gain in the third quarter of 2012. In the third quarter of 2012 a HUF 6 417 million additional provision was recorded in the consolidated income statement due to changes in the management assessment.

The Group has changed the valuation of Visa Inc. from cost less accumulated impairment to fair value in 2012 because quoted market price is available for the shares. The effect of the first time application of fair value amounted to HUF 681 million unrealised gain before tax and it was recorded in the Consolidated other comprehensive income in 2012.

NOTE 3 – SEGMENT INFORMATION

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

Definitions of customer segments:

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

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

Markets: proprietary trading activity.

Leasing: retail car loans and fleet services.

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 34), 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 hedge accounting.

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

The Group only operates in Hungary.
All investments in associates, property, plant and equipment and intangible assets (including capital expenditures) are shown in "General management" segment.

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2012:

	Retail MHUF	Corporate MHUF	Markets MHUF	Leasing MHUF	General management MHUF	Total MHUF
Net interest income / (expense)	52 475	19 544	5 984	3 668	(7 678)	73 993
Net fee and commission income / (expense)	24 580	4 460	-	(110)	(220)	28 710
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	5 581	4 830	(449)	1	12 981	22 944
Net realised gains / (losses) from available-for-sale assets	64	23	-	-	44	131
Dividend income	-	-	-	-	8	8
Other net income / (expense)	(148)	(448)	(437)	433	847	247
Total income / (expense)	82 552	28 409	5 098	3 992	5 982	126 033
of which:						
external income / (expense)	82 236	28 725	5 098	3 992	5 982	126 033
internal income / (expense)	316	(316)	-	-	-	-
Operating expenses	(52 265)	(12 528)	(2 796)	(3 167)	(15 113)	(85 867)
Impairment	(6 734)	(2 928)	-	(3 021)	(946)	(13 629)
Share in results of associated companies	-	-	-	-	441	441
Profit / (loss) before tax	23 555	12 953	2 302	(2 196)	(9 636)	26 978
Income tax benefit / (expense)	(5 079)	(2 307)	(444)	392	917	(6 521)
Segment profit / (loss)	18 476	10 646	1 858	(1 804)	(8 719)	20 457
Total assets	700 650	625 552	220 277	52 486	863 229	2 462 194
Total liabilities and equity	1 456 564	579 065	3 799	519	422 247	2 462 194

NOTE 3 – SEGMENT INFORMATION (continued)

Segment reporting information by customer segments for 2011 after reclassification:

	Retail MHUF	Corporate MHUF	Markets MHUF	Leasing MHUF	General management MHUF	Total MHUF
Net interest income / (expense)	59 782	21 391	11 243	4 183	6 005	102 604
Net fee and commission income / (expense)	25 013	5 031	-	(279)	(347)	29 418
Net gains / (losses) from financial instruments at fair value through profit or loss and from 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	(244)	194
Total income / (expense)	91 093	30 629	4 131	4 636	20 769	151 257
of which:						
external income / (expense)	90 645	30 229	4 133	5 481	20 769	151 257
internal income / (expense)	43	(43)	-	-	-	-
Operating expenses	(47 297)	(11 186)	(2 586)	(3 601)	(2 682)	(67 351)
Impairment	(19 147)	(6 857)	-	(5 845)	(47 665)	(79 514)
Share in results of associated companies	-	-	-	-	342	342
Profit / (loss) before tax	24 649	11 586	1 545	(4 810)	(29 236)	4 734
Income tax benefit / (expense)	(3 464)	(1 341)	(169)	(210)	1 036	(4 148)
Segment profit / (loss)	21 185	11 245	1 376	(5 020)	(28 200)	586
Total assets	854 916	713 804	184 847	53 587	1 063 589	2 870 743
Total liabilities and equity	1 435 315	642 330	5 350	1 911	785 837	2 870 743

NOTE 4 – NET INTEREST INCOME

	2012 MHUF	2011 MHUF
Loans and receivables	92 085	108 338
Held to maturity	32 291	26 948
Available-for-sale assets	21 150	34 049
Subtotal, interest income from financial assets not measured at fair value through profit or loss	145 526	169 335
of which accrued for impaired financial assets	-	-
Financial assets held for trading	7 562	12 388
Asset/liability management derivatives	8 490	16 372
Other financial assets at fair value through profit or loss	226	375
Total interest income	161 804	198 470
Financial liabilities measured at amortised cost	(70 790)	(70 948)
Other liabilities not measured at fair value through profit or loss	(756)	(514)
Subtotal, interest income from financial assets not measured at fair value through profit or loss	(71 546)	(71 462)
Financial liabilities held for trading	(159)	(221)
Asset/liability management derivatives	(1 569)	(10 257)
Other financial liabilities at fair value through profit or loss	(14 537)	(13 926)
Total interest expenses	(87 811)	(95 866)
Net interest income	73 993	102 604

NOTE 5 – NET FEE AND COMMISSION INCOME

	2012 MHUF	2011 MHUF
Brokerage services	5 162	6 242
Trust and fiduciary activities	3 908	3 597
Credit and guarantee fee income	3 503	3 704
Structured finance	108	555
Payment services	20 127	19 585
Card services	8 690	9 369
Other	1 309	1 276
Fee and commission income	42 807	44 328
Brokerage services	(990)	(1 024)
Credit and guarantee fee expense	(2 197)	(2 430)
Commissions to agents	(83)	(141)
Structured finance	(42)	(22)
Payment transactions	(4 183)	(4 388)
Card services	(4 821)	(4 798)
Insurance services	(1 682)	(2 006)
Other	(99)	(101)
Fee and commission expense	(14 097)	(14 910)
Net fee and commission income	28 710	29 418

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

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

	2012 MHUF	2011 MHUF
Trading securities	1 988	(194)
Interest rate derivatives (including interest and fair value changes in trading derivatives)	7 777	1 752
Other financial instruments designated at fair value through profit or loss at initial recognition	(4 882)	1 779
Foreign exchange trading (including interest and fair value changes in trading foreign exchange derivatives)	357	15 725
Fair value adjustments in hedge accounting*	17 704	(218)
Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange	22 944	18 844

* Results of cash flow hedge derivatives transferred from Consolidated other comprehensive income to the Consolidated income statement amounted to HUF 17 724 million gain in 2012 (HUF 149 million loss in 2011), and HUF 20 million loss was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 69 million loss in 2011).

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 356 million loss in 2012 (HUF 65 million gain in 2011).

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

	2012 MHUF	2011 MHUF
Fixed-income securities	131	192
Net realised gains from available for sale	131	192

NOTE 8 – DIVIDEND INCOME

	2012 MHUF	2011 MHUF
Available-for-sale shares	8	5

Dividends in 2012 and 2011 were paid by VISA Inc.

NOTE 9 – OTHER NET INCOME

	2012 MHUF	After reclassification 2011 MHUF
Gain on property, plant and equipment	(174)	12
Sale of goods	949	924
Revenue on other services	735	824
Gain / (loss) due to operational risks	(1 251)	(1 779)
Other (after reclassification)	(12)	213
Other net income	247	194

The income of HUF 735 million reported as revenue on other services in the table (HUF 824 million 2011) 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 contained HUF 454 million compensation income for covering the losses resulting from operational risk (see Note 34).

NOTE 10 – GENERAL ADMINISTRATIVE EXPENSES

	2012 MHUF	After reclassification 2011 MHUF
IT expenses (after reclassification)	(11 847)	(9 720)
Rental expenses (after reclassification)	(3 174)	(4 300)
Repair and maintenance (after reclassification)	(1 170)	(1 365)
Marketing expenses	(1 337)	(1 677)
Professional fees	(2 525)	(2 457)
Other facilities expenses	(5 858)	(5 710)
Communication expenses	(198)	(224)
Travel expenses	(76)	(95)
Training expenses	(284)	(572)
Personnel related expenses	(422)	(232)
Other administrative expenses	(5 285)	(4 698)
Other provision	345	(47)
Total general administrative expenses	(31 831)	(31 097)

NOTE 11 – BANK TAX

The Group paid a bank tax of HUF 15 841 million in 2012 before deductions (HUF 15 878 million in 2011). The basis and the tax rate of the tax payable by financial institutions can differ per group members, dependent on their activities. Due to the debtor relief program 30% of the obligation waived by the Group (in case of retail foreign exchange mortgage debtors who fulfil the conditions required to convert their overdue loans into HUF mortgage loans) could be deducted from the bank tax in 2012 (in 2011 30% of the losses resulting from early repayment at a preferential rate could be deducted) (see Note 26).The Group reclaimed a bank tax expense of HUF 890 million in 2012 (HUF 15 340 million in 2011).

The tables below present the details of the bank tax paid by the group members in 2012 and 2011 (and do not include the reclaimed bank tax).

2012	Activity	Tax base	Tax rate	Tax
		MHUF	%	MHUF
Group members:				
K&H Bank Zrt.	Credit institution	2 886 688	0.539*	15 556
K&H Autófinanszírozó Zrt.	Finance leasing	1 313	6.500	85
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		3 573 191	0.443	15 841

2011	Activity	Tax base	Tax rate	Tax
		MHUF	%	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

*Effective rate

The bank tax payable by the Group members for the year 2012 is calculated as follows.

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

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

The bank tax for credit institutions is payable at 0.15% on tax base below HUF 50 000 million and 0.53% on tax base above HUF 50 000 million in 2012 and 2011.

The increase in the Bank's tax base in 2012 is caused by the merger of K&H Pannonlízing Zrt. in 2011.

Tax base used by finance lease companies includes interest income and net 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%.

Finance lease companies are allowed to adjust the tax base by net fee expenses from 2012 on, this causes the changes of the tax base at the finance lease companies in 2012.

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 for asset management companies is 0.028%.

The Bank tax for the Group is expected to be HUF 15 841 million in 2013, which liability is established on January 1, 2013.

NOTE 12 – AVERAGE NUMBER OF PERSONNEL

	2012	2011
White-collar staff	3 276	3 289
Blue-collar staff	24	25
Management	185	187
Total average number of persons employed	3 485	3 501

NOTE 13 – IMPAIRMENT (income statement)

	2012 MHUF	2011 MHUF
Impairments and provisions on loans and receivables and credit commitments		
Specific impairments for loans and receivables	(37 220)	(54 174)
Specific provisions on credit commitments	(663)	758
Portfolio-based impairments and provisions	25 022	(25 657)
Total impairments and provisions on loans and receivables and credit commitments	(12 861)	(79 073)

For more detailed information on changes in the impairment loss see Note 26.

