Kereskedelmi és Hitelbank Zrt.

Basel III. - Disclosure according to Pillar 3.

Risk Report

For the 2016 Financial Year

K&H Bank Zrt and K&H Mortgage Bank Zrt

31.12. 2016

[This page was deliberately left blank.]

Table of Contents

Chapter I. - Background Information

Disclosure requirements at K&H (CRR Articles 431.-434.)

K&H committed itself to conform to the requirements of Pillar 3 defined in Chapter 8 of 575/2013/EU Regulation of the European Parliament and of the Council (CRR) and in Article 122 of the Hpt.[1]. K&H prepares this "*Risk Report*" for such purposes, containing the information required by law. In line with its general communications policy, K&H is trying to communicate its market risk exposures as openly as possible. Consequently, it discloses information on risk management taking place at K&H in a separate chapter of the "*Annual Report*" and also in more detail in this document in order to satisfy the requirements of the market as much as possible.

K&H publishes its "*Risk Report*" once a year, simultaneously with the disclosure of the "*Annual Report*" and makes it also accessible in Hungary (and in English) on the K&H corporate website (www.kh.hu). Similarly to the "*Annual Report*", the "*Risk Report*" is prepared for the last day of the financial year i.e., for the cut-off date. Simultaneously with the display of the report on the K&H corporate portal, the Bank also submits the "*Risk Report*" to the CBH which can also publish it in its own website. Pursuant to Article 431 of the CRR and Article 263 of the Hpt, the external auditor also checks the content and accuracy in value of the information and data required under the disclosure rules under Pillar 3.

This "*Risk Report*" was prepared for the cut-off date of 31 December 2016 and contains:
- Individual, financial and statutory reporting data of K&H Bank, audited according to HAS, and
- Consolidated, audited financial and preliminary statutory reporting data of the K&H Group, according to IFRS.

K&H Group Structure (CRR Article 436.)

The K&H group may be divided into the following three main parts:
- Bank
- Mortgage Bank
- Leasing Group
- other subsidiaries

In total, the following companies were fully consolidated at the end of the year:

Company name	Company type	Consolidation method	Ownership ratio % (direct)	Company balance sheet Total (HUF million)	Company Equity (HUF million)	Post-tax Profit (HUF million)	Net Profit/Loss (HUF Million)
K&H Jelzálogbank Zrt.	Credit Institution	full consolidation	100.00	3 494	3 473	-27	-27
K&H Ingatlanlízing zRt.	Financial	full consolidation	100.00	24 406	173	80	80
K&H Autópark Kft.	Operational leasing	full consolidation	100.00	3 024	366	87	87
K&H Eszközlízing Kft.	Operational leasing	full consolidation	100.00	24	21	-4	-4
K&H Faktor Pénzügyi Szolgáltató Zrt.	Financial	full consolidation	100.00	14 821	692	165	165
K&H Csoportszolgáltató Kft.	Auxiliary	full consolidation	100.00	5 013	548	33	33
K&H Befektetési Alapkezelő Zrt	Investment Fund management	full consolidation	100.00	3 660	3 068	2 068	2 068
K&H Equities ZRt.	Other	full consolidation	100.00	4 924	4 748	-89	-89

1.* Table*: Companies fully consolidated in the K&H Group

Within the K&H Group there are no actual or predictable major practical or legal obstacles preventing any immediate transfer of own funds, or repayment of obligations between the parent company and subsidiaries.

[1] Act CCXXXVII of 2013 on "credit institutions and financial enterprises" (Hpt.)

Chapter II. – Capital Adequacy

Capital Policy

The capital strategy supplementing the risk policies of the KBC Group referred to above contains the following:

- Creation of durable values for the shareholders, which means the most efficient utilisation of the capital of the KBC Group with maximum return available under the assumed risks and without any excessive unused capital.
- Compliance with the restrictions on the capital funds of the KBC Group, defined by the regulatory authorities and rating agencies.
- Maintaining capital adequacy by also taking into account the business development outlook of the KBC Group beyond one year as an organic part of the strategic, business and capital planning process.
- Maintaining capitalisation at the KBC Group in order to cover all material risks up to a set high funding level.

Capital structure and capital adequacy (CRR Articles 437. and 451.)

The supervisory available own funds (also referred to as supervisory equity) consists of Tier 1 and Tier 2) capital. Tier 1 capital consists primarily of share capital and other capital market securities eligible according to the current legislation, less the required negative components. The Tier 2 capital consists primarily of hybrid and debt securities eligible under the current laws and regulations, less the required negative components. The total own funds equal the total of Tier 1 and Tier 2 capital less deductions.

Accounting category	equity	subordinated loan capital #1	subordinated loan capital #2
Applicable regulation	CRR Article 28.	CRR Article 62.	CRR Article 62.
Transition rules of the regulation on capital requirements (CRR)	core Tier 1 capital instrument	Tier 2 capital instrument	Tier 2 capital instrument
Rules of the CRR after the transition period	core Tier 1 capital instrument	Tier 2 capital instrument	Tier 2 capital instrument
Eligible based on individual and/or sub-consolidated basis	Individual and (sub)consolidated	Individual and (sub)consolidated	Individual and (sub)consolidated
Nominal value of the instrument	HUF 140,978 million	EUR 60 million	EUR 30 million
Currency of issue	HUF	EUR	EUR
Issue price	-	100%	100%
Redemption price	-	100%	100%
Original date of issue	-	2006.06.30	2015.09.28
Maturity	until further notice	2026.06.30	2025.09.28
The (call) option of the issuer requires prior supervisory approval	-	No	No
Optional purchase date, pending purchase date and redemption amount	-	Pursuant to CRR Article 63	Pursuant to CRR Article 63
Interest payment date, conditions	N/A	EURIBOR+2.70%	EURIBOR+3.05%
fixed or variable dividend / interest coupon	-	variable	variable
Advancing or redemption incentive	-	No	No
Not accumulating, accumulating	-	Not accumulating	Not accumulating
Convertible, non-convertible	-	Nonconvertible	Nonconvertible
Description	-	No	No
Position in the liquidation hierarchy	in the case of insolvency or liquidation of the institution, the instruments are classified behind all other receivables	Pursuant to CRR Article 63	Pursuant to CRR Article 63

2.* Table*: Main components of the capital instruments (K&H Group)

Accounting Category	Equity
Applicable regulation	CRR Article 28
Transition rules of the regulation on capital requirements (CRR)	Core Tier 1 capital instrument
Rules of the CRR after the transition period	Core Tier 1 capital instrument
Eligible based on individual and/or sub-consolidated basis	Individual and (sub)consolidated
Nominal value of the instrument	HUF 3,5 million
Currency of issue	HUF
Issue price	-
Redemption price	-
Original date of issue	-
Maturity	until further notice
The call option of the issuer requires prior supervisory approval	-
Optional purchase date, pending purchase date and redemption amount	-
Interest payment date, conditions	N/A
Fixed or variable dividend/interest coupon	-
Advancing or redemption incentive	-
Not accumulating, accumulating	-
Convertible, non-convertible	-
Description	-
Position in the liquidation hierarchy	in the case of insolvency or liquadation of the institution, the instruments are classified behind all other receivables

3. Table Main components of the capital instruments (K&H Mortgage Bank Zrt)

According to the Hungarian laws and regulations the K&H Group must have minimum own funds that exceed 8% of the risk weighted assets but, during the SREP review, the Supervisory Authority may set an additional capital requirement on a pro rata basis according to the capital requirement under Pillar 1. The Bank also takes into account this requirement while planning and preparing its detailed budget and sets aside further reserves in order to have enough own funds in case the HUF weakens or other unexpected market events occur. The Bank reports its capital adequacy position to the Supervisory Authority monthly and also prepares monthly projections for the Bank's Capital and Risk Oversight Committee, CROC). When necessary, the Bank's Executive Committee EXCO) makes decisions on the required actions (e.g., capital increase, dividend payment, etc.).

The table below provide information about the risk weight assets of the bank and the exact value of the capital adequacy ratio at the end of 2016.

Risk Weight Asset (RWA) -2015	KBC Group	K&H Bank
Total RWA	1537	1592
Credit Risk (CVA included)	1273	1305
Market Risk	23	23
Operational Risk	241	264
Capital Adequecy Ratio	13,89%	13,00%

4. Table: Risk weight assets and CAD ratio of the previous financial year (values in HUF million)

Risk Weight Asset (RWA)	KBC Group	K&H Bank
Total RWA	1465	1532
Credit Risk (CVA included)	1193	1240
Market Risk	20	20
Operational Risk	251	272
Capital Adequecy Ratio	15,32%	14,09%

5. Table: Risk weight assets and CAD ratio (values in HUF million)

The tables below provide an overview of the leverage ratio, capital adequacy of the Group and the Bank and the detailed composition of the Tier 1 and Tier 2 capital components.

Components of own funds (HUF million)	K&H Group (IFRS)	K&H Bank (HAS)
OWN FUNDS	**224 351**	**215 981**
_TIER 1 CAPITAL(TIER 1 OR T1 CAPITAL)	**196 360**	**187 989**
__COMMON EQUITY TIER 1 CAPITAL (CET 1 CAPITAL)	**196 360**	**187 989**
___ Capital instruments eligible as CET1 capital	**189 753**	**155 371**
___ Paid up capital instruments	**140 978**	**140 978**
____ Memorandum item: Capital instruments not eligible	**-**	**-**
____ Share premium	**48 775**	**14 393**
____ (-) Own CET1 instruments	**-**	**-**
_____ (-) Direct holdings of CET1 instruments	**-**	**-**
_____ (-) Indirect holdings of CET1 instruments	**-**	**-**
____ (-) Synthetic holdings of CET1 instruments	**-**	**-**
___ (-) Actual or contingent obligations to purchase own CET1 instruments	**-**	**-**
___Retained earnings	**6 405**	**39 388**
____Previous years retained earnings	**6 405**	**39 388**
____Profit or loss eligible	**-**	**-**
_____Profit/loss attributable to owners of the parent	**37 897**	**47 134**
____(-) Part of interim or year-end profit not eligible	**- 37 897**	**- 47 134**
___ Accumulated other comprehensive income	**17 640**	**-**
___Other reserves	**-**	**8 786**
___Funds for general banking risk	**8 750**	**8 750**
___Transitional adjustments due to grandfathered CET1 Capital instruments	**-**	**-**
___Minority interest given recognition in CET1 capital	**-**	**-**

___Transitional adjustments due to additional minority interests	-	-
___Adjustments to CET1 due to prudential filters	- 6 390	- 271
(-) Increases in equity resulting from securitised assets	-	-
___ Cash flow hedge reserve	- 6 094	-
____Cumulative gains and losses due to changes in own credit risk on fair valued liabilities	- 25	-
___ Fair value gains and losses arising from the institution's own credit risk related to derivative liabilities	- 6	- 6
____(-) Value adjustments due to the requirements for prudent valuation	- 264	- 264
___(-) Goodwill	-	-
____(-) Goodwill accounted for as intangible asset	-	-
____(-) Goodwill included in the valuation of significant investments	-	-
____Deferred tax liabilities associated to goodwill	-	-
___ (-) Other intangible assets	- 12 060	- 15 753
____(-) Other intangible assets gross amount	- 12 060	- 15 753
____Deferred tax liabilities associated to other intangible assets	-	-
___(-) Deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	- 7	-
___(-) IRB shortfall of credit risk adjustments to expected losses	- 7 731	- 8 282
___(-) Defined benefit pension fund assets	-	-
____(-) Defined benefit pension fund assets gross amount	-	-
____Deferred tax liabilities associated to defined benefit pension fund assets	-	-
____ Defined benefit pension fund assets which the institution has an unrestricted ability to use	-	-
___(-) Reciprocal cross holdings in CET1 Capital	-	-
___(-) Excess of deduction from AT1 items over AT1 Capital	-	-
___(-) Qualifying holdings outside the financial sector which can alternatively be subject to a 1,250 % risk weight	-	-
___(-) Securitisation positions which can alternatively be subject to a 1250 % risk weight	-	-
____(-) Free deliveries which can alternatively be subject to a 1,250 % risk weight	-	-
___(-) Positions in a basket for which an institution cannot determine the risk weight under the IRB approach, and can alternatively be subject to a 1,250 % risk weight	-	-
___(-) Equity exposures under an internal models approach which can alternatively be subject to a 1,250 % risk weight	-	-
___(-) CET1 instruments of financial sector entities where the institution does not have a significant investment	-	-
___(-) Deductible deferred tax assets that rely on future profitability and arise from temporary differences	-	-
___(-) CET1 instruments of financial sector entities where the institution has a significant investment	-	-
___(-) Amount exceeding the 17,65 % threshold	-	-
___Other transitional adjustments to CET1 Capital	-	-
___Additional deductions of CET1 Capital due to Article 3 CRR	-	-
___CET1 capital elements or deductions — other	-	-
ADDITIONAL TIER 1 CAPITAL (AT1 CAPITAL)	-	-
__Capital instruments eligible as AT1 Capital	-	-
___Paid up capital instruments	-	-
____ Memorandum item: Capital instruments not eligible	-	-
____ Share premium	-	-
___(-) Own AT1 instruments	-	-
_____ (-) Direct holdings of AT1 instruments	-	-
_____ (-) Indirect holdings of AT1 instruments	-	-
____ (-) Synthetic holdings of AT1 instruments	-	-
___ (-) Actual or contingent obligations to purchase own AT1 instruments	-	-
___Transitional adjustments due to grandfathered AT1 Capital instruments	-	-
___Instruments issued by subsidiaries that are given recognition in AT1 Capital	-	-