	2012 MHUF	After reclassification 2011 MHUF
Impairment on other		
Intangible assets (after reclassification)	(208)	(21)
Property and equipment (after reclassification)	(469)	(322)
Other (after reclassification)	(91)	(98)
Total impairment on other	(768)	(441)

NOTE 14 – SHARE IN THE RESULTS OF ASSOCIATED COMPANIES

	2012 MHUF	2011 MHUF
Giro Elszámolásforgalmi Zrt.	441	349
HAGE Zrt.	-	-
K&H Lízingház Zrt. "v.a"	-	(7)
Share of the results of associates	441	342

The impairment made on HAGE Zrt. was a HUF 217 million in 2012 (HUF 33 million in 2011). 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 2012 and 2011 are:

	2012 MHUF	2011 MHUF
Statutory income tax expense	(1 905)	(112)
Statutory income tax from self revision of prior years	(60)	417
Local business tax expense	(3 492)	(4 263)
Deferred taxes on income	(1 064)	(190)
Income tax expense	(6 521)	(4 148)

Statutory income tax expense

In 2012 and 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.

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. The review of the next three years had started in 2012 and it will be closed in 2013. Management is not aware of any additional significant unaccrued potential tax liability which might arise relating to years not audited by the tax authorities.

The amount of the contingent asset due from reviewing the taxation of Loss due to operational risks amounts to HUF 2 848 million.

NOTE 15 – INCOME TAXES (continued)

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

	2012 MHUF	After reclassification 2011 MHUF
Profit before tax	26 978	4 734
Income tax rate*	19.00%	19.00%
Income tax calculated (after reclassification)	(5 126)	(899)
Plus/minus tax effects attributable to:		
Tax base decreasing items (after reclassification)	769	1 528
Adjustments related to prior years	(51)	510
Adjustments, opening balance of deferred taxes due to change in tax rate	-	(1 387)
Unused tax losses to reduce current tax expense	45	63
Unused tax losses to reduce deferred tax expense	268	1 251
Reversal of previously recognised deferred tax on unused tax losses and tax credits	-	(398)
Local taxes (after reclassification)	(2 772)	(3 384)
Tax base increasing items (after reclassification)	(873)	(1 604)
Other	1 219	172
Total tax effects* (after reclassification)	(1 395)	(3 249)
Income tax expense (income tax calculated + total tax effects)	(6 521)	(4 148)

*In the Consolidated Financial Statements of previous years the Group had modified the 19% of statutory income tax rate for presentation purposes, because local business taxes are presented as income taxes in the Consolidated income statements, which creates an increase of about 1.62% in the statutory income tax rate. In this Consolidated Financial Statements the Group has returned to the legal tax rate of 19% to ensure the comparability to other entities' financial statements. The effective income tax rate for 2012 is 24.17% (2011: 82.29%).

The 10% income tax rate expected to be applied for the periods beginning on 1 January 2013 was cancelled due to the changes in the income tax law in 2011. The effect of the change in the tax rate is presented as Adjustments, opening balance of deferred taxes due to change in tax rate in the table above and was recorded in the Consolidated Income statement and in Other comprehensive income.

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 2012 and 2011. The following amounts were used in the calculation of earnings per share:

	2012	2011
Net profit attributable to shareholders (MHUF)	20 457	586
Weighted average shares outstanding (in millions)	140 978	123 237
Earnings per share (HUF)	0.1451077	0.0047551

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 2012							
Loans and advances to credit institutions and investment firms*	-	-	-	71 345	-	-	71 345
Loans and advances to customers	-	-	-	1 189 004	-	-	1 189 004
Trading receivables	-	-	-	24 317	-	-	24 317
Consumer credit	-	-	-	44 448	-	-	44 448
Mortgage loans	-	-	-	497 338	-	-	497 338
Term loans	-	-	-	505 416	-	-	505 416
Finance leasing	-	-	-	30 355	-	-	30 355
Current account advances	-	-	-	85 113	-	-	85 113
Other	-	-	-	2 017	-	-	2 017
Equity instruments	9 926	-	1 878	-	-	-	11 804
Debts instruments issued by public bodies	105 707	3 022	291 136	55 597	507 751	-	963 213
Derivatives	44 001	-	-	-	-	-	44 001
Total carrying value	159 634	3 022	293 014	1 315 946	507 751	-	2 279 367

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 55 332 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 12 853 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 (after reclassification)	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
Trading receivables (after reclassification)	-	-	-	19 654	-	-	19 654
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 (after reclassification)	-	-	-	90 529	-	-	90 529
Other (after reclassification)	-	-	-	1 359	-	-	1 359
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	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities as at 31 December 2012					
Deposits from credit institutions and investment firms*	-	-	-	288 462	288 462
Deposits from customers and debt certificates	-	241 826	-	1 520 772	1 762 598
Deposits from customers	-	235 567	-	1 493 180	1 728 747
Demand deposits	-	-	-	436 357	436 357
Time deposits	-	235 567	-	884 932	1 120 499
Savings deposits	-	-	-	171 891	171 891
Debt certificates	-	6 259	-	27 592	33 851
Certificates of deposits	-	-	-	260	260
Non-convertible bonds	-	6 259	-	5 159	11 418
Non-convertible subordinated liabilities	-	-	-	22 173	22 173
Derivatives	39 642	-	67 465	-	107 107
Short positions	6 400	-	-	-	6 400
In debt instruments	6 400	-	-	-	6 400
Other	-	-	-	862	862
Total carrying value	46 042	241 826	67 465	1 810 096	2 165 429

*Of which HUF 147 504 million is deposits from banks repayable on demand.

Deposits from credit institutions and investment firms includes repo transactions of HUF 18 443 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.

Assets pledged as collateral for liabilities and contingent liabilities

	2012	2011
	MHUF	MHUF
Assets pledged for:		
Repo liabilities	17 696	34 767
Refinancing credits with EIB	58 327	54 982
Derivative transactions	27 506	23 234
Clearing transactions	34 864	34 841
Total assets pledged as collateral	138 393	147 824

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

Details of financial instruments

Equity and debt instruments

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

	2012 MHUF	2011 MHUF
Held for trading		
Treasury bills	41 727	41 455
Government bonds issued in HUF	63 980	111 496
Government bonds issued in foreign currency	-	1 366
Listed equity instruments	3 542	6 290
Unlisted equity instruments	6 384	6 048
Total held for trading securities	115 633	166 655

	2012 MHUF	2011 MHUF
Available for sale		
Treasury bills	24 532	1 288
Other government bonds issued in HUF	266 604	386 906
Listed equity instruments	1 232	-
Unlisted equity instruments	646	952
Total available for sale	293 014	389 146

Available-for-sale equity instruments contain as at 31 December 2012 unlisted equity instruments in a value of HUF 646 million (HUF 952 million at the end of 2011) for which a fair value cannot be measured reliably. These investments are not traded on active markets.

Management believes that the carrying value of the investments held at amortised cost approximates their fair value.

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

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

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

	2012 MHUF	2011 MHUF
Garantiqa Hitelgarancia Zrt.	640	640
VISA Inc.	-	306
SWIFT S.C.	6	6
	646	952

The Group has changed the valuation of Visa Inc. from cost less accumulated impairment to fair value in 2012, because quoted market price is available for the shares. The revaluation result of Visa Inc. amounted to HUF 748 million after tax and it is recorded in Other comprehensive income. The fair value of Visa Inc. was HUF 1 232 million as at 31 December 2012.

The table does not contain Risk Kft., as it is fully impaired as at the end of 2012 and 2011.

The Group recorded HUF 7 093 million gain after tax in Other comprehensive income as a result of the fair value revaluation of available-for-sale debt instruments in 2012 (HUF 2 007 million loss after tax in 2011).

The unrealised result of available-for-sale debt instruments is cumulatively HUF 3 267 million loss after tax as at 31 December 2012 (HUF 10 286 million loss as at 31 December 2011).

	2012 MHUF	2011 MHUF
Loans and receivables		
Bonds issued by municipality - issued in foreign currency	55 597	62 433
Total loans and receivables debt instruments	55 597	62 433

	2012 MHUF	2011 MHUF
Held to maturity		
Consolidation bonds issued in HUF	112 316	112 017
Government bonds issued in HUF	395 435	309 435
Total held to maturity	507 751	421 452

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

Due to the changes of the Group's intention concerning available-for-sale securities the proportion of the portfolios in the total security position and the structure of the portfolios were revised. Government bonds in amount of HUF 65 865 million and included in the available-for-sale portfolio in 2012 were reclassified into the held-to-maturity portfolio.

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 2012 and 2011. As they are repriced regularly Management believes that amortized historical cost is the most appropriate estimation of their fair value.

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 2012, 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.

	2012 MHUF	2011 MHUF
Refinancing credits	144 197	173 790

Non-convertible subordinated liabilities

	2012 MHUF	2011 MHUF
Subordinated loan from KBC Group	17 450	18 630
Bonds issued to the State	4 723	4 714
	22 173	23 344

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 instruments mature in 2014. Non-convertible subordinated liabilities are presented as financial liabilities at amortised cost in the consolidated statement of financial position.

NOTE 18 – TRANSFERRED FINANCIAL ASSETS

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

	2012		2011	
	Carrying amount of transferred asset	**Carrying amount of associated liability**	**Carrying amount of transferred asset**	**Carrying amount of associated liability**
	MHUF	**MHUF**	**MHUF**	**MHUF**
Held-for-trading debt instruments	7 892	7 921	17 527	14 489
Available-for-sale debt instruments	742	743	862	911
Held-to-maturity debt instruments	9 062	9 779	16 378	15 352
Total transferred assets and associated liabilities	17 696	18 443	34 767	30 752

Repo and reverse repo agreements

Under reverse repo transactions, the Group obtains legal ownership of the respective collateral received and, thus, is permitted to utilise the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity, which generates a liability recorded as financial liability held at amortised cost in the consolidated financial position. The fair value of securities accepted as collateral in connection with reverse repo transactions as at 31 December 2012 was HUF 12 655 million, of which HUF 6 400 million (reported as short positions in the consolidated statement of financial position) has been sold (31 December 2011 HUF 24 925 million and HUF 6 494 million respectively).

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

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

NOTE 19 – 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.

NOTE 19 – RECLASSIFICATION OF FINANCIAL ASSETS (continued)

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

	After reclassification MHUF	Without reclassification MHUF
Carrying amount as at 31 December 2012	43 495	40 457
Available for sale reserve (before tax)	(5 866)	(8 830)
Income statement (before tax)	47	-

	After reclassification MHUF	Without reclassification MHUF
Carrying amount 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 fair value gain that the Group would have recognised in other comprehensive income if the financial assets had not been reclassified amounted to HUF 8 084 million gain in 2012 (HUF 7 090 million loss in 2011).

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

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

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

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

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

The Group reclassified government bonds from available-for-sale to held-to maturity portfolio in 2012 (see Note 17).