___Transitional adjustments due to additional recognition in AT1 Capital of instruments issued by subsidiaries	-	-
___(-) Reciprocal cross holdings in AT1 Capital	-	-
___(-) AT1 instruments of financial sector entities where the institution does not have a significant investment	-	-
___(-) AT1 instruments of financial sector entities where the institution has a significant investment	-	-
___(-) Excess of deduction from T2 items over T2 Capital	-	-
___Other transitional adjustments to AT1 Capital	-	-
__Excess of deduction from AT1 items over AT1 Capital (deducted in CET1)	-	-
__Additional deductions of AT1 Capital due to Article 3 CRR	-	-
__AT1 capital elements or deductions — other	-	-
_TIER 2 CAPITAL (T2 CAPITAL)	**27 992**	**27 992**
__ Capital instruments and subordinated loans eligible as T2 Capital	**27 992**	**27 992**
__Paid up capital instruments and subordinated loans	**27 992**	**27 992**
____ Memorandum item: Capital instruments and subordinated loans not eligible	**- 35**	-
____ Share premium	-	-
____ (-) Own T2 instruments	-	-
____(-) Direct holdings of T2 instruments	-	-
___(-) Indirect holdings of T2 instruments	-	-
____ (-) Synthetic holdings of T2 instruments	-	-
___(-) Actual or contingent obligations to purchase own T2 instruments	-	-
__Transitional adjustments due to grandfathered T2 Capital instruments and subordinated loans	-	-
__Instruments issued by subsidiaries that are given recognition in T2 Capital	-	-
__Transitional adjustments due to additional recognition in T2 Capital of instruments issued by subsidiaries	-	-
___IRB Excess of provisions over expected losses eligible	-	-
__SA General credit risk adjustments	-	-
__(-) Reciprocal cross holdings in T2 Capital	-	-
___(-) T2 instruments of financial sector entities where the institution does not have a significant investment	-	-
___(-) T2 instruments of financial sector entities where the institution has a significant investment	-	-
___Other transitional adjustments to T2 Capital	-	-
__Excess of deduction from T2 items over T2 Capital (deducted in AT1)	-	-
__(-) Additional deductions of T2 Capital due to Article 3 CRR	-	-
__T2 capital elements or deductions — other	-	-

6*. Table*: Components of own funds under Pillar 1 (K&H Bank and K&H Group)

Components of own funds (HUF million)	Mortgage Bank Zrt (HAS)
OWN FUNDS	**3 473**
_TIER 1 CAPITAL(TIER 1 OR T1 CAPITAL)	**3 473**
__COMMON EQUITY TIER 1 CAPITAL (CET 1 CAPITAL)	**3 473**
___ Capital instruments eligible as CET1 capital	**3 500**
___ Paid up capital instruments	**3 050**
____ Memorandum item: Capital instruments not eligible	**-**
____ Share premium	**450**
____ (-) Own CET1 instruments	**-**
_____ (-) Direct holdings of CET1 instruments	**-**

_____ (-) Indirect holdings of CET1 instruments	-
____ (-) Synthetic holdings of CET1 instruments	-
___ (-) Actual or contingent obligations to purchase own CET1 instruments	-
___Retained earnings	**- 27**
____Previous years retained earnings	-
____Profit or loss eligible	**- 27**
_____Profit/loss attributable to owners of the parent	**- 27**
____(-) Part of interim or year-end profit not eligible	-
___ Accumulated other comprehensive income	-
___Other reserves	-
___Funds for general banking risk	-
___Transitional adjustments due to grandfathered CET1 Capital instruments	-
___Minority interest given recognition in CET1 capital	-
___Transitional adjustments due to additional minority interests	-
___Adjustments to CET1 due to prudential filters	-
(-) Increases in equity resulting from securitised assets	-
___ Cash flow hedge reserve	-
____Cumulative gains and losses due to changes in own credit risk on fair valued liabilities	-
___ Fair value gains and losses arising from the institution's own credit risk related to derivative liabilities	-
____(-) Value adjustments due to the requirements for prudent valuation	-
___(-) Goodwill	-
____(-) Goodwill accounted for as intangible asset	-
____(-) Goodwill included in the valuation of significant investments	-
____Deferred tax liabilities associated to goodwill	-
___ (-) Other intangible assets	-
____(-) Other intangible assets gross amount	-
____Deferred tax liabilities associated to other intangible assets	-
___(-) Deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	-
___(-) IRB shortfall of credit risk adjustments to expected losses	-
___(-) Defined benefit pension fund assets	-
____(-) Defined benefit pension fund assets gross amount	-
____Deferred tax liabilities associated to defined benefit pension fund assets	-
____ Defined benefit pension fund assets which the institution has an unrestricted ability to use	-
___(-) Reciprocal cross holdings in CET1 Capital	-
___(-) Excess of deduction from AT1 items over AT1 Capital	-
___(-) Qualifying holdings outside the financial sector which can alternatively be subject to a 1,250 % risk weight	-
___(-) Securitisation positions which can alternatively be subject to a 1250 % risk weight	-
____(-) Free deliveries which can alternatively be subject to a 1,250 % risk weight	-
___(-) Positions in a basket for which an institution cannot determine the risk weight under the IRB approach, and can alternatively be subject to a 1,250 % risk weight	-
___(-) Equity exposures under an internal models approach which can alternatively be subject to a 1,250 % risk weight	-
___(-) CET1 instruments of financial sector entities where the institution does not have a significant investment	-
___(-) Deductible deferred tax assets that rely on future profitability and arise from temporary differences	-
___(-) CET1 instruments of financial sector entities where the institution has a significant investment	-
___(-) Amount exceeding the 17,65 % threshold	-

___Other transitional adjustments to CET1 Capital	-
___Additional deductions of CET1 Capital due to Article 3 CRR	-
___CET1 capital elements or deductions — other	-
ADDITIONAL TIER 1 CAPITAL (AT1 CAPITAL)	-
__Capital instruments eligible as AT1 Capital	-
___Paid up capital instruments	-
____ Memorandum item: Capital instruments not eligible	-
____ Share premium	-
___(-) Own AT1 instruments	-
_____ (-) Direct holdings of AT1 instruments	-
_____ (-) Indirect holdings of AT1 instruments	-
____ (-) Synthetic holdings of AT1 instruments	-
___ (-) Actual or contingent obligations to purchase own AT1 instruments	-
___Transitional adjustments due to grandfathered AT1 Capital instruments	-
___Instruments issued by subsidiaries that are given recognition in AT1 Capital	-
___Transitional adjustments due to additional recognition in AT1 Capital of instruments issued by subsidiaries	-
___(-) Reciprocal cross holdings in AT1 Capital	-
___(-) AT1 instruments of financial sector entities where the institution does not have a significant investment	-
___(-) AT1 instruments of financial sector entities where the institution has a significant investment	-
___(-) Excess of deduction from T2 items over T2 Capital	-
___Other transitional adjustments to AT1 Capital	-
__Excess of deduction from AT1 items over AT1 Capital (deducted in CET1)	-
__Additional deductions of AT1 Capital due to Article 3 CRR	-
__AT1 capital elements or deductions — other	-
_TIER 2 CAPITAL (T2 CAPITAL)	-
__ Capital instruments and subordinated loans eligible as T2 Capital	-
__Paid up capital instruments and subordinated loans	-
____ Memorandum item: Capital instruments and subordinated loans not eligible	-
____ Share premium	-
____ (-) Own T2 instruments	-
____(-) Direct holdings of T2 instruments	-
___(-) Indirect holdings of T2 instruments	-
____ (-) Synthetic holdings of T2 instruments	-
___(-) Actual or contingent obligations to purchase own T2 instruments	-
__Transitional adjustments due to grandfathered T2 Capital instruments and subordinated loans	-
__Instruments issued by subsidiaries that are given recognition in T2 Capital	-
__Transitional adjustments due to additional recognition in T2 Capital of instruments issued by subsidiaries	-
___IRB Excess of provisions over expected losses eligible	-
__SA General credit risk adjustments	-
__(-) Reciprocal cross holdings in T2 Capital	-
___(-) T2 instruments of financial sector entities where the institution does not have a significant investment	-
___(-) T2 instruments of financial sector entities where the institution has a significant investment	-
___Other transitional adjustments to T2 Capital	-
__Excess of deduction from T2 items over T2 Capital (deducted in AT1)	-
__(-) Additional deductions of T2 Capital due to Article 3 CRR	-

__T2 capital elements or deductions — other	-

7. Table Components of own funds under Pillar 1 (K&H Mortgage Bank Zrt)

Leverage ratio	2016.12.31
SFT exposure according to CRR 222	47
Derivatives	83 300
Undrawn credit facilities, which may be cancelled unconditionally at any time without notice	156 469
Medium/ low risk trade related off-balance sheet items	8 353
Medium risk trade related off-balance sheet items and officially supported export finance related off-balance sheet items	233 091
Other off-balance sheet items	349 541
Other assets	2 885 929
Tier 1 capital	188 115
Regulatory adjustments excluding regulatory adjustments on our own credit risk	-16 024
Leverage ratio calculated as a simple mathematical average	**5,08%**

8.* Table*: Leverage ratio (K&H Bank)

Leverage ratio	2016.12.31
SFT exposure according to CRR 222	47
Derivatives	83 292
Undrawn credit facilities, which may be cancelled unconditionally at any time without notice	157 856
Medium/ low risk trade related off-balance sheet items	84 870
Medium risk trade related off-balance sheet items and officially supported export finance related off-balance sheet items	207 253
Other off-balance sheet items	296 809
Other assets	2 851 230
Tier 1 capital	195 988
Regulatory adjustments excluding regulatory adjustments on our own credit risk	-18 451
Leverage ratio calculated as a simple mathematical average	**5,35%**

9.* Table*: Leverage ratio (K&H Group)

ICAAP Strategy, Process (CRR Article 438 /a)

The KBC Group considers ICAAP an ideal step to gradually move the whole group towards high level and reliable risk management procedures, Consequently, KBC does not consider ICAAP a separate regulatory burden but a tool that may have a major role in achieving the above objective. This is why the KBC Group considers it important to have a well-founded ICAAP approach. Internal procedures and systems must be elaborated that ensure the availability of sufficient funding for a long term, paying sufficient attention to each important risk.

In 2007 KBC developed an ICAAP procedure for the whole group which was renewed in 2015. The procedure contains internal models for measuring capital requirements, more specifically economic capital[2]. This ensures the set funding ratio at KBC, which is associated with the predefined reliability level of default in economic sense.
Under Pillar 2, the KBC Group uses the ICM model to calculate the total economic capital requirement. The model has also been implemented in the K&H Group, K&H calculates economic capital for 4 risk types for the same time horizon and confidence level, they are the building blocks of ICM.

[2] The concept of economic capital is different from own funds as own funds refers to the minimum level of necessary and mandatory capital required by the regulators to be maintained by the institution; economic capital is the closest estimate of the required amount of capital that the financial institutions use internally to manage their own risks and distribute the costs of maintenance of own funds within the various units or between the members of the organisation.

Chapter III – Risk governance and risk management at K&H

(CRR Article 435)

Risk governance

The KBC Group's value and risk management governance model seeks to define the responsibilities and tasks of various bodies and persons within the organization with a view to ensuring the sound management of value creation and of the associated risks to which both the banking and insurance businesses are exposed. The effective risk management process ensures that all the material risks of the institution are addressed.

The K&H governance model defines the responsibilities and tasks required for the management of value creation and of all the associated risks. Similarly to the KBC Group's standards, the K&H Group's risk governance model is organized in three tiers:

Tier I: Overarching company and risk committees

Board of Directors (BoD)
The BoD is responsible for formulating the Bank's long-term strategy, and manages and monitors the Bank's operations.

Within the Board of Directors, three committees have been set up: the Audit, Risk and Compliance Committee, Nomination Committee and the Remuneration Committee.

Board of Directors	Title	Committee Membership
Luc Gijsens	Chairman	RCC, NomCo, RemCo
Christine Van Rijsseghem	Member	RCC, NomCo, RemCo
Willem Hueting	Member	RCC, NomCo, RemCo
Hendrik Scheerlinck	Member	
Lajos Beke	Member	
Attila Gomás	Member	

10. Table: Members of BoD

The **Risk and Compliance Committee (RCC)** is a discussion forum for the Bank's management, members of the management delegated to the Board of Directors, as well as internal auditors of K&H and the shareholders.
The Risk and Compliance Committee supervises, on behalf of the Board, the integrity, efficiency and effectiveness of the internal regulatory measures and the risk management in place, paying special attention to correct financial reporting, and overseeing the company's processes to comply with laws and regulations. The Committee meets 4 times a year.

The **Remuneration Committee (RemCo)** approves the Bank's remuneration policy as well as the salaries of the Bank's senior managers. They decide about fringe benefits and performance based benefits as well. The Committee has 3 members and met 5 times in 2016. (February 25, 2016; May 14, 2016; June 8, 2016; October 5, 2016; December 7, 2016.)

The Nomination Committee (NomCo) recommend the candidates for the senior positions. Apart from this task they regularly challenge the experience, knowledge and skills if they are really appropriate for their actual role. The committee met once in 2016 (April 20, 2016)

The management of K&H subsidiaries (Group members) is independent in legal terms. However, adherence to a common Group strategy is ensured by the presence of members of the K&H Board of Directors on the subsidiaries' Supervisory Boards.

The Board of Directors and the Risk and Compliance Committee have an important role to play in value creation and risk governance. Regular reporting to the Risk and Compliance Committee ensures that there is an ample flow of information to the relevant members of the Board over the course of the year.

The **Executive Committee (EXCO)** is the body in control of the operations of the Bank and a decision-making and consulting forum for the top management of the Bank. This is an executive body responsible for the implementation of Group strategy in all business segments.

The Executive Committee is responsible for the implementation of the value and risk management strategy, and outlines the structure to allow risk management tasks to be carried out and makes the necessary resources available. A Chief Risk Officer (CRO) has been appointed within the EXCO and entrusted with the specific task of supervising risk management and the internal control structure. The Executive Committee is always informed about the topics raised on the below mentioned Risk Committee through the ratification of meeting minutes.

The **Capital and Risk Oversight Committee (CROC)** is to assist the Executive Committee of the K&H Bank Group with the operation, implementation and application of an overall risk management framework that meets the expectations of internal and external stakeholders and complies with applicable laws and regulations. The CROC is the single integrating committee on risk and capital matters that supports, and leverages the time of, the Executive Committee of the K&H Bank Group. The CROC can rely on support from one or more Risk Councils that act as advisory forums for specific risk areas. The committee is chaired by the Chief Risk Officer.

The **Crisis Preparation Committee (CrisPreCo)** is charged with managing the preparations for risk events (crises) that pose a significant threat to the Bank's operations, and monitor the status of the related tasks. The committee is chaired by the Chief Risk Officer.

The **Crisis Committee (CrisCo)** is a committee to take control whenever a crisis actually occurs, manage decision making as well as internal and external communication, give instructions and monitor the execution of the individual Business Continuity Processes (BCPs) to be followed in a given crisis event and, as the case may be, also of the Recovery Plan. The members of the Crisis Committee are the Executive Committee and the managers with the expertise in handling the given crisis event.

New and Active Products Process (NAPP). The purpose of the NAPP is to establish across K&H Group a smooth but robust and transparent process for approving new and regularly reviewing existing products whereby commercial aspects are balanced against risk and operational matters. All existing products on offer are reviewed at regular intervals to make sure that they are still appropriate from a commercial and risk management perspective in an ever changing world.

Tier II: Specialized risk councils

- **Credit risk council (CRCs).** The CRCs' role is to assist the ExCo and CROC of K&H Bank Group with the operation, implementation and application of a credit risk management framework that meets the expectations of internal and external stakeholders and complies with applicable laws and regulations. The CRCs are the preliminary discussion and advisory forum for all credit risk-related activities of the K&H Bank Group in close collaboration with line management, which is primarily responsible and accountable for credit risk management. The CRCs are chaired by the Bank's Chief Risk Officer.

- **Trading risk council (TRC).** The TRC's role is to assist the ExCo and CROC of K&H Bank Group with the operation, implementation and application of a trading risk management framework that meets the expectations of internal and external stakeholders and complies with applicable laws and regulations. The TRC is the preliminary discussion and advisory forum for all trading risk-related activities of the K&H Bank Group in close collaboration with line management, which is primarily responsible and accountable for trading risk management. The TRC is chaired by the Bank's Chief Risk Officer.

- **Operational Risk Councils (ORCs).** The ORCs' role is to assist the ExCo and CROC of K&H Bank Group with the operation, implementation and application of an operational risk management framework that meets the expectations of internal and external stakeholders and complies with applicable laws and regulations. The ORCs are the preliminary discussion and advisory forum for all operating risk-related activities of the K&H Bank Group in close collaboration with line management, which is primarily responsible and accountable for operational risk management. The councils are chaired by senior line managers.

In addition to the above-mentioned committees, the key governing bodies of K&H are:

- **Country Team Hungary (CT-H, since January 2007).** This is a group of the top managers of K&H Group and K&H Insurance who are in key managerial positions in Hungary (members of the Board of Directors or persons holding other important top managerial positions). The goal of the Country Team is to improve mutual communication among managers and coordinate the KBC Group's principal activities in Hungary. The Country Team is headed by a Country Manager, who reports to the CEO of the Central Europe Business Unit.

- **Management Committee International Markets (MC IM, since January 2013).** The goal of the MC IM is to improve mutual communication among the Country Teams and coordinate the KBC Group's principal activities in Central and Eastern Europe and Ireland.

Risk management

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

- Value, risk and capital management are closely linked to one another. KBC entities must have adequate capital to be able to deal with any unforeseen consequences of adverse market developments.

- Risk management should be approached from a comprehensive, company-wide angle, taking into account all the risks the company is exposed to and all the activities it engages in. Policies and methodologies must be coherent and consistent throughout the KBC Group.

- Every significant subsidiary is required to adhere to the same risk governance model as the parent company (KBC), which – in terms risk management – is based on the following underlying principles: primary responsibility for value and risk management lies with line management, while a separate organizational unit – operating independently of line management – performs an advisory, supporting and supervisory role.

Risk policy

The KBC Group has relied on its fundamental attitude to risk and risk management in approaching the key issues and defining general strategic conditions for the organization. Consequently, it has drawn up a group-wide strategy and policy with regard to risk and capital.

The following high-level policies form the basis for risk strategy in the KBC Group:
- Maintain an environment where all significant and material risks are identified, assessed, controlled, managed, reported and monitored.
- Have independent supervision in place to govern risk-taking activities, with clearly established responsibilities and accountability.
- Follow an open risk culture that is designed to effectively facilitate timely risk mitigation.
- Optimize risk-return in a controlled manner at high standards.

The foundations of risk management

In accordance with the policies above, the following basic principles form the foundations of risk management at the KBC Group:

- A single, consistent approach should be taken to value, risk and capital management within the group.
- A single, global risk governance model applies to all entities, in accordance with the proportionality principle.
- Value and risk management has advisory, supporting and monitoring tasks and operates independently of business lines.
- KBC Group implements new risk management techniques as soon as they are considered to be industry standards.

The role of "line management"

According to the risk governance model applied throughout the KBC Group, line management has primary responsibility for value and risk management, which includes the following tasks:

- being accountable for risk management and risks incurred within its area of responsibility to superiors in the management structure and to the senior management of the legal entity;
- ensuring that the risk management framework applicable to its business line is embedded in policies and procedures and communicated to the staff;
- taking measures to manage the risks that are not (yet) addressed in the risk management framework; additionally, reporting shortcomings in compliance with the bottom-up communication line applicable to its business;
- delivering risk data in the required format and by specified deadlines to the local Value and Risk Management unit and ensuring their integrity by performing the specified controls.

The role of "value and risk management"

Value and Risk Management (VRM) is part of the CRO Services Division, and is tasked with resolving value, risk and capital management issues independently of business lines. VRM has an advisory, supporting and supervisory role with respect to risk management according to the KBC Group standards.

Although efficient cooperation between line management and Value and Risk Management is indispensable, Value and Risk Management operates independently of business lines. The Risk Management departments assist business lines in taking calculated risks, thus assuming an advisory, supporting and monitoring role.

The departments report to the CRO and assist the CRO in performing his activities, namely value, risk and capital management. Therefore this organizational unit provides the *"risk control"* function at the different KBC Group entities.

By approving the 2014 "Internal Control Statement" the K&H governing body has confirmed that the risk management system in place is compliant in light of the profile and strategy of the institution. On 26 November 2014 the K&H governing body approved the "Risk Appetite" document, which briefly presents the general risk profile of the institution related to the business strategy it applies, and based on which the risk profile of the institution is in line with the risk appetite defined by the governing body.

Credit risk

Credit risk management refers to the structural and repetitive tasks performed with regard to the identification, measurement and reporting of credit risks. Credit risk is managed by means of rules and procedures approved by the Executive Committee that govern the acceptance process for new loan and limit applications, the process of monitoring and supervising credit risks, and portfolio management.

Framework for credit risk management and governance at KBC

Credit risk management decisions are taken by the Capital and Risk Oversight Committees organized at group level (Group CRC) and/or at local level (local CRC) (with approval from the group-level or local Executive Committee (ExCo)).

The ultimate responsibility of credit risk management lies with line management, which is assisted by several activity-specific committees. A separate credit risk unit is established may have an advisory, supporting and supervisory role with respect to credit risk management.

The significant entities in the KBC Group must implement a credit risk governance structure that includes a risk committee and a credit risk management unit that is independent of the business. K&H complies with these requirements.

Credit risk is managed at two levels: transaction and portfolio level. Managing credit risk at the transaction level means that there are sound procedures, processes and applications in place to assess and monitor risks before and after the given credit exposures are accepted. Managing the risk at the portfolio level entails risk assessment, monitoring and reporting on (parts of) the consolidated loan portfolio.

Rating systems (CRR Articles 442, 444 and 452)

A key element of measuring credit risk is having a credit rating system. K&H uses several credit risk models – developed in-house or by KBC – to determine the Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD) for different debtors or facilities.

Financial institutions are required to perform a rating exercise including the analysis of the client's financial position, creditworthiness, and future solvency, as well as the valuation of the collaterals pledged in order to measure credit risks associated with the business activity. Credit institutions justify their debtor and/or debt rating decisions based on several aspects. All client and facility ratings must be reviewed regularly, but at least once a year. During this review process it is possible to assess and identify the changes in the counterparty's creditworthiness, including any change in collateral characteristics.

Internal ratings are available for all counterparties in the K&H portfolio.

External ratings used under the standardized approach may be accepted from the following external credit rating agencies: Standard & Poor's, Fitch and Moody's. K&H does not use the external ratings of export credit agencies. The following ratings of the Hungarian State have been considered: Standard and Poor's: BB; Moody's: Ba1; Fitch: BB+ (credit rating: 4).

Debtor ratings are based on the obligor's probability of default (PD). The KBC Group has defined default as a situation where full repayment at maturity is (at least) uncertain. There are three categories of default, depending on the extent the obligor is performing its liabilities still outstanding and on the chances of recovering the loan.

The KBC Group applies a single group-wide PD rating scale to all counterparties. External ratings provided by rating agencies (Standard & Poor's, Fitch, Moody's) are also mapped to this master scale. There are nine PD rating categories for counterparties "not in default" (PD 1-9) and, as mentioned above, three PD rating categories for counterparties in default (PD10: possible loss - performing; PD11: possible loss – non-performing; PD12: irrecoverable).

The Bank has also developed loss given default and exposure at default calculation models for the corporate segment, which are also used in business processes.

The bank implemented the so called Forborne definition, which replaces the standing restructured definition. The main difference compared to the previous definition is the Forbearance affects distressed clients. This means that clients affected with forbearance can not be rated as performing, they have to at least be put into PD 10 category. The details of Forbearance can be found in EBA ITS Definition of Forbearance (EBA ITS 2013/03).

In the retail segment, ratings are assigned at pool level, that is, on the basis of grouping together exposures with similar characteristics. Debtor rating in the consumer segment is performed with the help of different scorecard models such as application scorecards and behavioral scorecards, which K&H uses as inputs for pool-level credit risk models. Separate models are used to estimate the other credit risk parameters (i.e. LGD and EAD) of retail exposures.

Loans past due comprise the assets that the client failed to settle at the due date (even if the delay is one day only).

When preparing its balance sheet, the Group always reviews whether it needs to recognize impairment on its financial assets. A financial asset or a group of financial assets can be considered impaired if – and only if – there are objective external factors that result from events occurring after the purchase of the asset, such events have an impact on the estimated future cash flow of the financial asset or group of financial assets, and such impact can be estimated reliably. The impairment recognized on financial assets must be used when the asset is derecognized because it is irrecoverable or its title is transferred. The objective external factors underlying impairment may be the following signals: the borrower or borrower group is facing significant financial difficulties, interest payments or principal repayments are made late or missed, bankruptcy or some other financial restructuring is likely, and where the available data show a tangible decrease in the estimated future cash flow, such as a failure to pay, or economic conditions that correlate with insolvency.

Credit risk limits

Maximum credit risk exposure and/or credit risk concentration is managed and monitored via limits, which define the maximum credit risk exposure allowed in terms of a specific measurement approach.
Transactions that carry a credit risk may only be entered into if authorized by a positive credit decision, which will stipulate, among others, the maximum acceptable credit risk exposure (limit), which may refer to:

- Case-by-case approval for a given transaction (a given counterparty);
- A pre-approved limit for all the transactions of a particular risk type.

Limits at individual counterparty level

In addition to the limit types above, an overall KBC Group limit (as decided by the KBC Group Executive Committee) also applies to corporate exposures in terms of Loss Given Default (LGD) and Expected Loss (EL). These are “hard limits”, which means that immediate action is required if such limit is or would be exceeded.

Apart from the limits defined internally at debtor/guarantor/counterparty and country level, large exposure limits are also monitored in compliance with applicable law.

Limits at group/sector/portfolio level

The limits assigned to client groups and sectors/portfolios are designed to define the maximum desirable exposure concentration for client groups, industry sectors, etc. These limits are not approved individually for each client but apply to all clients that fit the scope of the particular limit (e.g. a given industry sector).

Credit Risk creates reports concerning the whole credit portfolio of K&H on a quarterly basis for the top management. These reflect the new segmentation within the Bank. A separate report is created for the Retail Banking division (individuals, and Micro SME) and Business Banking division, which include a deeper analysis of the different risk parameters. These reports are created for the Country Team and Credit Risk Council.

The so-called Integrated Risk report, prepared for the Country Team on a monthly basis, is aimed at presented and monitoring credit risk, among others.