NOTE 20 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The table below presents information concerning the fair value of financial assets and liabilities for year 2012:

	At fair value							
	Quoted market price	Valuation techniques - market observable inputs	Valuation techniques - non market observable inputs	At amortised cost	Total carrying amount	Recognised in profit or loss - non market observable inputs	Fair value	Unrecognised gain/(loss)
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Held for trading	50 554	107 698	1 383	-	159 635	140	159 635	-
Designated at fair value through profit or loss	-	-	3 022	-	3 022	(232)	3 022	-
Available for sale	32 200	260 168	-	646	293 014	-	293 014	-
Loans and receivables	-	-	-	1 315 946	1 315 946	-	1 303 562	(12 384)
Held to maturity	-	-	-	507 751	507 751	-	524 851	17 100
Hedging derivatives	-	-	-	-	-	-	-	-
Total financial assets	82 754	367 866	4 405	1 824 343	2 279 368	(92)	2 284 084	4 716
Financial liabilities								
Held for trading	6 400	38 368	1 274	-	46 042	(137)	46 041	-
Designated at fair value through profit or loss	-	241 826	-	-	241 826	-	241 826	-
Measured at amortised cost	-	-	-	1 810 096	1 810 096	-	1 797 735	12 361
Hedging derivatives	-	67 465	-	-	67 465	-	67 465	-
Total financial liabilities	6 400	347 659	1 274	1 810 096	2 165 429	(137)	2 153 067	12 361

NOTE 20 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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

	At fair value							
	Quoted market price	Valuation techniques- market observable inputs	Valuation techniques- non market observable inputs	At amortised cost	Total carrying amount	Recognised in profit or loss - non market observable inputs	Fair value	Unrecognised gain/(loss)
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial assets								
Held for trading	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 20 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Hungarian government bonds have quoted market price except for bonds maturing within 3 months, which are valued based on BUBOR yield curve within 3 months maturity. In 2012 held-for- trading debt instruments in an amount of HUF 9 026 million and available-for sale debt instruments in an amount of HUF 34 731 million were transferred from Quoted market price to Valuation techniques-market observable inputs category due to this change in valuation.

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

Financial assets	**Held-for trading-derivatives**	**Government and corporate bonds at fair value through profit or loss**	**Total**
	MHUF	**MHUF**	**MHUF**
Balance as at 31 December 2011	3 923	3 297	7 220
Net gains / (losses)			
In profit or loss	(2 227)	(1 130)	(3 357)
Acquisitions	-	855	855
Settlement	(313)	-	(313)
Balance as at 31 December 2012	1 383	3 022	4 405

NOTE 20 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

Financial assets	Held-for trading-derivatives	Government and corporate bonds at fair value through profit or loss	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

NOTE 20 – 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 2011	3 914	-	3 914
Net (gains) / losses			
In profit or loss	(2 335)	25	(2 310)
In other comprehensive income	-	-	-
Acquisitions	-	-	-
Settlement	(305)	(25)	(330)
Balance as at 31 December 2012	1 274	-	1 274

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

NOTE 20 – 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, except for Hungarian government bonds maturing within 3 months, which are valued based on BUBOR yield curve within 3 months maturity.

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 financial liabilities designated at fair value through profit or loss and most of the derivatives are valued based on these techniques, such as currency forwards and swaps, foreign exchange and interest rate options, cross currency- and interest rate swaps and forward rate agreements.

The Group has changed the valuation technique of financial liabilities designated at fair value through profit or loss in 2012 and shifted the discounting yield curves used for the fair value calculation by the maturity-related liquidity premium being the best estimation of the own credit risk. The adjustment of the valuation resulted in a gain of HUF 1 235 million which was recorded as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange in the Consolidated Income Statement in 2012.

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.

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 had been distributed and used consistently within KBC group. However, since 2009 the value of these instruments was permanently zero in the Group. Fixed rate corporate bonds were sold in 2012.

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. Issued bonds linked to fixed rate corporate bonds were entirely repurchased in 2012.

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

Shifting the yield curves of EUR denominated Hungarian government bonds with +10 basis points would reduce the current carrying value by HUF 8 million (HUF 10 million decrease in 2011).

NOTE 20 – 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 2012 and 2011.

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 2012 equity instruments in a value of HUF 646 million (HUF 952 million at the end of 2011) which fair value cannot be measured reliably.

The Group has changed the valuation of Visa Inc. from cost less accumulated impairment to fair value in 2012, because quoted market price is available for the shares. For the first time application effect of the new valuation see Note 2.8.

Management believes that the carrying value of the investments held at cost 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 maturing over 3 months disclosed in this Note is calculated based on regularly quoted market prices, since these instruments have an active market. Hungarian government bonds maturing within 3 months are valued based on BUBOR yield curve within 3 months maturity.

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

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.

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.

Municipality bonds in the Loans and receivables portfolio 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.

NOTE 20 – FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

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

	2012 MHUF	2011 MHUF
Financial assets designated at fair value through profit or loss		
Government bonds issued in foreign currencies	3 022	3 297
Loans to customers	-	-
	3 022	3 297

	2012 MHUF	2011 MHUF
Financial liabilities designated at fair value through profit or loss		
Term deposits:		
- retail	4 218	7 874
- corporate	7 827	4 161
- investment funds	223 522	179 067
Other issued bonds	6 259	5 359
	241 826	196 461

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 35 million gain in 2012 (HUF 1 509 million loss in 2011).

The loan designated at fair value through profit or loss had no credit risk exposure as at 31 December 2012 (and 2011).

NOTE 21 – FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

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 was linked to purchased bonds which were fixed rate corporate bonds issued in a foreign currency. The fair value measurement significantly reduced the valuation inconsistency (the 'accounting mismatch') between the assets and the liabilities. The repurchase of these issued bonds was finished in 2012;
- another portion of the issued bonds are economically hedged by derivatives which do not achieve the criteria for hedge accounting.

Included in financial liabilities designated at fair value through profit or loss are retail and corporate term deposits combined with currency options which are 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 Group has changed the valuation technique of financial liabilities designated at fair value through profit or loss in 2012 and shifted the discounting yield curves used for the fair value calculation by the maturity-related liquidity premium being the best estimation of the own credit risk (not recorded in the fair value in the previous years) (see Note 2.8). The adjustment of the valuation resulted in a gain of HUF 1 235 million which was recorded as Net gains / (losses) from financial instruments at fair value through profit or loss and from foreign exchange and represents the cumulative change in the fair value due to credit risk.

The amount that the Group would contractually be required to pay at maturity is HUF 15 072 million higher than the fair value of the deposits and issued bonds (HUF 22 214 million higher in 2011).

NOTE 22 – 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 2012 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	122 230	3 022	291 776	1 246 507	507 751	-	-	2 171 286
EMU countries	31 370	-	6	9 460	-	-	-	40 836
East-European countries	143	-	-	13 832	-	-	-	13 975
Russia	-	-	-	12 536	-	-	-	12 536
Other European countries	5 885	-	-	32 202	-	-	-	38 087
Non-European countries	6	-	1 232	1 409	-	-	-	2 647
Total	159 634	3 022	293 014	1 315 946	507 751	-	-	2 279 367
Financial liabilities								
Hungary	10 467	240 914	-	-	-	-	1 502 626	1 754 007
EMU countries	24 042	753	-	-	-	49 540	267 663	341 998
East-European countries	147	59	-	-	-	-	7 971	8 177
Russia	-	-	-	-	-	-	9 596	9 596
Other European countries	11 386	-	-	-	-	17 925	13 011	42 322
Non-European countries	-	100	-	-	-	-	9 229	9 329
Total	46 042	241 826	-	-	-	67 465	1 810 096	2 165 429

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

The geographical breakdown of financial assets and financial liabilities as at 31 December 2011 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	187 844	3 297	388 835	1 498 962	421 452	-	-	2 500 390
EMU countries	20 097	-	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 23 – 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 2012:

	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
Unimpaired assets	159 634	3 022	293 014	1 242 372	507 751	2 205 793
Impaired assets	-	-	513	186 022	-	186 535
Impairment	-	-	(513)	(112 448)	-	(112 961)
Total carrying value	159 634	3 022	293 014	1 315 946	507 751	2 279 367

The credit quality of assets as at 31 December 2011 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	Total
	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

NOTE 23 – 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 2012 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	79 747	3 658	83 918
Individually assessed impairment	(513)	(49 777)	(2 129)	(52 419)
Total	-	29 970	1 529	31 499

The balance of individually impaired financial assets and commitments and contingent liabilities as at 31 December 2011 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	108 499	6 068	115 080
Individually assessed impairment	(513)	(54 570)	(1 415)	(56 498)
Total	-	53 929	4 653	58 582

NOTE 23 – 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 2012 is as follows:

	Less than 30 days MHUF	30 days or more, but less than 90 days MHUF	Total MHUF
Loans to customers			
- Corporate	6 993	4 775	11 768
- Retail	115 596	39 198	154 794
Total	122 589	43 973	166 562

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

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

Collaterals behind impaired or past due financial assets amounted to HUF 352 245 million as at 31 December 2012 (HUF 486 684 million as at 31 December 2011).

NOTE 23 – 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.

	2012 MHUF	2011 MHUF
Equity instruments*	11 804	13 290
Debt instruments*	963 213	1 029 744
Loans and advances	1 315 430	1 646 312
Derivatives*	44 001	46 164
Other assets	40 620	46 630
Total assets	2 375 068	2 782 140
Commitments to extend credit	260 468	283 676
Guarantees	118 479	136 003
Letters of credit	5 474	3 178
Total commitments and contingent liabilities	384 421	422 857
Total credit exposure	2 759 720	3 204 997

*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 44.4.

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 2012 was HUF 22 969 million (HUF 29 334 million as of 31 December 2011) before taking account of any collateral or other credit enhancements.

NOTE 24 – 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 2012:

	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	96 221	35	266 567	487 247	148 788	-	-	998 858
More than one but not more than five years	39 137	2 987	24 569	385 970	253 631	-	-	706 294
More than five years	14 350	-	-	442 729	105 332	-	-	562 411
Without maturity	9 926	-	1 878	-	-	-	-	11 804
Total	159 634	3 022	293 014	1 315 946	507 751	-	-	2 279 367
Financial liabilities								
Not more than one year	14 150	121 290	-	-	-	15 857	1 637 895	1 789 192
More than one but not more than five years	23 474	116 672	-	-	-	51 608	130 080	321 834
More than five years	8 418	3 864	-	-	-	-	42 121	54 403
Without maturity	-	-	-	-	-	-	-	-
Total	46 042	241 826	-	-	-	67 465	1 810 096	2 165 429

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

NOTE 24 –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 2011:

	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	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

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

NOTE 24 –REMAINING MATURITY OF ASSETS AND LIABILITES (continued)

The remaining maturity of non-financial assets and liabilities held as at 31 December 2012 is presented in the table below.

	< 1 year MHUF	> 1 year MHUF	Total MHUF
Tax assets	3 223	67	3 290
Investments in associated companies	354	1 847	2 201
Investment property	472	-	472
Property and equipment	5 011	40 623	45 634
Intangible assets	2 617	9 209	11 826
Other assets	18 852	21 768	40 620
Total assets	30 529	73 514	104 043
Tax liabilities	-	368	368
Provisions for risks and charges	4 916	30 591	35 507
Other liabilities	45 020	-	45 020
Total liabilities	49 936	30 959	80 895

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

NOTE 25 – IMPAIRMENT ON AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2012 MHUF	2011 MHUF
Opening balance	513	513
Impairment reversed	-	-
Closing balance	513	513

Risk Kft. (see Note 17 and Note 41) is fully impaired as at the end of 2012 and 2011.