The credit management functions prepare monthly reports on the following segments:

- Retail
- SME
- Corporate

IRB HUF bln	Exposure	Net Exposure	RWA
Central governments and central banks	38 839	37 145	7 329
Institutions	322 214	322 214	79 736
Corporates	655 871	574 594	427 813
Small and medium sized enterprises	568 995	385 263	392 103
Retail other	58 591	58 591	39 809
Retail mortgage	506 223	0	158 672
Total	**2 150 733**	**1 377 808**	**1 105 460**

Standard HUF bln	Exposure	Net Exposure	RWA
Central governments and central banks	935 030	935 030	0
Corporates	262	262	185
Retail	2 857	2 857	2 013
Past due	3 061	3 061	224
Other	160 291	160 291	66 595
Total	**1 101 501**	**1 101 501**	**69 017**

11. **Table*: Loan portfolio by exposure class (K&H Bank) CRR Article 442/c***

IRB HUFbln	Exposure	Net Exposure	RWA
Central governments and central banks	35 670	33 859	5 913
Institutions	689 084	689 084	77 954
Corporates	582 860	491 542	378 425
Small and medium sized enterprises	568 995	359 020	391 180
Retail other	58 591	58 591	39 809
Retail mortgage	507 270	0	158 814
Total	**2 442 470**	**1 632 098**	**1 052 096**

Standard HUF bln	Exposure	Net Exposure	RWA
Central governments and central banks	952 372	952 372	0
Corporates	30 493	30 493	14 776
Retail	2 857	2 857	2 013
Past due	3 061	3 061	224
Other	162 244	162 244	58 255
Total	**1 151 027**	**1 151 027**	**75 268**

12. **Table*: Loan portfolio by exposure class (K&H Group) CRR Article 442/c***

A more detailed breakdown of the loan portfolio is provided in the appendix.

Once risks have been identified, measured, monitored and reported, it is the responsibility of both line management and committees to respond, i.e. to bring risks in line with the risk appetite.

Risk avoidance can be achieved by the introduction of credit policies (e.g. forbidding credit risk resulting from lending to specific borrowers), withdrawing or reducing limits (e.g. suspending country limits upon actions of monetary authorities) or deciding to stop certain activities (e.g. when risk and return are not in balance).

Main findings for 2016: Corporate and Premium SME portfolio stable, no significant changes during 2016. Quality of FFG portfolio remains stable.
Retail portfolio showed slight improvements in risk parameters during 2016, which are due to two main factors. High volume of new lending had a diluting effect on the portfolio improving all risk metrics, and the debt sale activity of the Bank was highly effective, which decreased the NPL volume. New lending was only slightly able to counterbalance the natural amortization, and debt sale in the portfolio, thus overall portfolio volume remained stable. Only Consumer Finance portfolio showed significant growth. Quality of new lending (New Book) is good, risk parameters remain stable.

Credit risk adjustments (CRR Article 442)

Corporate segment

The Bank uses the *"normal rating procedure"* for all receivables related to corporate clients, that is, all the aspects specified in applicable law are taken into account during the rating process. K&H does not apply the *"group valuation procedure"* in the corporate segment, thus all items are rated manually, using the *"individual valuation procedure"* in all cases.

Valuation is performed on a quarterly basis unless the Bank obtains new, negative information concerning the client's financial position or the collaterals pledged, which triggers an extraordinary review of the rating categories of the client and all of its exposures. Impairment and provisions are calculated on the basis of *"gross risk"*.

SME segment

In the case of SME clients, the rating classification is based on the *"group valuation procedure"* by default, considering the relatively high number of exposures in this segment. As provided for by applicable law, K&H uses the *"simplified rating procedure"* for this purpose. Classifications are revised automatically on a monthly basis, and the results are reported to senior management.

The rating process also takes into consideration past due status and the collaterals. An indicator derived from the "*net risk*" serves as the final basis for classifying the exposures for SME clients and is also used to calculate the required level of impairment and provisions to be recognized on these exposures. As a consequence, impairment loss and provisions are determined on the basis of *"net risk"*.

In the case of exposures related to clients managed by the Special Credits Department, rating classification and the calculation of the required level of impairment loss provisions is based on the "*individual valuation procedure*" applied to corporate clients.

Retail segment

The Bank uses the *"simplified rating procedure"* for all its retail receivables. By default, the Bank assigns retail items into *"valuation groups"* in accordance with the rules of the *"group valuation procedure"* prescribed by Hungarian law. The Bank defines the *"valuation groups"* in such a way that transactions with similar characteristics are included in the same group.

In the case of the *"group valuation procedure"*, items are assigned to *"valuation groups"* automatically, and impairment and provisions are also calculated automatically during the preparation of the regular portfolio reports by the Consumer MIS and Modelling Unit, i.e., there is no need for a separate proposal or decision of a competent authority.
In addition to the default *"group valuation procedure"*, in certain special cases the Bank uses the *"simplified rating procedure"* as part of the *"individual valuation procedure"*, whereby the Bank decides the rating of each transaction individually, on a case-by-case basis, also determining the required level of impairment and provisions. The rating of receivables under the *"individual rating procedure"* is

reviewed each quarter based on the previously determined *"asset rating categories"* and the required impairment and provisions.

HUF million	Opening 01.01.2016	Recognized	Released	Used	Discount effect	FX revaluation	Closing 31.12.2016.
Impairment	100 667	14 780	-18 733	-17 244		-28	79 442
Provisions	6 438	653	-4 913			-48	2 130
Total	107 105	15 433	-23 646	-17 244	0	-76	81 572

13. **Table**: ***Changes in value adjustments and provisions during the year (K&H Bank)***

HUF million	Opening 01.01.2016	Recognized	Released	Used	Discount effect	FX revaluation	Closing 31.12.2016.
Impairment	50 227	28 297	-18 432	-17 248	-183	143	42 804
Provisions	6 212	1 020	-1 751	-3 212	14	-48	2 235
Total	56 439	29 317	-20 183	-20 460	-169	95	45 039

14. **Table**: ***Changes in value adjustments and provisions during the year (K&H Group)***

HUF bln	Original Exposure Pre Credit Conversion Factors	Value adjustments and provisions
Sovereign	973 868	196
Institutions	322 214	0
Corporates	656 133	7 860
SME	568 995	11 249
Retail Other	61 448	1 721
Retail Mortgages	506 223	57 820
Total	**3 088 882**	**78 846**

15. **Table**: **Loan portfolio affected by value adjustments and provisions, by exposure class (K&H Bank)**

HUF bln	Original Exposure Pre Credit Conversion Factors	Value adjustments and provisions
Sovereign	988 042	89
Institutions	689 084	6
Corporates	613 354	8 726
SME	568 995	11 249
Retail Other	61 448	1 721
Retail Mortgages	507 270	57 646
Total	**3 428 193**	**79 436**

16. **Table**: **Loan portfolio affected by value adjustments and provisions, by exposure class (K&H Group)**

Continent HUF mln	Original Exposure Pre Credit Conversion Factors	Value adjustments and provisions
Central Eastern Europe	2 815 404	78 846
Western Europe	145 961	0
Asia	103 295	0
North America	23 670	0
Africa	497	0
Australia and Oceania	37	0
Middle East	17	0
Összesen	**3 088 882**	**78 846**

17. **Table**: **Loan portfolio affected by value adjustments and provisions, by continent (K&H Bank)**

Continent HUF mln	Original Exposure Pre Credit Conversion Factors	Value adjustments and provisions
Central Eastern Europe	3 288 992	79 436
Western Europe	136 131	0
North America	2 110	0
Africa	497	0
Asia	409	0
Australia and Oceania	37	0
Middle East	17	0
Total	**3 428 193**	**79 436**

18. **Table**: **Loan portfolio affected by value adjustments and provisions, by continent (K&H Group)**

Country HUF mln	Original Exposure Pre Credit Conversion Factors	Value adjustments and provisions
Hungary	2 755 430	78 846
Singapur	102 886	0
Slovakia	49 238	0
France	48 335	0
Other	132 992	0
Összesen	**3 088 882**	**78 846**

19. **Table**: **Loan portfolio affected by value adjustments and provisions, by country (K&H Bank)**

Country HUF mln	Original Exposure Pre Credit Conversion Factors	Value adjustments and provisions
Magyarország	3 279 459	79 436
Szingapúr	47 091	0
Szlovákia	28 299	0
Franciaország	21 889	0
Egyéb	51 454	0
Total	**3 428 193**	**79 436**

20. **Table***:* **Loan portfolio affected by value adjustments and provisions, by country (K&H Group)**

Sector *HUF mln*	**Original Exposure Pre Credit Conversion Factors**	**Value adjustments and provisions**
Authorities	954 564	196
Private Persons	566 380	59 366
Finance & Insurance	414 333	2 466
Agriculture Farming Fishing & Food	207 396	1 202
Distribution & Traders	203 702	3 907
Building & Construction	107 695	279
Services	87 944	433
Commertial Real estate	85 119	1 834
Energy Electricity & Water	83 817	341
Automotive	83 416	413
Chemicals	56 589	503
Metals Machinery & Heavy Equipment	51 092	2 302
Textile Timber & Paper	45 125	191
unknown	42 654	1 205
Shipping & Aviation	37 979	528
IT & Electronics	32 965	2 167
HORECA	23 363	1 327
Media & Telecom	4 749	185
Total	**3 088 882**	**78 846**

21. **Table***:* **Loan portfolio affected by value adjustments and provisions, by sector (K&H Bank)**

Sector ***HUF mln***	**Original Exposure Pre Credit Conversion Factors**	**Value adjustments and provisions**
Authorities	980 308	0
unknown	576 697	1 864
Private Persons	566 380	59 366
Agriculture Farming Fishing & Food	207 396	1 202
Distribution & Traders	203 896	3 907
Finance & Insurance	171 287	2 466
Building & Construction	108 009	279
Commertial Real estate	85 119	1 834
Energy Electricity & Water	83 817	341
Automotive	83 722	413
Services	81 250	560
Shipping & Aviation	65 901	528
Chemicals	56 788	503
Metals Machinery & Heavy Equipment	51 349	2 302
Textile Timber & Paper	45 182	191
IT & Electronics	32 976	2 167
HORECA	23 363	1 327
Media & Telecom	4 752	185
Total	**3 428 193**	**79 436**

22. **Table**: **Loan portfolio affected by value adjustments and provisions, by sector (K&H Group)**

A more detailed breakdown of these figures by exposure class is presented in the appendix.

(HUF million)	2015			2016		
	Expected loss	Impairment and provisions	Credit risk adjustments in the period	Expected loss	Impairment and provisions	Credit risk adjustments in the period
Retail mortgages	68 959	67 593	-10 977	58 703	57 703	-8 813
Retail other	2 281	7 237	545	2 182	2 331	119
Businesses	27 859	33 757	-1 856	18 142	22 358	-440
Total	99 100	108 587	-12 288	79 027	82 392	-9 134

23. **Table**: **Estimated and actual losses (K&H Group)**

The capital requirement of credit risk

Until 2010 the K&H Group had used the *"standardized approach"* to calculate the capital requirement of credit risk. Since 1 January 2011 the Bank has been using the *"internal ratings based (IRB) approach"* to determine its capital requirement (except for sovereign and leasing exposures and other items). Both in the retail and non retail segments the capital requirement is based on in-house estimates of PD, LGD and CCF risk parameters (Advanced IRB approach). Home-host joint decision of the National Bank of Belgium and Hungarian National Bank licensed K&H Banking Group the use of IRB Advanced method for non-retail segment as of the third quarter of 2015. (TF/2015/25/KND)

HUF million	Exposure	RWA	Capital Requirement
On Balance Items (1)	2 504 780	926 474	74 118
Off Balance Items (2)	747 453	248 003	19 840
Credits (1+2)	***3 252 234***	***1 174 477***	***93 958***
Derivatives	83 300	19 895	1 592
Repo	384 116	2 097	168
Total	**3 719 649**	**1 196 468**	**95 717**

24. **Table**: **Capital requirement of credit risks (K&H Bank)**

HUF million	Exposure	RWA	Capital Requirement
On Balance Items (1)	2 846 709	903 231	72 258
Off Balance Items (2)	746 789	224 132	17 931
Credits (1+2)	***3 593 497***	***1 127 363***	***90 189***
Derivatives	83 292	20 903	1 672
Repo	4 671	490	39
Total	**3 681 460**	**1 148 757**	**91 901**

25. **Table**: **Capital requirement of credit risks (K&H Group)**

	Asset Class *HUF million*	Original Exposure Pre Credit Conversion Factors	RWA	Capital Requirement
IRB	Corporate	655 871	427 813	34 225
	SME	568 995	392 103	31 368
	Retail Mortgages	506 223	158 672	12 694
	Institutions	322 214	79 736	6 379
	Retail Other	58 591	39 809	3 185
	Sovereign	38 839	7 329	586
Standard	Sovereign	935 035	0	0
	Other	160 291	66 595	5 328
	Retail Other	5 435	2 205	176
	Corporates	740	217	17

26. **Table**: **Capital requirement of the loan portfolio by exposure class (K&H Bank) CRR Article 438**

	Asset Class *HUF million*	Original Exposure Pre Credit Conversion Factors	RWA	Capital Requirement
IRB	Corporate	582 860	378 425	30 274
	SME	568 995	391 180	31 294
	Retail Mortgages	507 270	158 814	12 705
	Institutions	689 084	77 954	6 236
	Retail Other	58 591	39 809	3 185
	Sovereign	35 670	5 913	473
Standard	Sovereign	952 377	0	0
	Other	162 244	58 255	4 660
	Retail Other	5 435	2 205	176
	Corporates	30 971	14 807	1 185

27. **Table**: **Capital requirement of the loan portfolio by exposure class (K&H Group) CRR Article 438**

Counterparty credit risk (CRR Article 439)

K&H defines counterparty credit risk as the credit risk resulting from over-the-counter (i.e., off-exchange) transactions such as foreign exchange or interest rate swaps, commodity swaps, Credit Default Swaps (CDS), and caps/floors.