NOTE 26 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position)

	2012 MHUF	2011 MHUF
Breakdown by type		
Specific impairment for loans and receivables	99 298	104 372
Specific provision on credit commitments	2 129	1 415
Portfolio-based impairment and provision	13 275	39 022
Total impairment and provision on loans and receivables and credit commitments	114 702	144 809

	2012 MHUF	2011 MHUF
Breakdown by counterparty		
Impairment for loans and advances to customers (excluding banks)	111 423	141 812
Impairment for debt instruments issued by municipalities	1 025	1 235
Specific and portfolio based provision, credit commitments	2 254	1 762
Total impairment and provision on loans and receivables and credit commitments	114 702	144 809

NOTE 26 – 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 2012	104 372	1 415	39 022	144 809
Movements with an impact on results				
Loan loss expenses	90 283	2 212	24 339	116 834
Loan loss recoveries	(53 063)	(1 549)	(49 361)	(103 973)
Discount effect	(998)	75	-	(923)
Movements without an impact on results				
Write-offs	(36 923)	-	-	(36 923)
Other	(4 373)	(24)	(725)	(5 122)
Closing balance as at 31 December 2012	99 298	2 129	13 275	114 702

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 installments are fixed at preferential foreign exchange rates (HUF/CHF: 180, HUF/EUR: 250, HUF/JPY: 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 and thus this measure had no significant impact on the financial position of the Group.
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 had 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.

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

NOTE 26 – 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.

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. Considering the adequate impairment coverage at 31 December 2011 no additional impairment loss was incurred in 2012 (the HUF 22 135 million portfolio based impairment available at 31 December 2011 was released and the realised corresponding loss was accounted for among specific impairments).

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).

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 installments 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 March 2013 (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).

According to the related regulation, 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 installment 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).

The interest part of the monthly installment above the preferential foreign exchange rates is borne entirely by the Hungarian government although 50% of this difference is refunded by the banks in form of additional tax charge reported under ‘general administrative expenses’ (in relation to that the Group incurred HUF 250 million pre-tax loss in 2012). Should the foreign exchange rate exceed the levels of HUF/CHF 270, HUF/EUR 340 andHUF/JPY 3.3 the excess amounts will be borne by the Hungarian state.

NOTE 26 – IMPAIRMENT ON LOANS AND RECEIVABLES AND PROVISION FOR CREDIT COMMITMENTS (statement of financial position - continued)

Based on an estimation of management, assuming a client participation rate of 60% in the program, the pre-tax present value impact on the 'buffer' account bearing below market interest is HUF 390 million negative impact as at 31 December 2012. The management does not expect the final participation rate to have a material impact on the 2013 figures.

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 were able to request to have their foreign exchange mortgage loans converted into HUF mortgage loans. For all loans converted, the Group was required to waive 25% of the converted total obligations at the date of conversion. Further as part of this regulation, 30% of the obligation waived by the Group was deducted from the bank tax due for 2012 (see Note 11). In connection with this measure the Group waived HUF 2 967 million claim (resulted in a bank tax reduction of HUF 890 million) in 2012.

As part of the measures to assist defaulted debtors 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. This part of the measure had no substantial impact on the 2012 figures.

	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

NOTE 27 – DERIVATIVE FINANCIAL INSTRUMENTS

	Year ended 31 December 2012				Year ended 31 December 2011			
	Notional amount Assets	Notional amount Liabilities	Positive fair value Assets	Negative fair value Liabilities	Notional amount Assets	Notional amount Liabilities	Positive fair value Assets	Negative fair value Liabilities
Derivatives held for trading	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**	**MHUF**
Foreign exchange derivatives								
Currency forwards	69 846	72 652	685	(1 604)	90 748	89 653	5 078	(949)
Currency futures	4 637	4 652	2	(6)	7 683	7 647	6	(6)
Currency swaps	223 614	222 840	1 441	(1 041)	587 588	584 694	10 607	(8 798)
Currency options	108 395	108 395	3 111	(3 115)	149 465	148 754	9 972	(9 938)
Total foreign exchange derivatives	406 492	408 539	5 239	(5 766)	835 484	830 748	25 663	(19 691)
Interest rate derivatives								
Interest rate swaps	1 094 712	1 094 713	37 244	(24 184)	738 220	738 220	14 667	(13 106)
Cross currency interest rate swaps	278 795	286 422	435	(7 939)	652 044	764 085	4 372	(111 758)
Interest rate options	89 958	89 958	889	(889)	178 607	178 607	639	(639)
Forward rate agreements	57 913	185 000	164	(578)	308 000	205 129	749	(1 285)
Total interest rate derivatives	1 521 378	1 656 093	38 732	(33 590)	1 876 871	1 886 041	20 427	(126 788)
Equity options	457	7 733	21	(285)	482	9 958	35	(849)
Commodity swaps	377	377	9	-	442	442	10	(10)
Commodity options	-	-	-	-	197	197	29	(29)
Total derivatives held for trading	1 928 704	2 072 742	44 001	(39 641)	2 713 476	2 727 386	46 164	(147 367)
Derivatives designated as cash flow hedges								
Currency options	-	-	-	-	-	-	-	-
Cross currency interest rate swaps	356 210	424 266	-	(67 465)	3 990	6 852	-	(545)
Total derivatives held for hedging	356 210	424 266	-	(67 465)	3 990	6 852	-	(545)
Total derivative financial instruments	2 284 914	2 497 008	44 001	(107 106)	2 717 466	2 734 238	46 164	(147 912)

NOTE 27 – 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.

Cash flow hedge of assets reclassified in 2011

In 2011 the Group reclassified municipality bonds from the available-for-sale to the loans and receivables portfolio. The fair value adjustment as at the date of reclassification was 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 were 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. The Group mitigates this volatility with deposits in 2012 (with deposits and CCIRS deals in 2011). Deals are taken into account from the Group's portfolio of available instruments, by having the appropriate ratio of them to avoid overhedging as prescribed by IAS 39.

Realised results of micro cash flow hedge derivatives amounted to HUF 19 million loss in 2012 (HUF 149 million loss in 2011), and HUF 556 million gain was recorded as the unrealised revaluation of the ineffective cash flow hedge transactions (HUF 69 million loss in 2011).

Cash flow hedge of interest rate risk

In 2012 the Group has started to apply hedge accounting for some of its derivatives concluded in frame of Asset and Liability Management. The aim of the cash-flow hedge is to hedge changes in cash flows of group of assets and liabilities related to changes in interest and foreign exchange rates. The hedging instruments are CHF/HUF and CHF/EUR cross currency interest rate swaps.

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

The Group transferred HUF 17 724 million gain to the net profit from other comprehensive income excluding the ineffective part. Due to ineffectiveness HUF 20 million loss was transferred to the net profit.

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

	2012		2011	
	Expected cash flows		Expected cash flows	
	Inflow	Outflow	Inflow	Outflow
	MHUF	MHUF	MHUF	MHUF
< 3 months	(860)	72	-	(11)
3-6 months	(691)	203	-	(11)
6 months - 1 year	(1 308)	751	-	(23)
1-2 years	(2 331)	923	-	(45)
2-5 years	(1 280)	53	-	(134)
> 5 years	58	-	-	(360)
Total	(6 412)	2 002	-	(584)

NOTE 27 – DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Forecast transactions for which hedge accounting had previously been used but which is no longer expected to occur amounted to HUF 48 million as at 31 December 2012 (HUF 892 million as at 31 December 2011).

NOTE 28 – OTHER ASSETS

	2012 MHUF	2011 MHUF
Prepayments	1 764	15 878
Trade receivables	491	1 020
Receivables from employees	15	16
Receivables from bankcard service	9 616	4 401
Items in transit due to payment services	856	350
Receivables from compensation (see Note 34)	21 933	20 921
Items in transit due to trading in securities	1 447	11
Income accruals and cost prepayments	3 471	3 062
Inventories	507	637
Other receivables	520	333
	40 620	46 630

As at 31 December 2012 prepayments include HUF 1 178 million asset recorded due to the reclaim of the bank tax (HUF 15 340 million in 2011) (see Note 11).

NOTE 29 – 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 2012:

	Assets MHUF	Liabilities MHUF	Income statement MHUF	Equity MHUF
Employee benefits	-	-	-	-
Losses carry forward	67	(225)	(1 994)	-
Tangibles and intangibles assets	-	(570)	91	-
Provisions for risk and charges	-	(278)	75	-
Impairment for losses on loans and advances	-	1 782	(18)	-
Financial instruments at fair value	-	42	294	-
Fair value adjustments AFS	-	(653)	-	(2 018)
Cash flow hedge	-	(895)	-	789
Other	-	1 165	488	-
Total	67	368	(1 064)	(1 229)

NOTE 29 – DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (continued)

For the period ended 31 December 2011:

	Assets	Liabilities	Income statement	Equity
	MHUF	MHUF	MHUF	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

In 2012 and 2011, based on the actual corporate income tax law income taxes were calculated on all temporary differences under the asset and liability method using a tax rate of 20.62% (19% corporate income tax and 1.62% local business tax).

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

From the total of HUF 2 168 million tax losses carried forward as at 31 December 2012 (HUF 14 192 million at 31 December 2011), HUF 631 million (HUF 2 181 million at 31 December 2011) 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 1 537 million as at 31 December 2012 (HUF 12 011 million as at 31 December 2011).

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 30 – INVESTMENTS IN ASSOCIATED COMPANIES

	2012 MHUF	2011 MHUF
GIRO Elszámolásforgalmi Zrt.	1 642	1 547
HAGE Zrt.	542	542
Lízingház Zrt. “v.a.”	17	17
Total	2 201	2 106

	2012 MHUF	2011 MHUF
Opening balance	2 106	2 104
- Carrying value, transfers, liquidation	-	(81)
- Share in the result for the period	441	431
- Dividends paid	(346)	(348)
Closing balance	2 201	2 106

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 2012.

	Total assets MHUF	Revenue MHUF	Profit or loss MHUF
GIRO Elszámolásforgalmi Zrt.	8 149	5 840	1 684
HAGE Zrt.	11 945	5 363	697
Lízingház Zrt. “v.a.”	17	-	-

The table includes preliminary financial data for HAGE Zrt.

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
Lízingház Zrt. “v.a.”	17	-	86

NOTE 31 – INVESTMENT PROPERTIES

	Investment properties MHUF
At 31 December 2011	
Cost	-
Accumulated depreciation	(-)
Net book value	-
Movements in 2011	
Additions	56
Disposals - net	-
Impairment charge	-
Depreciation charge	(1)
At 31 December 2011	
Cost	56
Accumulated depreciation	(1)
Net book value	55
Movements in 2012	
Additions	458
Disposals - net	(31)
Impairment charge	-
Depreciation charge	(10)
At 31 December 2012	
Cost	484
Accumulated depreciation	(12)
Net book value	472

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

The difference between the fair value and the carrying amount of the assets is immaterial as at 31 December 2012 (and as at 31 December 2011).