The pre-settlement counterparty credit risk is the sum of the (positive) current replacement value (marked-to-market) of a transaction and the applicable add-on (= current exposure method).

Counterparty limits are set for each individual counterparty taking into account the general rules and procedures set out in the K&H Group's applicable documents. The Bank keeps track of risks through a daily monitoring report, which is available to all Bank employees on the Bank's intranet. Dealers are obliged to carry out a pre-transaction check before entering into any transaction using "heavy" add-ons, which are higher than the regulatory add-ons.

The clients of K&H enter into derivative transactions for hedging purposes, so the impact of adverse risks is negligible, as any deterioration in clients' positions is offset by the improvement in their export-import balance.

Close-out netting and collateral techniques are used in the internal limit utilization monitoring process to manage counterparty risk. When derivative transactions are secured by a cash deposit, the Bank manages the collateral on a bilateral basis, which is not affected by any downgrade. Netting benefits are used in the capital calculation procedure for OTC derivatives. . Cash collateral received due to CSAs are also taken into the capital charge calculation as a mitigation tool.

Transaction type	Mark-to-market (1)	Add-on (1)	Counterparty exposure	Notional value of contracts (1)	Capital requirement
Credit derivatives	**0**	**0**	**0**	**0**	**0**
CDS bought – trading portfolio	0	0	0	0	0
CDS sold – trading portfolio	0	0	0	0	0
Other	0	0	0	0	0
Interest rate-related transactions	**94 947**	**28 736**	**67 134**	**2 326 898**	**1 286**
Interest rate swaps	90 822	20 312	59 006	2 034 791	1 238
Caps/floors	4 125	8 423	8 127	292 107	49
Other	0	0	0	0	0
FX-related transactions	**9 926**	**22 987**	**15 753**	**566 830**	**297**
FX forwards	244	1 126	1 363	29 688	41
FX swaps	3 516	7 084	4 475	270 525	48
CIRS	6 165	14 777	9 915	266 618	208
Other	0	0	0	0	0
Equity-related transactions	**0**	**0**	**0**	**0**	**0**
Equity swaps	0	0	0	0	0
Equity options	0	0	0	0	0
Commodity transactions	**120**	**293**	**413**	**1 570**	**9**
TOTAL gross counterparty risk	**104 994**	**52 015**	**83 300**	**2 895 298**	**1 592**
- Netting benefit	0	0	- 31 674	0	0
- Collateral benefit	0	0	- 24 210	0	0
TOTAL net counterparty risk	**104 994**	**52 015**	**27 416**	**2 895 298**	**1 592**

28. **Table**: **Capital requirement of counterparty credit risk (K&H Bank)**

Transaction type	Mark-to-market (1)	Add-on (1)	Counterparty exposure	Notional value of contracts (1)	Capital requirement
Credit derivatives	**0**	**0**	**0**	**0**	**0**
CDS bought – trading portfolio	0	0	0	0	0
CDS sold – trading portfolio	0	0	0	0	0
Other	0	0	0	0	0
Interest rate-related transactions	**94 947**	**26 701**	**67 126**	**3 955 587**	**1 357**
Interest rate swaps	90 822	20 312	58 998	3 371 146	1 242
Caps/floors	4 125	6 389	8 127	584 441	115
Other	0	0	0	0	0
FX-related transactions	**9 926**	**22 987**	**15 753**	**1 336 646**	**306**
FX forwards	244	1 126	1 363	95 843	44
FX swaps	3 516	7 084	4 475	652 237	50
CIRS	6 165	14 777	9 915	588 567	212
Other	0	0	0	0	0
Equity-related transactions	**0**	**0**	**0**	**0**	**0**
Equity swaps	0	0	0	0	0
Equity options	0	0	0	0	0
Commodity transactions	**120**	**293**	**413**	**1570**	**9**
TOTAL gross counterparty risk	**104 994**	**49 981**	**83 292**	**5 293 804**	**1 672**
- Netting benefit	-	-	-30 740	-	-
- Collateral benefit	-	-	-24 210	-	-
TOTAL net counterparty risk	**104 994**	**49 981**	**28 342**	**5 293 804**	**1 672**

29. **Table**: **Capital[3] requirement of counterparty credit risk (K&H Group)**

A breakdown of net counterparty risk is provided below by residual maturity, geographic region (i.e. where the counterparty is located), and industry sector.

Net Exposure by maturity in HUF mln	Institutions	SME Corporates	Central governments and central banks	Corporates	**Total**
<1 year	17 541	2 786	392	2 282	23 002
=>1 to <5 year	37 094	2 024	1 655	2 591	43 365
=>5 to <10 year	7 217	167	753	7 623	15 760
=>10 year	194	-	-	979	1 173
Total	**62 047**	**4 977**	**2 801**	**13 475**	**83 300**

30. **Table**: **Counterparty credit risk by maturity (K&H Bank)**

[3] Including internal deals' effect, but EAD does not contain them.

Net Exposure by maturity in HUF mln	Institutions	SME Corporates	Central governments and central banks	Corporates	**Total**
<1 year	17 541	2 786	392	2 282	8 084
=>1 to <5 year	37 094	2 024	1 655	2 583	12 815
=>5 to <10 year	7 217	167	753	7 623	10 230
=>10 year	194	-	-	979	52 163
Total	**62 047**	**4 977**	**2 801**	**13 467**	**83 292**

31. **Table**: **Counterparty credit risk by maturity (K&H Group)**

Net Exposure by region in HUF mln	Institutions	SME Corporates	Central governments and central banks	Corporates	**Total**
ASIA	50 727	0	0	0	50 727
CENTRAL & EASTERN EUROPE & RUSSIA	1 246	4 977	2 801	13 475	22 499
WESTERN EUROPE	10 074	0	0	0	10 074
Total	**62 047**	**4 977**	**2 801**	**13 475**	**83 300**

32. **Table**:**Counterparty credit risk by continent (K&H Bank)**

Net Exposure by region in HUF mln	Institutions	SME Corporates	Central governments and central banks	Corporates	**Total**
ASIA	50 727	0	0	0	177
CENTRAL & EASTERN EUROPE & RUSSIA	1 246	4 977	2 801	13 467	73 431
WESTERN EUROPE	10 074	0	0	0	9 684
Total	**62 047**	**4 977**	**2 801**	**13 467**	**83 292**

33. **Table**: **Counterparty credit risk by continent (K&H Group)**

Sector	Institutions	SME Corporates	Central Govermnents and central banks	Corporates	Total
Agriculture Farming Fishing & Food	-	1 909	-	810	**2 719**
Authorities	-	-	2 801	-	**2 801**
Automotive	-	282	-	1 197	**1 479**
Building & Construction	-	555	-	825	**1 379**
Chemicals	-	86	-	173	**259**
Commertial Real estate	-	4	-	793	**796**
Distribution & Traders	-	793	-	241	**1 034**
Energy Electricity & Water	-	-	-	114	**114**
Finance & Insurance	62 047	-	-	31	**62 078**
IT & Electronics	-	318	-	322	**640**
Metals Machinery & Heavy Equipment	-	753	-	123	**876**
Private Persons	-	-	-	-	**-**
Services	-	114	-	114	**229**
Shipping & Aviation	-	51	-	7 305	**7 355**
Textile Timber & Paper	-	112	-	329	**441**
Other	-	-	-	1 098	**1 098**
Total	**62 047**	**4 977**	**2 801**	**13 475**	**83 300**

34. **Table**: **Counterparty credit risk by sector (K&H Bank)**

Sector	Institutions	SME Corporates	Central Govermnents and central banks	Corporates	**Total**
Agriculture Farming Fishing & Food	-	1 909	-	810	**2 719**
Authorities	-	-	2 801	-	**2 801**
Automotive	-	282	-	1 197	**1 479**
Building & Construction	-	555	-	825	**1 379**
Chemicals	-	86	-	173	**259**
Commertial Real estate	-	4	-	793	**796**
Distribution & Traders	-	793	-	241	**1 034**
Energy Electricity & Water	-	-	-	114	**114**
Finance & Insurance	10 863	-	-	31	**10 894**
IT & Electronics	-	318	-	322	**640**
Metals Machinery & Heavy Equipment	-	753	-	123	**876**
Private Persons	-	-	-	-	**-**
Services	-	114	-	106	**221**
Shipping & Aviation	-	51	-	7 305	**7 355**
Textile Timber & Paper	-	112	-	329	**441**
Other	51 184	-	-	1 098	**52 282**
Total	**62 047**	**4 977**	**2 801**	**13 467**	**83 292**

35. **Table**: **Counterparty credit risk by sector (K&H Group)**

Application of credit risk mitigation techniques (CRR Article 453)

The acceptance and valuation of collaterals the Bank receives from its clients and the calculation of collateral value must be governed by the principle of conservatism. Before any risk-taking decision the representatives of the business line must verify the existence, fair value and enforceability of the required credit protection and collaterals. In the acceptance and valuation of collaterals must the following prerequisites and factors must be considered:

- The (legal) status of the collateral must be clear and unambiguous in every case.
- When a collateral deposit is accepted, it must be held with a member company of the Bank Group.
- Securities may only be accepted as collateral if they are unconditionally negotiable, can be endorsed and have been deposited with K&H Bank or a member of a K&H Group or the KBC Group.
- In the case of guarantees given by banks and companies and debt securities issued by banks, a country and bank or company limit applicable to the issuer of the guarantee/securities is a prerequisite for acceptance.

In the mitigation of credit risk the Bank may take into account the following types of credit protection, which meet the minimum requirements of eligibility.

Types of funded credit protection that may be taken into account by the Bank:

- financial collateral (collateral deposits in particular)
- physical collateral on real property (mortgages in particular), pledge, lien or purchase option on movable property (e.g. vehicles)

Types of unfunded credit protection that may be taken into account by the Bank (solely pursuant to an individual decision and a specific legal opinion):

- guarantee
- unconditional (first-loss) surety guarantee

The collateral value of a real property that may be taken into account is based on its market value or credit protection value, also considering the regular reviews prescribed by applicable law and any encumbrance arising from any right related to the property that may reduce the value of the property. Therefore, the collateral value of the property cannot exceed its market value. As under applicable law when the internal rating based approach is used, the property must be valued by an independent appraiser – excluding regular, statistics-based property value reviews – only properties whose value has been determined this way are eligible for collateral purposes.

With respect to capital requirement, credit risk mitigation entails the use of methods that may reduce the calculated minimum capital requirement of credit risk. Credit risk may be reduced by a number of risk-mitigating factors, the most important of which are:

- netting and delivery versus payment (DVP) mechanisms
- surety guarantees / collateral received
- credit derivatives (bought credit protection)

K&H does not engage in on-balance sheet netting (i.e., the offsetting of balance sheet items such as loans and deposits). K&H Bank uses both netting and collateral received through CSAs and GMRA as risk mitigation tool in the capital charge calculation.

When making estimates for loss given default, K&H Bank takes into consideration the risk-mitigating effects of certain types of collaterals. Eligible collaterals are governed by an internal regulation and procedures, in compliance with applicable law.

In the retail segment, a Bank's internal model-based LGD parameter estimate depends on the coverage ratio of mortgage-backed exposures. In the non-retail segment, the only types of funded credit protection taken into account in the calculation of the regulatory LGD are the financial collaterals and mortgages that meet the eligibility and minimum requirements set out in applicable law. The risk-mitigating effect of unfunded credit protection (e.g. surety guarantees) are taken into consideration in the PD estimates used in capital requirement calculation. The discount rates of the corporate LGD model apply to the following non-retail segments: corporates, SMEs, municipalities, financial institutions, independent commercial real estate projects. The discount rate-based LGD models are applied as part of the use test preceding the planned implementation of the Advanced IRB approach. The Bank uses a discount rate to determine collateral value; the rate is calculated on the basis of the LGD model developed according to KBC-approved methods, and is updated regularly. The Bank uses these discount rates for collateral valuation with Advanced IRB approach. The eligible value of credit protection, i.e., the collateral value ($C_{adjusted}$) is calculated using the initial value ($C_{initial}$) and the discount rate (d). By default, the initial value may be the market, liquidation or book value – pursuant to the relevant decision.

The collateral value of credit protection: $C_{adjusted} = C_{initial} * d$, except for the special case if the contractual amount is smaller, as in this case the contractual value serves as the upper limit.
The discount rate may be reduced by the relationship manager of the credit sponsor when the credit application is written, or by the credit advisor or the competent decision-makers during the pre-decision or decision phase.