Most of the investment properties were purchased in 2012 and therefore the Group believes that the carrying amount of investment properties approximates their fair value.

NOTE 32 – PROPERTY AND EQUIPMENT

	After reclassification Land and buildings	After reclassification IT equipment	After reclassification Office equipment	Other	After reclassification Total
	MHUF	MHUF	MHUF	MHUF	MHUF
At 1 January 2011					
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 (after reclassification)	(242)	(2)	(77)	-	(321)
Depreciation charge	(1 470)	(1 278)	(978)	(336)	(4 062)
Other (after reclassification)	(58)	(163)	(606)	(312)	(1 139)
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
Movements in 2012					
Additions (acquired separately)	913	1 775	244	1 562	4 494
Disposals - net	(116)	(10)	(12)	(813)	(951)
Impairment charge	(158)	(9)	(59)	(244)	(470)
Depreciation charge	(2 364)	(1 056)	(1 046)	(394)	(4 860)
Other	75	(556)	98	(540)	(923)
At 31 December 2012					
Cost	48 823	17 620	10 267	5 645	82 355
Accumulated depreciation	(12 723)	(14 485)	(7 191)	(2 322)	(36 721)
Net book value	36 100	3 135	3 076	3 323	45 634

Expenditure on items in the course of construction amounted to HUF 4 796 million as at 31 December 2012 (HUF 4 861 million as at 31 December 2011).

During 2009 the Group entered into a contract for the construction of a new headquarter building. In 2011 the new headquarter building has been capitalized. The carrying amount of the building amounted to HUF 23 029 million as at the date of capitalization.

NOTE 33 – INTANGIBLE ASSETS

	After reclassification Acquired software	Other intangible assets	After reclassification Total
	MHUF	MHUF	MHUF
At 1 January 2011			
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
Impairment charge (after reclassification)	(21)	-	(21)
Depreciation charge	(1 266)	(1 080)	(2 346)
Other (after reclassification)	(781)	938	157
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
Movements in 2012			
Additions (acquired separately)	5 189	36	5 225
Disposals - net	(15)	(32)	(47)
Impairment charge	(208)	-	(208)
Depreciation charge	(1 312)	(1 343)	(2 655)
Other	(2 415)	2 018	(397)
At 31 December 2012			
Cost	30 040	9 218	39 258
Accumulated depreciation	(22 838)	(4 594)	(27 432)
Net book value	7 202	4 624	11 826

Fully amortised intangible assets which were still in use amounted to HUF 22 430 million as at 31 December 2012 (HUF 24 353 million as at 31 December 2011).

NOTE 34 – 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 2011	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
Amounts allocated	195	1 798	132	2 125
Amounts used	-	(1 703)	(70)	(1 773)
Unused amounts reversed	-	(680)	(408)	(1 088)
Discount effect	-	674	-	674
Other (foreign exchange revaluation)	-	(43)	-	(43)
Balance as at 31 December 2012	195	32 965	93	33 253

From the total of HUF 32 965 million provision for pending legal disputes the Group has a provision of HUF 30 024 million (HUF 28 968 million in 2011) 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 485 million in 2012 (no charge in 2011).

The Group has during 2012 further revised its previous estimate for the fraud case and increased the provision by HUF 867 million (HUF 1 063 million increase in 2011).

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 21 768 million as at 31 December 2012 (HUF 20 921 million as at 31 December 2011) 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 244 million gain in 2012 and HUF 32 million gain in 2011). From 2007 the calculation of provision is based on an effective interest rate method which results in a HUF 674 million increase recorded as interest expense in the consolidated income statement (HUF 420 million increase in 2011).

NOTE 34 – 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 2 941 million from the total provision for losses from tax litigation and pending legal disputes at 31 December 2012 (HUF 4 155 million at 31 December 2011) 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 reached further settlements. Management considers the provision raised for the still pending cases adequate to cover any remaining potential losses.

Provisions on credit commitments of HUF 2 254 million as at 31 December 2012 (HUF 1 762 million as at 31 December 2011) is presented in Note 26.

NOTE 35 – OTHER LIABILITIES

	2012	2011
	MHUF	MHUF
Trade creditors	4 863	5 567
Lease liabilities	521	528
Items in transit due to payment services	20 669	26 866
Items in transit due to lending activity	1 220	544
Liabilities from bankcard service	3 895	1 893
Other	13 852	11 423
Total other liabilities	45 020	46 821

NOTE 36 – SHARE CAPITAL

	2012	2011
	MHUF	MHUF
Ordinary shares issued and outstanding	140 978	140 978

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.

The nominal value of the ordinary shares issued and outstanding at 31 December 2012 is HUF 1 per share (31 December 2011: HUF 1).

NOTE 36 - SHARE CAPITAL (continued)

Shareholders of the Bank:

	2012 Shareholding %	2011 Shareholding %
KBC Bank N. V.	100.00%	100.00%
	100.00%	100.00%

NOTE 37 – 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 37 – COMMITMENTS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES (continued)

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

	2012 MHUF	After restatement 2011 MHUF
Credit commitments – undrawn amount		
Received	8 158	6 431
Given		
Irrevocable	153 183	170 980
Revocable	107 347	112 988
Total given	260 530	283 968
Collaterals		
Given	126 145	140 651
Guarantees received/collateral		
For impaired and past due assets		
Non-financial assets (after restatement)	338 532	457 474
Financial assets (after restatement)	10 170	29 210
For assets that are not impaired or past due		
Non-financial assets (after restatement)	1 027 065	980 091
Financial assets (after restatement)	183 540	389 668
Total guarantees received/collateral (after restatement)	1 559 307	1 856 443

For information on the contingent asset the Group recognised related to tax self-revision see Note 15.

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 included the collateral value at loan origination, instead of the indexed or reviewed collateral value, as currently presented.

The total of collateral received to mitigate the maximum exposure to credit risk amounts to HUF 925 784 million as at 31 December 2012 (HUF 1 078 779 million as at 31 December 2011). Collaterals include the fair value for financial instruments. The collateral value of retail mortgages comprise the indexed property value calculated from the property value at loan origination revalued via house price index. Corporate non-financial collaterals are presented based on their periodically reviewed collateral value.

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Group has an established protocol of dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Group makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year-end the Group had several unresolved legal claims in the amount of HUF 8 739 million (HUF 10 314 million as at 31 December 2011) 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 38 – 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 finance lease according to the IFRS terminology.

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

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

	2012 MHUF	Restated 2011 MHUF
Finance lease receivables		
Total of gross investment in the lease, receivable:		
less than one year	10 709	13 418
one to five years	21 141	22 278
more than five years	330	1 416
	32 180	37 112
The present value of minimum lease payments receivables*:		
less than one year	9 019	12 773
one to five years	21 017	19 924
more than five years	319	1 257
	30 355	33 954
Unearned finance income	1 847	2 845
Contingent rents recognized as income - gross	4 986	2 383
Non-guaranteed residual values (restated)	6 683	5 447

*Net of impairment.

The total impairment recorded on finance lease receivables amounted to HUF 3 123 million as at 31 December 2012 (HUF 3 312 million as at 31 December 2011).

NOTE 38 – FINANCE AND OPERATING LEASES (continued)

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

	2012 MHUF	2011 MHUF
Total of future minimum lease payments:		
less than one year	225	1 436
one to five years	1 029	1 226
	1 254	2 662
Contingent rents recognised as income - gross	56	60

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

	2012 MHUF	2011 MHUF
Other equipment	1 724	2 439
Accumulated depreciation	1 070	750

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:

	2012 MHUF	2011 MHUF
Total of future minimum lease payments under non-cancellable operating leases:		
less than one year	809	811
one to five years	7 530	6 936
more than five years	4 101	5 060
	12 440	12 807

	2012 MHUF	2011 MHUF
Minimum lease payments recognized as expense	3 987	4 738

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 39 – 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 (2011: 100.00%). The ultimate parent of the Group is KBC Group N.V.

Subsidiaries:

See list of subsidiaries in Note 41.

Associates:

See list of associates in Note 41.

Members of KBC Group and other related parties:

CBC Banque SA
Československa Obchodni Banka a.s.
Dorset Street Finance Ltd
Garantiqa Hitelgarancia Zrt.
Gulliver Kft. (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 Lease Holding N.V. (no transactions in 2012)
KBC Securities N.V.
K&H Biztosító Zrt.
Kredyt Bank SA (sold in 2012)
KBL European Private Bankers SA (formerly Kredietbank SA Luxembourgeoise) (sold in 2012)
Pembridge Square Ltd (no transactions in 2012)
Regent Street Ltd (no transactions in 2012)
RTI Invest Kft. (merged into KBC Global Services N.V. in 2012)
Sydney Finance Street Ltd (no transactions in 2012)
VIV Docu Kft. (merged into RTI Invest Kft. in 2011)
VIV Server I. Kft. (merged into RTI Invest Kft. in 2011)

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 39 - RELATED PARTY TRANSACTIONS (continued)

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

	Parent	Associ-ates	Other related parties (KBC Group)	Other related parties (through key management)	Total
	MHUF	MHUF	MHUF	MHUF	MHUF
As at 31 December 2012					
Assets					
Loans and advances	5 330	-	710	9 090	15 674
Current accounts	5 330	-	242	329	5 901
Term loans	-	544	467	8 758	9 769
Finance leases	-	-	1	3	4
Other receivables	10	-	999	-	1 009
Total assets	5 340	544	1 709	9 090	16 683
Liabilities					
Deposits	160 155	90	15 892	8 764	184 901
Current accounts	139 550	90	2 093	436	142 169
Term deposits (with agreed maturity)	20 605	-	13 799	8 328	42 732
Subordinated liabilities	17 450	-	-	-	17 450
Other liabilities	364	26	2 236	-	2 626
Total liabilities	177 969	116	18 128	8 764	204 977
Income statement					
Net interest income	(1 480)	16	(955)	(125)	(2 544)
Interest income	289	21	130	416	856
Interest expense	(1 769)	(5)	(1 085)	(541)	(3 400)
Net fee and commission income	(819)	(336)	1 023	112	(20)
Fee and commission income	283	4	2 004	158	2 449
Fee and commission expense	(1 102)	(340)	(981)	(46)	(2 469)
Other net income	24	(19)	(7 118)	-	(7 113)
Other income	51	-	1 107	-	1 158
Other expense	(27)	(19)	(8 225)	-	(8 271)
Total income statement	(2 275)	(339)	(7 050)	(13)	(9 677)
Off-statement of financial position items					
Commitments and contingent liabilities	19 205	-	5 103	1 115	25 423
Guarantees received	35 269	-	162	-	35 431
Notional amount of derivatives	1 235 120	-	11 684	-	1 246 804

The table excludes the fair value of derivatives.

NOTE 39 - 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 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)	(3 869)	(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 39 - 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 2012 was HUF 235 million (HUF 276 million at 31 December 2011), 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 2012 the outstanding amount of deposits was HUF 778 million (HUF 1 549 million at 31 December 2011). In 2012 the Bank paid HUF 41 million interest on these deposits (HUF 43 million in 2011).