Exposure class (Values in HUF million)	Other	Guarantees	Mortgages	Cash Collateral
SME	46 222	68 048	104 328	25 561
Sovereign	-	12 826	583	1 107
Retail Mortgages	-	-	293 009	-
Corporates	21 515	59 411	56 514	3 131
Total	**67 737**	**140 285**	**454 434**	**29 799**

36. **Table***:* **Credit risk mitigation by exposure class (K&H Bank)**

Exposure class (Values in HUF million)	Other	Guarantees	Mortgages	Cash Collateral
SME	47 943	71 957	121 632	32 360
Sovereign	-	45 120	695	1 112
Retail Mortgages	-	-	293 005	-
Corporates	23 475	64 922	60 613	7 112
Total	**71 418**	**181 998**	**475 944**	**40 584**

37. **Table***:* **Credit risk mitigation by exposure class (K&H Group)**

Guarantor	Rating
Central government	
Magyar Export-Import Bank Zrt.	BB+
Hungarian State	BB+
Regional governments and local municipalities	
Cece Village Municipality	BB+
Jánoshalma Town Municipality	BB+
Szeged Municipality	BB+
Pécs City Municipality	BB+
Gádoros Village Municipality	BB+
Lakitelek Village Municipality	BB+
Nagyatád Municipality	BB+
Institutions	
ABN AMRO Bank	A+
Agrár-Vállalkozási Hitelgarancia Alapítvány	BB+
Bank of Valletta	BBB+
Garantiqa Hitelgarancia Zrt.	BB+
OTP Bank	BB
Royal Bank of Scotland	BBB+
UniCredit Bank Hungary Zrt.	BB+

38*. Table*: Name and rating of guarantors by exposure class

Information on concentrations arising in the course of credit risk mitigation

In this chapter the concentration of credit protection is presented in respect of the types of collateral most often accepted by the Bank for the mitigation of credit risk. As the collaterals pledged to the leasing group represent an insignificant part of the total collateral portfolio, in this document we only disclose the information on the concentration of collaterals accepted to secure loan transactions.

Type of Collateral	Total book value HUF million
State Guarantee	12 214
Bank Guarantee	30 684
State Surety	95 237
Other Surety	325 181
Cash	52 705
Mortgages	1 971 440
Lien on Movables	493 129
Other Mortgages	589 343
Other	46 640
Total	3 616 574

39*. Table*: Total book value of collaterals by type (K&H Bank)

Guarantees, unconditional surety guarantees

Guarantees and unconditional (first-loss) surety guarantees make up 12,8% of the total collateral portfolio. Within this category, other unconditional surety guarantees are the most dominant (9%), unconditional surety guarantees from the central budget represent 2,5%, while state and bank guarantees account for 0,3% and 0,8%. KBC guarantees make up three-fourths of the bank guarantee portfolio.

Mortgages

Mortgages on real estate show significant concentration in both the retail and non-retail portfolios. They account for 81% of the total collateral portfolio at book value. Within mortgages, residential properties make up 51%, commercial properties represent 30%, and other properties account for 1,3%. Most residential properties pledged as collateral are related to retail mortgage-backed transactions (97%), and only the remaining 3% are linked to non-retail transactions.

Collateral deposits

Collateral deposits make up 1,5% of the total collateral portfolio.

Internal Rating Based (IRB) models (CRR Article 452)

The Bank back-tests and reviews its internal rating systems on an annual basis. The processes of developing, testing and authorising new models are governed by KBC group-level guidelines and methodologies. A substantial part of the models was designed by statistical modelling, using the internal data of the Bank, while in the case of segments where fewer observations were available (for example: Country risk PD model, Project Financing PD model) KBC Group level models were introduced.

The Bank determines the default probability of the exposures on product level in the retail segment and on client level in the rest of the segments. The table below presents the IRB systems, broken down by exposure class, applied by the Bank:

Exposure class	Rating model
Central governments and central banks	Country risk model
Credit institutions, investment undertakings	Bank PD model
Corporates	Corporate PD model
	Large SME PD model
	Small SME PD model
	SME behaviour model
	Municipalities PD model
	Commercial Real Estate Project PD model
	Project Financing PD model
	MBO/LBO PD model
	Others
Retail	Behavioural PD model and PD pooling model

40. **Table***:* Rating models

The Bank performs the rating of its retail transactions using behavioural scorecards. The behaviour points belonging to the specific transactions are computed automatically in the data warehouse of the Bank, and serve as a basis for the allocation of the exposure to the appropriate risk pools. In the non-retail segments the client rating is established in the course of the credit approval process and the annual reviews. The Bank has a sophisticated automated process in place to identify transactions in default, which ensures that these exposures are assigned to the appropriate risk category. In the case of non-retail exposures the Bank measures the expected default probability on a standardised rating scale.

PD rating	Default probability 1-year time span
1	0.00% - 0.10%
2	0.11% - 0.20%
3	0.21% - 0.40%
4	0.41% - 0.80%
5	0.81% - 1.60%
6	1.61% - 3.20%
7	3.21% - 6.40%
8	6.41% - 12.80%
9	12.81% - 100%
10	exposures in default
11	
12	

41. **Table**: *KBC master scale for rating non-retail clients*

In the retail segment the loss given default (LGD) rate was determined by product type and in proportion to the coverage rate. During the calculation of exposure at default, in addition to the application of an internal credit conversion factor (CCF) the Bank makes an additional adjustment to estimate the increase in the exposure of FX-based loans that might result from exchange rate changes.

PD	Exposure HUF mln	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
01 [0,00% - 0,10%*]	EAD	158 787	499	0	3 000	0	0	162 286
	RWA	52 720	131	0	391	0	0	53 243
	Weighted Average	33%	26%	0%	13%	0%	0%	33%
02 [0,10% - 0,20%*]	EAD	43 909	19 177	6	4 290	103 728	71 818	242 928
	RWA	20 411	6 724	2	742	6 004	52 018	85 901
	Weighted Average	46%	35%	33%	17%	6%	72%	35%
03 [0,20% - 0,40%*]	EAD	1 855	42 622	13 216	12 256	67 886	69 996	207 831
	RWA	1 969	21 051	639	4 821	7 019	47 808	83 307
	Weighted Average	106%	49%	5%	39%	10%	68%	40%
04 [0,40% - 0,80%*]	EAD	1 550	114 418	3 393	7 653	71 433	115 983	314 430
	RWA	1 424	72 256	2 498	4 059	14 968	96 584	191 789
	Weighted Average	92%	63%	74%	53%	21%	83%	61%
05 [0,80% - 1,60%*]	EAD	578	122 158	2 516	11 261	79 785	139 089	355 387
	RWA	854	96 661	2 797	8 969	32 432	138 111	279 823
	Weighted Average	148%	79%	111%	80%	41%	99%	79%
06 [1,60% - 3,20%*]	EAD	389	81 162	366	6 532	24 125	49 478	162 052
	RWA	690	69 920	19	5 828	15 183	50 634	142 274
	Weighted Average	177%	86%	5%	89%	63%	102%	88%
07 [3,20% - 6,40%*]	EAD	797	54 067	566	10 698	18 988	15 868	100 983
	RWA	1 641	57 363	1 373	10 116	16 626	18 528	105 647
	Weighted Average	206%	106%	243%	95%	88%	117%	105%
08 [6,40% - 12,80%*]	EAD	11	15 956	0	1 232	14 206	2 779	34 185
	RWA	27	21 332	1	1 314	18 172	3 875	44 720
	Weighted Average	249%	134%	232%	107%	128%	139%	131%
09 [12,80% - 100,00%*]	EAD	0	9 451	0	1 949	30 743	4 464	46 607
	RWA	0	14 789	0	3 222	48 267	11 808	78 087
	Weighted Average	0%	156%	0%	165%	157%	265%	168%
Total gross exposure [EAD]		207 874	459 509	20 064	58 871	410 893	469 477	1 626 688
Total risk-weighted assets		79 736	360 227	7 329	39 462	158 672	419 367	1 064 792
Total weighted average		38%	78%	37%	67%	39%	89%	65%

42. **Table*: Average weight of the IRB portfolio broken down by PD pool (K&H Bank)***

PD	Exposure HUF mln	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
01 [0,00% - 0,10%*]	EAD	492 524	853	0	3 000	0	0	496 377
	RWA	40 027	186	0	391	0	0	40 604
	Weighted Average	8%	22%	0%	13%	0%	0%	8%
02 [0,10% - 0,20%*]	EAD	120 773	19 212	6	4 290	103 728	32 154	280 163
	RWA	31 422	6 888	2	742	6 004	14 510	59 567
	Weighted Average	26%	36%	35%	17%	6%	45%	21%
03 [0,20% - 0,40%*]	EAD	1 855	42 383	11 142	12 256	67 886	65 509	201 030
	RWA	1 958	21 085	252	4 821	7 019	46 286	81 422
	Weighted Average	106%	50%	2%	39%	10%	71%	41%
04 [0,40% - 0,80%*]	EAD	1 549	114 340	3 393	7 653	71 433	112 678	311 046
	RWA	1 461	72 149	2 532	4 059	14 968	92 854	188 022
	Weighted Average	94%	63%	75%	53%	21%	82%	60%
05 [0,80% - 1,60%*]	EAD	578	122 162	1 422	11 261	79 785	111 123	326 331
	RWA	888	96 436	1 734	8 969	32 432	115 540	255 998
	Weighted Average	154%	79%	122%	80%	41%	104%	78%
06 [1,60% - 3,20%*]	EAD	389	81 087	366	6 532	24 125	68 408	180 907
	RWA	668	69 681	19	5 828	15 183	66 762	158 141
	Weighted Average	172%	86%	5%	89%	63%	98%	87%
07 [3,20% - 6,40%*]	EAD	797	54 064	566	10 698	20 034	15 868	102 027
	RWA	1 505	57 292	1 373	10 116	16 768	18 486	105 541
	Weighted Average	189%	106%	243%	95%	84%	116%	103%
08 [6,40% - 12,80%*]	EAD	11	15 956	0	1 232	14 206	2 779	34 185
	RWA	26	21 260	1	1 314	18 172	3 926	44 700
	Weighted Average	245%	133%	225%	107%	128%	141%	131%
09 [12,80% - 100,00%*]	EAD	0	9 451	0	1 949	30 743	4 464	46 607
	RWA	0	14 328	0	3 222	48 267	11 615	77 433
	Weighted Average	0%	152%	0%	165%	157%	260%	166%
Total gross exposure [EAD]		618 475	459 509	16 895	58 871	411 939	412 985	1 978 674
Total risk-weighted assets		77 954	359 304	5 913	39 462	158 814	369 979	1 011 427
Total weighted average		13%	78%	35%	67%	39%	90%	51%

43**. Table**: **Average weight of the IRB portfolio broken down by PD pool (K&H Group)**

	PD rating	1	2	3	4	5	6	7	8	9	Total
Corporates	EAD	0	71 818	69 996	115 983	139 089	49 478	15 868	2 779	0	**465 012,8**
	Outstanding amount	0	46 015	39 320	74 296	71 754	39 782	13 834	2 387	0	**287 389**
	Undrawn amount	0	25 803	30 676	41 688	67 335	9 696	2 034	392	0	**177 624**
	Average CCF - %	0,0%	73,5%	72,2%	81,1%	88,6%	91,0%	92,2%	99,8%	0,0%	**82,4%**
	Average LGD - %	0,0%	59,6%	52,6%	51,6%	47,3%	33,1%	34,7%	33,4%	0,0%	**49,0%**
Institutions	EAD	158 787	43 909	1 855	1 550	578	389	797	11	0	**207 874,5**
	Outstanding amount	125 723	9 594	1 417	167	540	184	600	0	0	**138 225**
	Undrawn amount	33 064	34 315	438	1 383	38	205	197	11	0	**69 650**
	Average CCF - %	88,1%	47,5%	92,0%	97,8%	100,5%	100,3%	98,7%	100,0%	0,0%	**79,7%**
	Average LGD - %	58,5%	63,9%	59,5%	55,9%	64,4%	63,6%	62,6%	62,7%	0,0%	**59,6%**
SME	EAD	499	19 177	42 622	114 418	122 158	81 162	54 067	15 956	9 451	**459 509,0**
	Outstanding amount	405	12 060	28 955	91 174	104 536	70 940	48 532	14 792	8 771	**380 164**
	Undrawn amount	94	7 117	13 667	23 243	17 622	10 222	5 535	1 164	680	**79 345**
	Average CCF - %	99,7%	80,6%	84,3%	87,9%	92,0%	92,0%	94,4%	96,9%	96,9%	**90,4%**
	Average LGD - %	59,3%	54,3%	51,4%	45,7%	44,9%	43,0%	45,9%	47,6%	44,6%	**46,0%**
Retail Mortgages	EAD	0	103 728	67 886	71 433	79 785	24 125	18 988	14 206	30 743	**410 892,6**
	Outstanding amount	0	103 728	67 886	71 433	79 785	24 125	18 988	14 206	30 743	**410 893**
	Undrawn amount	0	0	0	0	0	0	0	0	0	**0**
	Average CCF - %	0,0%	100,2%	100,0%	101,4%	100,7%	101,9%	101,9%	102,0%	102,0%	**100,8%**
	Average LGD - %	0,0%	20,8%	21,2%	24,0%	23,9%	25,6%	26,9%	26,2%	26,8%	**23,2%**
Retail Other	EAD	3 000	4 290	12 256	7 653	11 261	6 532	10 698	1 232	1 949	**58 871,3**
	Outstanding amount	869	1 449	10 958	1 536	5 418	5 290	10 046	1 133	1 871	**38 571**
	Undrawn amount	2 131	2 841	1 298	6 117	5 842	1 242	651	99	79	**20 300**
	Average CCF - %	105,0%	105,5%	104,1%	103,5%	100,8%	108,0%	103,5%	107,6%	121,9%	**104,5%**
	Average LGD - %	58,5%	57,4%	60,1%	58,4%	70,3%	62,7%	59,6%	63,4%	67,4%	**62,1%**
Sovereign	EAD	18 211	6	13 216	3 393	2 516	366	566	0	0	**38 274,6**
	Outstanding amount	18 211	0	13 204	3 319	2 482	366	561	0	0	**38 144**
	Undrawn amount	0	6	12	74	34	0	5	0	0	**130**
	Average CCF - %	100,0%	97,6%	99,9%	97,8%	98,6%	116,2%	100,0%	97,6%	0,0%	**99,8%**
	Average LGD - %	0,0%	50,1%	3,1%	42,0%	46,4%	2,2%	59,0%	58,4%	0,0%	**8,7%**

44. **Table**: **Average LGD and CCF of the IRB portfolio (K&H Bank) (CRR Article 452 (e))**

	PD rating	1	2	3	4	5	6	7	8	9	Total
Corporates	EAD	0	32 154	65 509	112 678	111 123	68 408	15 868	2 779	4 464	**412 984,6**
	Outstanding amount	0	11 296	35 448	71 341	69 283	58 712	13 834	2 387	4 277	**266 579**
	Undrawn amount	0	20 858	30 061	41 338	41 841	9 696	2 034	392	187	**146 406**
	Average CCF - %	0,0%	58,6%	71,0%	80,9%	88,8%	93,5%	92,2%	99,8%	100,3%	**82,6%**
	Average LGD - %	0,0%	58,1%	52,6%	51,8%	47,4%	36,4%	34,7%	33,4%	55,8%	**47,9%**
Institutions	EAD	492 524	120 773	1 855	1 549	578	389	797	11	0	**618 475,0**
	Outstanding amount	490 906	9 845	1 417	166	540	184	600	0	0	**503 659**
	Undrawn amount	1 617	110 928	438	1 383	38	205	197	11	0	**114 816**
	Average CCF - %	99,9%	64,5%	92,0%	97,8%	100,5%	100,3%	98,7%	100,0%	0,0%	**93,0%**
	Average LGD - %	45,1%	51,8%	59,5%	55,9%	64,4%	63,6%	62,6%	62,7%	0,0%	**46,6%**
SME	EAD	853	19 212	42 383	114 340	122 162	81 087	54 064	15 956	9 451	**459 509,0**
	Outstanding amount	740	11 952	28 795	91 149	104 563	70 874	48 530	14 792	8 771	**380 164**
	Undrawn amount	113	7 260	13 589	23 191	17 599	10 213	5 534	1 164	680	**79 345**
	Average CCF - %	99,6%	80,3%	84,4%	87,9%	92,0%	92,0%	94,4%	96,9%	96,9%	**90,4%**
	Average LGD - %	52,7%	54,7%	51,3%	45,7%	44,9%	43,0%	45,9%	47,6%	44,6%	**46,0%**
Retail Mortgages	EAD	0	103 728	67 886	71 433	79 785	24 125	20 034	14 206	30 743	**411 939,0**
	Outstanding amount	0	103 728	67 886	71 433	79 785	24 125	20 034	14 206	30 743	**411 939**
	Undrawn amount	0	0	0	0	0	0	0	0	0	**0**
	Average CCF - %	0,0%	100,2%	100,0%	101,4%	100,7%	101,9%	101,8%	102,0%	102,0%	**100,8%**
	Average LGD - %	0,0%	20,8%	21,2%	24,0%	23,9%	25,6%	27,8%	26,2%	26,8%	**23,3%**
Retail Other	EAD	3 000	4 290	12 256	7 653	11 261	6 532	10 698	1 232	1 949	**58 871,3**
	Outstanding amount	869	1 449	10 958	1 536	5 418	5 290	10 046	1 133	1 871	**38 571**
	Undrawn amount	2 131	2 841	1 298	6 117	5 842	1 242	651	99	79	**20 300**
	Average CCF - %	105,0%	105,5%	104,1%	103,5%	100,8%	108,0%	103,5%	107,6%	121,9%	**104,5%**
	Average LGD - %	58,5%	57,4%	60,1%	58,4%	70,3%	62,7%	59,6%	63,4%	67,4%	**62,1%**
Sovereign	EAD	952 347	6	11 142	3 393	1 422	366	566	0	0	**969 242,6**
	Outstanding amount	924 387	0	11 130	3 319	1 388	366	561	0	0	**941 151**
	Undrawn amount	27 961	6	12	74	34	0	5	0	0	**28 091**
	Average CCF - %	100,0%	97,6%	99,9%	97,8%	97,6%	116,2%	100,0%	97,6%	0,0%	**100,0%**
	Average LGD - %	0,0%	50,1%	-18,6%	42,0%	47,5%	2,2%	59,0%	58,4%	0,0%	**0,0%**

45. **Table***:* **Average LGD and CCF of the IRB portfolio (K&H Group) (CRR Article 452 (e))**

Use of the rating models in internal processes – use test (CRR Article 452 (b))

Beyond the calculation of the capital requirement of the Bank, IRB parameter estimates are integrated in the following processes and procedures:

- determination of the credit approval authority
- credit-related decision, capital allocation
- provisioning
- portfolio monitoring
- portfolio limits
- pricing
- credit risk stress test

Trading risk (CRR Article 445)

Trading risks are managed centrally in the KBC Group. The development of models, measurement of the risk position, monitoring and reporting are all performed centrally, thus eliminating the duplication of the tasks on local level.

The trading risk manager of K&H is responsible for the following:

- analysing limit overruns and stress tests
- conducting parameter reviews
- following up on counterparty limits and tasks related to operational risks
- supporting local internal and external data supply

The primary "formal" tool used for the identification and recognition of risks related to trading operations is the New and Active Product Procedure (NAPP). A business proposal is required to be submitted for each new product, which analyses the material risks and describes the method of their management. (= measuring, mitigating, monitoring and reporting).

Several units of measurement are applied for capturing the market risk arising from trading operations, for example:

- Value at risk (VaR)
- Economic Capital (ICM)
- Basis point value(BPV)
- Concentrations
- Nominal position limits

For the purpose of managing and monitoring the market risk attached to the trading portfolio, the Bank applies the VaR methodology. The KBC Group selected the historical VaR (hVaR) method for measuring, managing and monitoring the market risk arising from the trading book. The hVaR method currently applied by KBC includes the following factors: 10-day position holding period and a 99% unilateral confidence level, calculated for a 500-day unweighted observation period.

In addition to the above, the Bank conducts several stress tests for the evaluation of the potential impact of a specific stress event and/or a "volatile" movement in the set of financial variables on its positions. Although K&H applies the KBC Group level scenarios to analyse the stress tests, it also developed local scenarios which provide a better view of the past and presumed Hungarian developments.

Besides making hVaR calculations and carrying out stress tests, K&H also monitors the risk concentrations through the secondary limits, such as the FX concentration limits for putting a cap on the exchange rate risk inherent in a specific FX position and the basis point value (BPV) limits for the interest rate risk. The BPV limits are set by foreign currency and periods.

KBC applies the combination of several limits for monitoring market risk, including the market risk arising from the trading activities of K&H (often in a hierarchy, whereby each sub-segment has its own limit).

- The framework system provides a clear and unambiguous description:
  - on the risk limits and the calculation of their utilisation rate,
  - on the scope of authority and responsibility of the various actors involved, as well as on their cooperation.

K&H monitors the hVaR global limit in respect of the entirety of its trading operations, and the periodic BVP limits, broken down by foreign currency in respect of its interest rate risk position. In addition, it also applies nominal limits relating to activities not falling within the scope of the hVaR limits.

The K&H Market and Liquidity Risk Department forwards an abstract of the available trading exposure data to the local dealers, the head of the Market Directorate by eRIS on a daily basis. The local Executive Committee (Integrated Risk Report) and the Board of Directors are kept informed on the limit utilisation rates in the form of a monthly and quarterly report, respectively. The Audit Committee also receives quarterly information regarding the key market risk indicators and issues.

The Bank applies the *standardised approach* for calculating the capital requirement of its exposures in the trading book. The Bank calculates the capital requirement of bonds and other securities, as well as for deposits and derivative transactions for the local regulator (MNB) on a daily basis. In addition, the capital requirement related to the exchange rate risk and commodities exposures is also calculated and reported daily.

Furthermore, in line with the *standardised approach* the Bank prepares a monthly supplementary report to the MNB showing the capital requirement of exposures from its bond and share positions as well as of the exchange rate risk and commodities risk. The following table presents the capital requirement of the market risks run by the K&H Group.

Capital requirement of market risk		
Risks	**Position value (HUF million)**	**Capital requirement (HUF million)**
Exposure to bond positions	59 799	1 490
Exposure to shares and investment risk	549	57
Exchange rate risk	1 156	93
Commodities exchange rate risk	0	0
TOTAL	**61 504**	**1 640**

46*. Table*: Capital requirements of market risks

The Bank also reports its exposure to high risk counterparties to the Supervision on a quarterly basis a (banking and trading books combined).

Operational risk (CRR Article 446)

At K&H the definition of operational risk comprises the risk of fraud as well as the legal and compliance risks, but excludes strategic and systemic risks. K&H also takes into consideration the reputation risk to a certain level: when assessing the vulnerability of K&H to operational risk events, the impact of various incidents on the reputation of K&H is also taken into account.

The ”*KBC Group Operational Risk Management Framework”* covers the management of operational risks end-to-end, from the identification of the risk up to its reporting. KBC Group implemented a uniform set of tools for applying the processes, risk event types and the methods for mitigating/measuring operational risks. For the purpose of reporting, processes and risk event types are used jointly as a common and general/uniform framework of reference. Risk mitigating controls comprise the processes for the proper separation of tasks and responsibilities, access management, reconciliation and monitoring. The tools currently applied for the management of operational risks were designed to cover the entire spectrum of expected, unexpected and even catastrophic loss events.

The following tools are used for the recognition and identification of the operational risks run by KBC Group entities:

Global Risk Surveys (GRS): GRS is a top-down, scenario-based questionnaire for the senior management to report the major issues that may give reason for concern as well as the existing operational and business risks. It is required to be completed once a year.

Risk Self-Assessment (RSA): These bottom-up assessments focus on the actual (residual) main operational risks posed by critical points, key products, processes and systems, which have not been properly mitigated as yet.

RSAs are forward-looking and allow the Bank to take into account future developments and events. Division heads and the *operational risk managers of the divisions (*LORM) are obliged to plan RSAs for a period of 3 years, using the process definitions of the relevant business area and their own professional experience.

Case Study Assessment (CSA): This assessment was designed to test and evaluation the level of defence against grave operational risk events – which actually occurred in the banking or insurance sector – ensured by the current regulatory environment.

Group key controls

These are the key principles for the uniform management of group-level key risks, and the regulation and mitigation of the material risks inherent in processes defined on KBC Group level. Group Key Controls ensure that significant operational risks are managed in a uniform manner throughout the entire group.

The following tools are applied for the purpose of measuring the operational risks of KBC Group entities:

Loss Event Database (LED): Since 2004 the KBC Group records each operational loss amounting to, or exceeding EUR 1,000 in a central database. The same database contains the legal claims filed against the Group entities. K&H adopted a decision to report each and every loss event to the central database, regardless of its amount.

Key Risk Indicators (KRIs): KRIs are metrics or indicators for monitoring exposure to a loss or other potential event. KRIs may pertain to the entire organisation or only a part thereof. The purpose of the KRIs is to combine the measurement of risk with the current risk management by way of a pragmatic approach allowing prompt application of the measures to the business area. The main KRIs are reported to the CROC.

At present there are no compulsory limits for operational risks, although certain risk limits have been set in respect of the Key Risk Indicators.

Internal risk reporting

The Capital and Risk Oversight Committee is responsible for monitoring the operational risk management framework in general. Their reporting obligation includes, without limitation, the following:
- developing and maintaining the proper regulation of operational risks
- reliability of operational risk management data – from financial and non-financial aspects – reported and/or identified within the organisation
- compliance with statutory, internal and external regulations
- allocating resources for the management of operational risks
- systematic review of all material operational risk related to loss events which occurred at K&H

The minutes taken at the meetings of the Operational Risk Committee are forwarded to the CROC.

External risk reporting

K&H regularly prepares reports and memoranda for the risk management of KBC Group presenting the developments in the main operational risks, internal controls and risk management processes of the K&H Group.

The (consolidated) capital requirement for operational risks is reported to KBC VRM in March each year. In the scope of the statutory reports to the Supervision, K&H regularly advises the MNB of the methodology of operational risk management and the changes therein. A periodical (quarterly) report is also submitted to the MNB on the capital requirement of operational risks.

In 2002 the KBC decided to manage its operational risks and calculate the capital requirement of operational risks according to the *standardised approach (*TSA) specified in Basel II. KBC Group seeks to focus on the actual (quality) management of operational risks rather than to optimise the capital requirement of operational risks using an internal financial/risk model.
Nevertheless – as it was discussed from the previous chapters – KBC applies the very same stringent standards as required under the *Advanced Measurement Approach (*AMA).

K&H has applied the *Standardised approach* since 1 January 2008.

According to the *Standardised approach* the total capital requirement of operational risks equals the simple aggregate of the capital requirements calculated by business line as defined in the Basel principles. The own funds requirement of the various business lines is calculated by multiplying the average of the eligible gross operating profit over three years with a *"beta factor"* assigned by the Capital Requirement Directive to the respective business line.