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

Type of benefit	**2012**	**2011**
	MHUF	**MHUF**
Short-term employee benefits	2 159	2 142
Other long-term benefits	75	145
Share based payment (cash settled)	134	108
Total benefits	2 368	2 395

The liability of HUF 242 million (108 million in 2011) resulting from the carrying amount of share based payment is recorded as other liability in the consolidated statement of financial position.

Share based payment

50% of the total variable remuneration of the key identified employees is awarded in the form of equity-related instruments called phantom shares, whose value is linked to the price of the KBC Group NV share. These shares must be retained for one year after being allocated. Phantom shares are allocated over a four-year period. The average price of the KBC share during the first three months of the year is used to calculate the number of phantom shares to which each key identified employee is entitled.

Phantom shares are converted into cash a year later on the basis of the average price of the KBC share during the first three months of that year. Specifically in 2013, key identified employees will receive 25% of their total annual variable remuneration for 2012 in the form of phantom shares, allocated on the basis of the average price of the KBC share during the first three months of 2013. These shares will be converted into cash in April 2014 using the average price of the KBC share for the first three months of 2014.

NOTE 39 - RELATED PARTY TRANSACTIONS (continued)

They are subject to the allocation and acquisition conditions, so called 'Clawback provisions' (evidence of misconduct or serious error; significant deterioration in the financial performance of the Group; major shortcomings in risk management; significant changes in the economic or regulatory capital base of the Group). Variable remuneration already acquired will exceptionally be clawed back when there is evidence of fraud or (use of) misleading information.

In 2012 14 193 pieces of phantom shares were granted for the year 2011. The phantom shares were granted at a price of 4 713 HUF/share, calculated as the average price of the KBC share during the first three months of 2012. The number of phantom shares outstanding as at 31 December 2012 was 14 193 pieces. The value of the phantom shares outstanding as at 31 December 2012 based on the year-end closing price of KBC shares was 7 644 HUF/share. There were no phantom shares converted into cash as at 31 December 2012.

The weighted average remaining contractual life of phantom shares outstanding as at 31 December 2012 is 16 months.

The Group applied the share based payment plan for the 2012 performance as well.

As at 31 December 2012 the information related to the number of phantom shares for the 2012 performance is not available, since the first grant date is in April 2013.

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

NOTE 40 – AUDITOR'S REMUNERATION

The remuneration recognised due to the audit of annual accounts performed by Ernst & Young Audit Kft. amounted to HUF 233 million in 2012 (HUF 272 million in 2011). In 2012 an additional remuneration of HUF 3 million was either accrued or paid to the auditor for other services, such as data custody and delivery of tax service in relation to K&H Equities Zrt. (HUF 5 million in 2011).

NOTE 41 – SUBSIDIARIES AND ASSOCIATES

	Principal activities	Effective Shareholding 2012	Effective Shareholding 2011
Fully consolidated subsidiaries		%	%
K&H Autópark Kft.	Operating lease	100	100
K&H Autófinanszírozó Zrt.	Finance lease	-	100
K&H Eszközfinanszírozó Zrt.	Finance lease	-	100
K&H Eszközlízing Kft.	Operating 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
Immaterial, non consolidated investment			
Risk Kft. "f.a."	Under liquidation	100	100

NOTE 41 – SUBSIDIARIES AND ASSOCIATES (continued)

K&H Autófinanszírozó Zrt. and K&H Eszközfinanszírozó Zrt. merged into the Bank as at 1 October 2012. The merger had no impact on the Consolidated Financial Statements.

NOTE 42 – SUBSEQUENT EVENTS

In March 2013 the Hungarian Parliament adopted the initiative aiming the amendment of the law regulating the debtor relief program. Due to the amendment the former deadline of 29 March 2013 for the qualifying customers to announce their intention to take part in the foreign exchange repayment scheme at preferential rates was extended to 31 May 2013 (for information on the debtor relief program see Note 26). Considering the adequate impairment coverage as at 31 December 2012 this modification has no material impact on the Consolidated Financial Statement.

For dividend proposed on ordinary shares see Note 45.

NOTE 43 – 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	26 441	180 031	2 470 087	2 263 615
Adjustments for IFRS accounts				
Capitalization of VAT, finance leases and revaluation of real estates	(87)	667	1 106	526
Portfolio-based allowance for loan losses	(442)	8 020	(2 330)	(9 908)
Specific allowance for loan losses	83	2 110	1 824	(369)
Adjustment on repos	(1 565)	4 789	1 523	(1 701)
Fair valuation of financial instruments (excluding AFS and cash flow hedge)	(5 206)	1 747	(5 527)	(2 068)
Fair valuation of AFS portfolio	(37)	(3 803)	(3 843)	(3)
Cash flow hedge	3 824	(3 824)	-	-
Amortisation of loan origination fees	(212)	1 375	1 136	(27)
Income tax	(1 676)	1 056	45	665
Bank standalone IFRS	21 123	192 168	2 464 021	2 250 730
Subsidiaries accounts prepared under Hungarian Accounting Standards	835	3 886	61 536	56 815
Adjustments for IFRS accounts				
Portfolio-based allowance for loan losses	(90)	(33)	(122)	1
Finance leases	(447)	658	223	12
Specific allowance for loan losses	108	72	180	-
Provisions for risk and charges	-	-	21 768	21 768
Deferred tax	587	(424)	193	30
Subsidiaries standalone IFRS	993	4 159	83 778	78 626
Adjustments for consolidation	(1 659)	(914)	(85 605)	(83 032)
Balance per IFRS report	20 457	195 413	2 462 194	2 246 324

[1] Excluding the current year profit

NOTE 44 – RISK MANAGEMENT

44.1 General

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

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

- Value, risk and capital management are inextricably linked to one another.
- Risk management is approached from a comprehensive, enterprise- wide angle, taking into account all the risks a company is exposed to and all the activities it engages in.
- Primary responsibility for value and risk management lies with line management, while 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 44 – RISK MANAGEMENT (continued)

Risk measurement and – monitoring

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

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

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

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

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

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

44.2 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 44 – 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 44 – 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 2012. For held-for-trading derivatives fair values are disclosed in the table.

	Held-for-trading derivatives	Held-for-trading short positions in debt instruments	Designated at fair value through profit or loss	Hedging derivatives	Measured at amortised cost	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
Financial liabilities						
On demand	-	-	408	-	797 556	797 964
Less than three months	2 306	6 241	25 505	788	653 991	688 831
More than three months but not more than one year	5 455	-	99 324	1 045	194 182	300 006
More than one but not more than five years	23 462	-	128 556	2 577	140 069	294 664
More than five years	8 418	-	4 347	-	43 735	56 500
Total	39 641	6 241	258 140	4 410	1 829 533	2 137 965

	Commitments to extend credit	Guarantees	Letters of credit	Total
	MHUF	MHUF	MHUF	MHUF
Commitments and contingent liabilities				
On demand	260 530	120 197	645	381 372
Less than three months	-	457	4 829	5 286
More than three months but not more than one year	-	17	-	17
More than one but not more than five years	-	-	-	-
More than five years	-	-	-	-
Total	260 530	120 671	5 474	386 675

NOTE 44 – 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 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 44 – 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 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 2012 and 2011, its operational liquidity situation being both sound and stable during 2012 despite the persistence of global economic crisis and FX mortgage prepayment.

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). LCR effective from 2015 with a 60% threshold and the minimum requirement would be gradually increased to 100% until 2019 according to latest BCBS guidelines. The Group's LCR ratio stood at 130% end of 2011 and at 155% end of 2012 respectively. NSFR effective from 2018 with 100% threshold. The Group stood at 96% end of 2011 and fulfils the limit with 103% already end of 2012.

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.

44.3 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 44 – RISK MANAGEMENT (continued)

Market risk – trading

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

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

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

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

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

VaR results can be presented as follows:

	Foreign exchange	**Interest rate**	**Total VAR**
	MHUF	**MHUF**	**MHUF**
2012 – 31 December	106	726	670
2012 – Average daily	125	769	782
2012 – Highest	737	1 252	1 267
2012 – Lowest	51	253	305
2011 – 31 December	64	326	320
2011 – Average daily	98	350	363
2011 – Highest	381	574	578
2011 – Lowest	2	160	152

NOTE 44 – RISK MANAGEMENT (continued)

The Group's hVaR exposure increased in 2012 compared to the year 2011, but the average limit utilization was well below the hVaR limit of the Group. Part of this increment is explained by change in methodology.

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

Market risk – Non-trading

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

Majority of the Group's ALM risks are interest rate related risks; consequently the tolerance level is limited in BPV terms. The interest rate risk is also measured with scenario analyses (including stressed environment). The Group also applies parametric VaR methodology for measuring interest rate risk. Foreign currency, equity or real-estate risk is not inherent in the banking book.

The BPV tables below present the results of reasonable possible changes of the fair value of the financial instruments held at fair value on 31 December 2012 and 2011. 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 2012. 2012 results contain the impact of derivative exposures too.

NOTE 44 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2012	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel up	CHF	40	22	62
	EUR	(29)	(239)	(268)
	HUF	(49)	68	18
	USD	-	11	11
10 bp parallel up total		(38)	(138)	(176)
100 bp parallel up	CHF	400	218	617
	EUR	(289)	(2 298)	(2 587)
	HUF	(489)	668	179
	USD	-	113	113
100 bp parallel up total		(378)	(1 299)	(1 678)
200 bp parallel up	CHF	795	437	1 232
	EUR	(575)	(4 412)	(4 987)
	HUF	(968)	1 313	346
	USD	-	223	223
200 bp parallel up total		(748)	(2 439)	(3 187)

DOWN Scenarios, 31 December 2012	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel down	CHF	(40)	(22)	(62)
	EUR	29	241	270
	HUF	49	(68)	(19)
	USD	-	(12)	(12)
10 bp parallel down Total		38	139	178
100 bp parallel down	CHF	(404)	(216)	(620)
	EUR	292	2 500	2 792
	HUF	500	(692)	(192)
	USD	-	(117)	(117)
100 bp parallel down total		388	1 475	1 863
200 bp parallel down	CHF	(813)	(431)	(1 244)
	EUR	588	5 221	5 808
	HUF	1 011	(1 408)	(397)
	USD	-	(238)	(238)
200 bp parallel down total		786	3 143	3 929

NOTE 44 – RISK MANAGEMENT (continued)

UP Scenarios, 31 December 2011	denomination	Sensitivity of equity MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel up	CHF	-	-	-
	EUR	-	-	-
	HUF	(373)	(13)	(386)
	USD	-	-	-
10 bp parallel up total		(373)	(13)	(386)
100 bp parallel up	CHF	-	-	-
	EUR	-	-	-
	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	-	-	-
	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 MHUF	Sensitivity of profit or loss MHUF	Total sensitivity MHUF
10 bp parallel down	CHF	-	-	-
	EUR	-	-	-
	HUF	373	13	386
	USD	-	-	-
10 bp parallel down Total		373	13	387
100 bp parallel down	CHF	-	-	-
	EUR	-	-	-
	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	-	-	-
	HUF	7 471	264	7 735
	USD	-	2	2
200 bp parallel down total		7 471	265	7 736

NOTE 44 – RISK MANAGEMENT (continued)

Currency risk

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

Fair valuation

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

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

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

44.4 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 44 – 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.

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

Credit risk management at transactional level

Acceptance

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

Supervision and monitoring

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

NOTE 44 – 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 renegotiation of the credit obligation where this is likely to result in a diminished financial obligation caused by material forgiveness or postponement of principal, interest or –where relevant – fees.
- 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 the Group 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 ‘risk weighted asset’, ‘expected loss’ and ‘loss given default’) are increasingly being used.

NOTE 44 – 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:

	2012	After reclassification 2011
	MHUF	MHUF
Industry sector		
Service industry (after reclassification)	208 754	294 031
Agriculture (after reclassification)	62 188	65 855
Manufacturing and building (after reclassification)	147 932	177 594
Food processing (after reclassification)	50 174	50 355
Wholesale and retail (after reclassification)	108 172	116 297
Power industry (after reclassification)	31 111	35 765
Individuals (after reclassification)	624 408	740 583
Central governments (after reclassification)	34 334	41 542
Municipalities (after reclassification)	32 781	47 812
Credit institutions	71 345	74 855
Other (after reclassification)	572	556
Gross loans and advances	1 371 771	1 645 245
Portfolio-based impairment for loan losses	(13 045)	(38 435)
Specific impairment for loan losses	(98 377)	(103 376)
Total impairment on loans and advances (see Note 26)	(111 422)	(141 811)
Total loans and advances	1 260 349	1 503 434

NOTE 44 – 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 895 million as at 31 December 2012 (HUF 462 million in 2011).

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 2012 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	144 920	3 022	291 137	10 486	507 751	957 316
Standard grade	10 420	-	1 877	665 569	-	677 866
Sub-standard grade	9 294	-	-	399 755	-	404 049
Total carrying value	159 634	3 022	293 014	1 075 810	507 751	2 039 231

NOTE 44 – RISK MANAGEMENT (continued)

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

	Held for trading (after reclassification)	Designated at fair value through profit or loss	Available for sale	Loans and receivables (after reclassification)	Held to maturity	Total
	MHUF	MHUF	MHUF	MHUF	MHUF	MHUF
High grade (after reclassification)	179 611	3 297	388 195	8 177	421 452	1 000 732
Standard grade (after reclassification)	23 753	-	952	869 208	-	893 913
Sub-standard grade (after reclassification)	9 454	-	-	408 348	-	417 802
Total carrying value	212 819	3 297	389 147	1 285 733	421 452	2 312 448

Due to changes in the Group's internal rating practice the comparative information for Held for trading and Loans and receivables were reclassified.

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* 2012	Average unsecured share of exposure 2012	Total 2012	Historical default rates* 2011	Average unsecured share of exposure 2011	Total 2011
	%	%	MHUF	%	%	MHUF
High grade	-	57.07	223 658	-	56.97	194 883
Standard grade	0.38	62.68	597 370	2.2	63.92	775 691
Sub-standard grade	6.85	32.13	741 649	8.25	32.75	822 239
Impaired	100.00	43.38	181 567	100.00	42.58	198 183
Total			1 744 245			1 990 996

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

NOTE 44 – RISK MANAGEMENT (continued)

Impairment assessment

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

- individually assessed impairments
- collectively assessed impairments

Collectively assessed impairments

Portfolio-based impairment

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

Statistical impairment

Impairments are assessed on a portfolio basis applying statistical methods for losses on loans and advances if there is an objective evidence that an impairment loss has incurred (PD10-12), 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).

The terminology 'specific impairment' comprises statistical impairments and individually assessed impairments in this Consolidated financial statements.

NOTE 44 – 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 Group is planning to adopt the IRB Advanced approach for the leasing activity (excluding car finance) in 2014 directly from being under Standardised approach (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.

44.5 Credit risk – renegotiated loans

Renegotiation refers to a process which aims finding a proper solution between the Group and the customer to fulfil the responsibilities from a contract regardless to the contract status as current or delinquent by significantly changing the original terms and conditions, including payment amounts, amortization schedule, or its final maturity. Loans can be renegotiated only when the customer is facing long-term difficulty in repaying the original payment amount but is able to pay less. The borrower must show a renewed willingness and ability to repay the loan. For the decision the Group investigates the creditworthiness of the client; in details depending on the customer and product type the income/cash flow, employment, contracts, etc. For unsecured loans an attempt is made to get collateral or a guarantor as well.

The Group implemented three major types of renegotiating activity: temporary payment relief, temporary payment relief with term extension, term extension.

NOTE 44 – RISK MANAGEMENT (continued)

1. Temporary payment relief: due to the renegotiated contract the customer has reduced installment for a temporary period (depending on the product type and decision it is up to 36 months), and the not paid part of the outstanding spread over the remaining tenor.

2. Temporary payment relief with term extension: this type is the same as the temporary payment relief, but the term is extended at the same time to reduce the monthly installment.

3. Term extension: installment reduction by term extension.

In the renegotiation process for non-retail customers the Group decides on a new PD for the client which is the PD 9 generally while in exceptional cases based on decision the PD can be worse when it seems that probably the client will not be able to meet the reduced obligation either. In retail processes the assigned PD is the PD 9 category.

After the end of the eased period the clients are kept still in the PD 9 category and just after 12 month performing period is the PD revised. For non-retail clients the PD is reassessed during the annual review.

One of the input parameters of the impairment calculation is the PD. According to the PD rating in case of non-default loans portfolio based impairment, in case of default loans specific impairment is recognised.

Loans are held in the renegotiated portfolio at least 1 year long following the renegotiation. They are no longer considered as renegotiated when the debtor is not past due more than 15 days within a period of 365 days after the renegotiation in case of non-retail loans and when the debtor is not past due more than 30 days within a period of 365 days after the end of the easement period in case of retail loans.

The following table presents renegotiated loans, loan commitments and guarantees in comparison to loans, loan commitments and guarantees which had not been renegotiated.

	2012		**2011**	
	Renegotiated	**Not renegotiated**	**Renegotiated**	**Not renegotiated**
	MHUF	**MHUF**	**MHUF**	**MHUF**
Gross loans	209 749	1 162 022	243 044	1 402 202
Specific impairment	(40 639)	(57 738)	(39 998)	(63 378)
Portfolio based impairment	(6 214)	(6 831)	(7 072)	(31 363)
Total loans and advances	162 896	1 097 453	195 974	1 307 461

NOTE 44 – RISK MANAGEMENT (continued)

For comparative information to the total loan portfolio see Note 26.

	2012		2011	
	Renegotiated MHUF	Not renegotiated MHUF	Renegotiated MHUF	Not renegotiated MHUF
Commitments and guarantees	16 355	370 320	15 433	409 186
Specific impairment	(32)	(93)	(33)	(314)
Portfolio based impairment	(993)	(1 136)	(1 292)	(123)
Total Commitments and guarantees	15 330	369 091	14 108	408 749

The table includes the amount of renegotiated commitments and guarantees given to corporate clients. The amount of renegotiated commitments and guarantees for which specific impairment was recognised amounted to HUF 3 457 million as at 31 December 2012 (HUF 5 407 million as at 31 December 2011).

The following table explains the change of renegotiated loans, loan commitments and guarantees during 2012 and 2011.

	2012 MHUF	2011 MHUF
Balance as at the beginning of the period	210 082	181 994
Addition	32 989	73 772
Decrease	(54 128)	(60 504)
Discount effect	(549)	(904)
Impairment recognised for the period	(1 524)	(9 519)
Foreign exchange revaluation	(8 644)	25 243
Balance as at the end of the period	178 226	210 082

The Group recorded HUF 11 172 million interest income on renegotiated loans in the consolidated income statement in 2012 (HUF 11 247 million in 2011).

The Group did not derecognise assets due to renegotiation in 2012 and 2011.

NOTE 44 – RISK MANAGEMENT (continued)

The following table includes the credit quality analysis of renegotiated loans as at 31 December 2012.

	Impaired	Past due but not impaired	Not impaired nor past due	Total
	MHUF	MHUF	MHUF	MHUF
Gross loans	87 114	71 253	51 382	209 749
Specific impairment	(40 639)	-	-	(40 639)
Portfolio based impairment	-	(6 107)	(107)	(6 214)
Total renegotiated loans and advances	46 475	65 146	51 275	162 896

The table below presents the credit quality analysis of renegotiated loans as at 31 December 2011.

	Impaired	Past due but not impaired	Not impaired nor past due	Total
	MHUF	MHUF	MHUF	MHUF
Gross loans	106 428	75 282	61 334	243 044
Specific impairment	(39 998)	-	-	(39 998)
Portfolio based impairment	-	(6 631)	(441)	(7 072)
Total renegotiated loans and advances	66 430	68 651	60 893	195 974

For comparative information to the total loan portfolio see Note 23.

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

	2012	2011
	MHUF	MHUF
Retail	83 302	92 807
Corporate	74 249	96 914
Leasing	5 345	6 253
Total renegotiated loans and advances	162 896	195 974

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

NOTE 44 – RISK MANAGEMENT (continued)

	2012 MHUF	2011 MHUF
Industry sector		
Service industry	38 186	41 605
Agriculture	5 966	5 366
Manufacturing and building	15 311	17 715
Food processing	6 889	7 125
Wholesale and retail	12 764	18 245
Power industry	12 142	12 093
Individuals	114 033	122 108
Municipalities	4 453	12 653
Credit institutions	-	6 128
Other	4	6
Gross renegotiated loans and advances	209 749	243 044
Portfolio-based impairment for loan losses	(6 214)	(7 072)
Specific impairment for loan losses	(40 639)	(39 998)
Total impairment on renegotiated loans and advances	(46 853)	(47 070)
Total renegotiated loans and advances	162 896	195 974

For comparative information to the total loan portfolio see Note 44 – Credit risk.

The table below includes the geographical breakdown of renegotiated loans.

	2012 MHUF	2011 MHUF
Hungary	197 783	230 269
East-European countries	11 951	12 759
Non-European countries	15	16
Total renegotiated loans and advances	209 749	243 044

For comparative information to the total loan portfolio see Note 22.

NOTE 44 – RISK MANAGEMENT (continued)

44.6 Operational risk

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

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

The first element of the toolkit is the use of *Group-wide 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 45 – 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 43. 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).

NOTE 45 – SOLVENCY AND CAPITAL (continued)

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.

The table below presents what the Group manages as capital.

	2012	2011
	MHUF	MHUF
Tier 1 capital elements	179 119	181 043
Deductions	(6 271)	(2 719)
Tier 1 total	172 848	178 324
Tier 2 capital elements	15 868	21 496
Deductions	(556)	(324)
Tier 2 total	15 312	21 172
Guarantee capital	188 160	199 496

According to Hungarian capital adequacy regulations, the Bank's capital adequacy ratio (tier 1 + tier 2; the latter includes subordinated debts) at 31 December 2012 was 12.91% (11.36% at 31 December 2011). The Bank fulfilled the capital requirements set by HFSA continuously during years 2012 and 2011 and at 31 December 2012 (and at 31 December 2011).

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 2012 was HUF 18 517 million (HUF 15 873 million as at 31 December 2011).

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 23 797 million as at 31 December 2012 (HUF 3 995 million as at 31 December 2011).

The dividend proposed on ordinary shares for approval by the shareholder (not recognized as a liability as at 31 December 2012) is HUF 23 797 million – 0.168799 HUF/share (HUF 3 995 million – 0.028338 HUF/share in 2011).

Approved by the Board of Directors on 8 April 2013.

Hendrik Scheerlinck
Chief Executive Officer
Member of the Board

Attila Gombás
Chief Financial Officer

K&H Bank Zrt.

Management Report (consolidated)

December 31, 2012

On December 31, 2012, the Group's consolidated balance sheet total stood at 2 462 billion HUF. As a financial institution which offers banking and insurance products alike and has a nation-wide branch network of 226 branches, K&H offers the full range of financial services to its clients.

1. Economic environment

The outlook for global economy further deteriorated throughout the year, although the efforts related to the European debt crisis management and the quantitative easing by the US Fed both contributed to the market's stabilisation in the 2nd half of the year.
The Hungarian economy contracted by 1.7% in 2012. As a result of the worsening external environment, the contribution of the export sector to the economic growth is more limited than in the previous periods. Domestic demand continued to be subdued as well.
Both the internal and external balances of Hungarian economy improved further in 2012, sustainability remains a question though.

	2011 actual	2012 preliminary
GDP growth	+1.7%	-1.7%
CPI (avg)	3.9%	5.7%
Investments	-4.5%	-5.2%
Unemployment rate	10.7%	10.7%
Budget deficit (ESA)	+4.2%	-2.7%
Balance of payments (in a % of GDP)	+0.9%	+2.0%

Source: MNB, KSH, K&H

Positive market sentiment resulted in a significant decrease in Hungarian risk premia over the year.
In the first half of 2012, the national bank's base rate remained unchanged, then the Monetary Council reduced the base rate by 25 bp at five consecutive rate setting meetings and as a result the base rate decreased from 7.0% at the beginning of the year to 5.75% by the year end.

2. The Strategic Objectives of K&H Group

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

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

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

Product strategy:

Retail:

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

SME:

- Reliable transactional banking services.
- More standard products fitting client needs with easy and quicker processes.
- Re-design of credit process.

Corporate:

- Full service provider, emphasis is advisory to provide tailored solutions to clients.

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

Key differentiators of the Bank Group:

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

3. The Group's consolidated activities

The Bank Group's total assets decreased by 14.2% in 2012. As a consequence of the merger by acquisition of Eszközfinanszírozó Zrt. and Autófinanszírozó Zrt. into K&H Bank on 30 September 2012, the share of subsidiaries within the group's total assets decreased to 3.4% from 3.9% in 2011.

Billion HUF	31 Dec 2011	31 Dec 2012	variance
Balance sheet total	2 870.7	2 462.2	-14.2%
Loans and receivables	1 565.9	1 315.9	-16.0%
Deposits from customers	1 756.4	1 728.7	-1.6%
Equity	194.7	215.9	+10.9%

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

- *Loans and receivables* decreased by 16% in 2012 primarily due to the repayment scheme for retail FX mortgage loans and subdued loan demand in retail and corporate business. The FX mortgage repayment scheme reduced the loan volume by HUF 188 billion (whereof 85 bln was realised in 2012).
- *Deposits from customers* lag behind by 1,6% from the closing balance of previous year. Despite the intensive competition for savings K&H Bank kept its market position stable in both retail and corporate segments.
- *Shareholders' equity* increased by 21.2 bln throughout the year as a net balance of the following factors: dividend payment after financial year 2011 (-4.0 bln); profit of year 2012 (+20.5 bln); cash flow hedge reserves (-3.0 bln) and AFS revaluation reserves (+7.8 bln).

The bank´s group profit show considerable improvement compared to previous year (2012: +20.5 bln, 2011: +0.6 bln), as the result of 2011 was heavily impacted by the final repayments of retail foreign currency mortgage loans (HUF 48.9 billion loss before taxation was accounted for among credit impairments in 2011 /and HUF 15.3 billion was deducted from the bank tax payable related to it/).

The evolution of the main P&L items:

- In comparison with previous year, *net interest and interest-type income* decreased by 28% (2012: 74.0 bln, 2011: 102.6 bln) primarily due to the lower income due to the FX mortgage repayment and structural change in EUR funding from KBC[1].
- *Net fee and commission income* (amounting to 28.7 bln) decreased by 2% year-on-year (decreasing income from mutual fund related investment services and loan related fees).
- The increase in *net gains from financial instruments at fair value* (2012: 22.9 bln, 2011: 18.8 bln) is primarily related to the above mentioned structural change in EUR funding from KBC (partly compensating the related decrease in interest income), while 2011 was boosted by ALM activity related income (mark-to-market of ALM derivatives).
- *Operating costs* amounted to 85.9 bln in 2012, whereof 15.0 bln is banktax (0.9 bln was recuperated from banktax related to the government initiated scheme to convert non-performing retail FX loans to HUF). Disregarding banktax costs increased by 4.1 bln compared to previous year (2012: 70.9 bln, 2011: 66.8 bln).

Non-performing loans	31 Dec 2011	30 June 2011	31 Dec 2012
Retail	13.4%	19.4%	16.9%
Corporate	8.0%	8.4%	8.0%
Leasing	9.2%	13.3%	11.6%
Total	**10.3%**	**13.3%**	**12.0%**

Impairments amounted to 12.9 bln HUF in 2012 (the 79.1 bln impairment figure in 2011 included 48.9 bln impact of final repayment of retail foreign currency mortgage loans): sustained good portfolio quality and low credit costs in corporate and SME segments, while the positive impact of the government's and the Bank's own payment easement programs on the evolution of portfolio quality in Retail business was perceptible.

[1] In the new financing structure KBC ensures the majority of EUR financing need of K&H Bank via HUF/EUR swap instead of the previous on-balance sheet sources starting from August 2011. The structural changes in the balance sheet (lower interbank financing was accompanied by a similar decrease in the HUF 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 HUF 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").

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

million HUF	**2011**	**2012**	**variance**
Cost / income	44.5%	68.1%	+23.6%
Cost / income *	44.2%	56.3%	+12.1%
Non-interest income/ total income	32.2%	41.3%	+9.1%
Commission income / total income	19.4%	22.8%	+3.3%
Operating income / average headcount	43.2	36.2	-16.3%
Operating costs* / average headcount	19.1	20.3	+6.6%
Operating profit* / average headcount	24.1	15.8	-34.4%
Credit cost ratio	1.75%	0.78%	-0.97%
Non-performing loans	10.3%	12.0%	+1.7%
Loan / deposit ratio	82.0%	70.0%	-12.0%
Capital**/total liabilities	7.6%	9.7%	+2.1%
Solvency ratio (Basel II)***	11.36%	12.91%	+1.6%
ROE (based on average balance of equity)	0.3%	10.1%	+9.8%
ROA (based on average balance sheet total)	0.0%	0.8%	+0.8%

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

Next to the relatively good profitability K&H Bank preserved its favourable liquidity and solvency position in 2012.

4. Introduction of strategically important subsidiaries

Leasing Group

In the course of 2012 two members of K&H Leasing Group merged with K&H Bank.

Name	Main profile	Comment
K&H Autófinanszírozó Zrt.	Financial leasing	on 30th of September 2012 it has merged with K&H Bank Zrt
K&H Autópark Kft.	Operative leasing, fleet management (lease)	
K&H Eszközfinanszírozó Zrt.	Financial leasing	on 30th of September 2012 it has merged with K&H Bank Zrt
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 30th of November 2011 it has merged with K&H Bank Zrt

At the end of 2012, **K&H Group's leasing** portfolio stood at 69 billion HUF, which represents a 25% decrease compared to the end of the previous year. 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 22 billion in 2012, 35% decrease vs 2011). The Group obtained a 3.6% share on the market in new production, and has a 8% market share in the fleet financing market and 4.1% in the Truck, Machinery and Equipment (TME) market.
Since 2009 K&H Group has been serving clients with lease product via its corporate and SME sales network. Since 2010 it also offers car leasing product to retail clients via the branch network of K&H Bank Zrt. In 2011, the Group launched a corporate real estate financing product on the market. In 2012, the sales strategy focused on the strengthening of sales via K&H Bank Zrt's sales network.

K&H Investment Fund Zrt.

In 2012 the assets managed in investment funds increased by 3,5%, the growth of the total AuM was 4,1%. In the beginning of the year the FX mortgage loan repayment scheme had negative effect on the investment fund market generating considerable outflow from K&H funds as well. Strong competition by Hungarian government bond sales to households and declining interest rate environment was also challenge for our fund issues and offer.
27 funds were launched in 2012: 14 retail closed-end CPF (Capital Protected Funds), 7 open-end CPF, 1 CPPI, 2 closed-end bond fund for our private bank clients. „The product of the year" was the new CPPI fund, which has new investment strategy and operation flow. We also launched two exclusive new funds for private banking clients investing in EUR denominated Hungarian government bonds.
Concerning institutional portfolio management, substantial decline was suffered in Q1 due to 9 terminated pension fund mandates. However, thanks to the acquisition efforts, the Company won 4 new non-group mandates in 2012.
At the end of 2012 the assets managed by K&H was 770 bln, of which assets managed in investment funds was 640 bln resulting in the second biggest market share of 19.5% for us

in the Hungarian investment funds market. We could keep our market leader position in CPF segment (50%).
The Company achieved a profit after tax of 1,6 bln in 2012.

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

In 2005, K&H Group has 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, logistics and bank security tasks, operative business responsibilities (the booking of trade receivables and payables, fixed assets etc.; tax accounting and payroll management). The company manages the 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 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 K&H Factoring, a company 100% owned by K&H.
A new Directorate was established on 1 January 2012 for SZÉP Card operation. The SZÉP card is a new cafeteria item and product at K&H group. KHCSK is responsible for the entire operation of the new SZÉP card system and the related transactions.

K&H Factoring Zrt.

The K&H Factoring Zrt's main activity is factoring (purchase of receivables, financing, discounting). The company's business activities have started in 2010, (factoring) turnover has been steadily increasing since then (2010: 5.9 billion, 2011: 22.3 billion, 2012: 54.5 billion). The amount of trade receivables towards debtors was 8.8 billion at year-end 2012.

Dated: Budapest, 29th April 2013

Hendrik Scheerlinck	Attila Gombás
Chief Executive Officer	Chief Financial Officer