Operational risk capital requirement (HUF million)	K&H Bank	K&H Group
Standardised approach	21 723	20 094

47*. Table*: Capital requirement of operational risks

ALM risk (CRR Article 448)

The primary official tool of risk identification and recognition is the compulsory New and Active Product Procedure (NAPP). This Group standard was designed to ensure that the organisation is ready and able to handle the new products and that all legal, taxation, compliance, accounting, risk management etc. issues are properly addressed before we undertake positions in new products. Since 2009 active products also need to be re-negotiated in the scope of the NAPP in line with their review date.

Basis point value

One of the specific units of measurements used in connection with interest rate risks is the basis point value (BPV). BPV denotes the change in the actual value upon a 10 basis point (i.e., 0.10%) parallel movement in the interest rate curve. The BPV allows the CROC to assess our existing positions as the direction of the risk is known. In addition, the BPVs are easy to aggregate. The impact of non-parallel shifts on the economic value is also calculated and monitored on a monthly basis.

Interest rate gaps

The interest rate gap is used as a supplementary technique for measuring interest rate risks, and is reported periodically. This is one of the fundamental methods for assessing interest rate sensitivity. A positive cumulative gap position shows the net surplus of the assets to be re-priced in a given period. Having a positive cumulative gap, the Bank can increase the net interest margin when the interest rate curve is rising.

ICM ALM

ICM ALM measures the impact of very severe events on the Available Capital under Pillar 1 through the Group level ICM model. Only the impact on available capital is measured in the ICM.
The ICM model is based on shifts which measure the impact of certain market risks in accordance with going concern principle and accounting logic

Net interest income (NII) sensitivity

By regularly calculating the change in the net interest income with the help of various scenarios, the Bank can analyse its re-pricing risk profile and keep track of the changes in the risk profile.

Scenario analysis and stress tests

With the view to measuring the ALM risks the KBC Group is exposed to, we conduct scenario analyses and stress tests both on individual risk factors and the comprehensive ALM risk factors. The following BPV tables present the year-end results of the stress test carried out on the economic value of the banking book. For the stress test, we used the scenario of 10, 100 and 200 basis point parallel shifts in the yield curve. An internal limit was implemented to put a cap on the BVP of the banking book.

Currency		BPV in HUF mln
	10bp parallel **UP** scenario	10bp parallel **DOWN** scenario
CHF	0	0
EUR	88	-88
HUF	-1 155	1 164
USD	-5	5
Total	-1 073	1 082
	100bp parallel **UP** scenario	100bp parallel **DOWN** scenario
CHF	-2	2
EUR	851	-909
HUF	-11 145	12 080
USD	-49	54
Total	-10 345	11 226
	200bp parallel **UP** scenario	200bp parallel **DOWN** scenario
CHF	-4	4
EUR	1 649	-1 884
HUF	-21 440	25 189
USD	-94	112
Total	-19 888	23 421

48*. Table*: Stress test results of the banking book positions

As K&H is an entity of the KBC Group, it has an ALM activity risk limit system, comprising a hierarchy of multiple limits. The limit system is reviewed by K&H on an annual basis to ensure that it remains updated.
As a substantial part of ALM is covered by interest rate risks in the K&H Group, the tolerance variance for BPV is narrow. The interest rate risk is also measured by way of conducting scenario analyses on the net interest income (see above). The banking book was characterised by an increasing exposure to interest rate risks due to early adoption of the maturity of transformation model. During the year the BPV limit was raised.

Both the Board of Directors and the Audit Committee of K&H receive information on the main ALM risk indicators and the utilisation of the limit on a quarterly basis.
The primary objective of the Asset and Liability Management of KBC and K&H is to create economic value. In the process of value creation, the role of ALM is restricted to providing market-compatible pricing of ALM risks to the business units (transfer pricing) to allow them to make well-informed pricing decisions. In addition, the ALM needs to set (i.e., to optimise) the appropriate risk/income profiles.

Due to No. 680/2014 Regulation (EU), the encumbered assets for K&H Bank are mainly driven by refinancing loans from EIB, and MNB LFG program.

Assets and collateral have been determined as encumbered with consistent with the definition provided in the EBA Guidelines on the Disclosure of Encumbered assets (EBA GL/2014/03), assets are considered encumbered when they have been pledged or used to secure, collateralise or credit enhance a transaction which impacts their transferability and free use. Asset encumbrance is integral to K&H Bank business and funding models which, over time, have increased as a result of participation on MNB LFG programs.

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of non-encumbered assets	Fair value of non-encumbered assets
Assets of the reporting institution	0	0	2 625 123 216	2 625 123 216
Equity instruments	220 715 086 935	239 319 062 349	489 246 466 877	517 697 573 685
Debt securities	0		170 510 842 052	
Other assets	0		0	

49*. Table*: Encumbered Assets (values in HUF)

	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Collateral received by the reporting institution	0	199 732 335 810
Equity instruments	0	0
Debt securities	0	176 135 708 962
Other collateral received	0	0
Own debt securities issued other than own covered bonds or ABSs	0	0

50*. Table*: Received Collateral (values in HUF)

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	235 595 222 788	229 051 698 438

51*. Table*: Liabilities due to encumbered assets and received collateral (values in HUF)

Liquidity risk

The prime objective of KBC liquidity management is to be capable of financing the group on the one hand, and to make the generation of income from the main business activities of the group possible, even under unfavourable conditions.

In the KBC Group – and consequently, at K&H as well – the liquidity risk management system covers the liquidity financing risk, and not the market liquidity risk. In the second half of 2009 a more sophisticated liquidity framework system was implemented based on the following pillars:

- operational liquidity risk management
- structural liquidity risk management
- liquidity reserve risk management

Operational liquidity risk

Operational liquidity is measured with (5, 30 and 90-day) liquidity gap. K&H is required to cover the entirety of the liquidity gap with highly liquid intra-day security.

Structural liquidity risk

The Bank manages structural liquidity through the loan-to-deposit ratio (LTD), the balance sheet coverage ratio, the deposit coverage ratio, the foreign currency financing ratio, the net stable financing ratio and the liquidity coverage ratio, serving as a common benchmark to assess liquidity.

Liquidity reserve risk

The group uses a number of liquidity stress scenarios to measure liquidity reserve risk. Stress tests are conducted with the aim of measuring the changes in the liquidity buffer of K&H Group in stress situations. The liquidity buffer is calculated for each and every scenario: this will be the liquidity surplus for the relevant time periods. In fact, there are two different types of the stress test: the general market scenario and the KBC/K&H-specific scenarios. K&H would remain a going concern for the internally defined survival period under either of the two scenarios.

The majority of the above mentioned measurements are subject to the limits set by KBC. The liquidity thresholds applicable to the various subsidiaries are governed by the KBC liquidity risk management guidelines. Nevertheless, K&H has additional local limits in place, which boosts the security of the group. It is important to note that the management of these local limits is the responsibility of the local treasury and local liquidity risk units.

In addition to the periodical follow-up on the above measurements and limits, the local ALM risk management also takes into account the liquidity risk during the analysis of other business developments and trading operations. It is important to note that the local ALM risk management is not authorised to make a decision regarding any steps of the liquidity risk management process autonomously, it merely provides advice to the local CROC concerning the implementation of an appropriate framework e.g., in respect to the acceptable risk level, etc.

The local liquidity report on monitoring the operational liquidity limit is submitted daily to the Treasury by Risk Management (ALM department). The Controlling Department reports the changes in the loan to deposit ratio (LTD) on a monthly basis. Risk Management submits a monthly report (in the Integrated Risk Report) to the Executive Committee, presenting the changes in the operational liquidity and a summary of all measures related to liquidity. The liquidity stress test scenarios are calculated by KBC based on the information provided by the local risk management. The results are also submitted to the Audit Committee on a quarterly basis.

If the report on the liquidity risk shows e.g., an overrun of the operational liquidity risk limits or a deterioration in the long term liquidity position, the (internal) stakeholders (i.e., the committees receiving this information) are responsible for making the decision on the eventual corrective measures to be taken.

Chapter IV – Remuneration policy

K&H publishes the remuneration policy applicable to all organisational units and employees of the Bank, and the employees of the subsidiaries K&H Csoportszolgáltató Kft., K&H Befektetési Alapkezelő Zrt. and K&H Faktor Zrt. on its web site (www.kh.hu).

A detailed description of the decision making process used to define the remuneration policy can be found in Chapter 5.2 of the referenced regulation. The most important features of the remuneration system (including information on the requirements related to performance measurement and identification of the relevant risk, on the deferral policy and remuneration eligibilities), the information about the relation between performance and performance remuneration, and the performance-related criteria which the eligibility for phantom shares, the variable part of remuneration and options is based on can be found in chapters 2.1–4.6. The characteristics and conditions of performance remuneration and other non-cash remuneration can be found in Chapter 1.

The following tables show all quantitative information about 2016 remunerations.

Breakdown by division of gross wage and bonus payments, with cafeteria benefits for 2016	
Division	**Gross wages, cafeteria, bonus (HUF mln)**
Retail Banking Division	1 849
Retail Banking Division - network	7 881
Business Banking Division	1 618
Business Banking Division - network	1 584
Chief Executive Officer	726
CRO Services Division	466
Change Management Division	494
Finance Division	1 568
Operation, Technologies and Retail Credit Management Division	4 998
Other	0
K&H Bank Zrt. Total	**21 185**
K&H Service Center	703
K&H Mortgage Bank	9
K&H Factor	83
K&H Asst management	289
K&H Bank Group Total	**22 270**

52. **Table**: **Gross remuneration in 2016**

Remuneration of persons in management position in 2016	
Number of persons receiving remuneration	7 persons
Fixed remuneration (HUF mln)	379,1
Performance based remuneration (HUF mln)	99,1
Of which cash (HUF mln)	50,9
Of which phantom stock (HUF mln)	48,2
Payments related to new employment contracts (0 item, HUF mln)	0 pcs, n/a

53. Table: Remuneration of persons in management position (K&H Group)

Deferred remuneration of persons in management position in 2016 (HUF mln)	
Deferred, already entitled (phantom stock):	22,1
Deferred, not yet entitled:	44,2
Deferred remuneration granted in 2015 paid out and performance-adjusted:	28,8

54. Table: Deferred remuneration of persons in management position (K&H Group)

Members of the management body are selected by the Nomination Committee based on the following criteria:

- identification of the roles and skills required for membership in the given management body,
- assessment of the coherence between the knowledge, skills and experience levels of management body members,
- specifying the gender ratio within the management body and develop the necessary strategy to achieve the appropriate ratio (at KBC level institutions are obliged to publish their gender ratios, their strategy developed to achieve those ratios and the method of implementing that strategy).

2 members of the management body hold membership on the Board of Directors.

Chapter V – Appendix

List of abbreviations

BCBS	*Basel Committee of Banking Supervision*
CRD	*Capital Requirements Directive*
MNB	*the Central Bank of Hungary*
SREP	*Supervisory Review and Evaluation Process*
ICM	*Internal Capital Model*
ICAAP	*Internal Capital Adequacy Assessment Process*
RWA	*Risk Weighted Assets*
IFRS	*International Financial Reporting Standards*
HAS	*Hungarian Accounting Standards*
HPT	Credit Institutions and Financial Enterprises Act (Act CXII of *1996)*
STA	*Standardized Approach (credit risk)*
IRB	*Internal Ratings Based approach (credit risk)*
FIRB	*Foundation IRB approach (credit risk)*
AIRB	*Advanced IRB approach (credit risk)*
SMA	*Standardized Measurement Approach (market risk)*
IMA	*Internal Models Approach (market risk)*
BIA	*Basic Indicators Approach (operational risk)*
TSA	*Standardized Approach (operational risk)*
ASA	*Alternative Standardized Approach (operational risk)*
AMA	*Advanced Measurement Approach (operational risk)*
PD	*Probability of Default*
EAD	*Exposure at Default*
LGD	*Loss Given Default*
RAROC	*Risk-adjusted Return on Capital*
ERM	*Enterprise-wide Risk Management*
MC IM	*Management Committee International Markets*
CT	*Country Team*
BoD	*Board of Directors*
EXCO	*Executive Committee*
CROC	*Capital and Risk Oversight Committee*
CRC	*Credit Risk Council*
TRC	*Trading Risk Council*
ORC	*Operational Risk Council*
VRM	*Value and Risk Management*
ARC	*Audit Committee*
CRO	*Chief Risk Officer*
RC	*Remuneration Committee*
CrisCo	*Crisis Committee*
NAPP	*New and Active Products Process*
RCC	*Retail Credit Committee*
RPC	*Retail Product Committee*
RCs	*Retail Committees*
NCC	*National Credit Committee*
NCsC	*National Credit Sub-Committee*
CIC	*Corporate Institutional Committee*

Shares

Values in HUF million	Direct at net value	Indirect	PIBB	Regulatory Capital adjustment due to PIBB	Net value of all investments
credit institution	3 500		3 500		3 500
financial company	1 990		1 990		1 990
insurance cmpany					
other domestic company	5 766				5 766
foreign financial company	918		918		918
foreign insurance company					
other foreign company					
Összesen	12 174	0	6 408	0	12 174

55. **Table**: **K&H Bank shares CRR Article 447**

Detailed breakdown of K&H Bank's loan portfolio

Maturity (Values in HUF million)	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
<1 year	202 696	127 584	293 432	23 633	50 659	180 324	**878 329**
=>1 to <5 year	70 310	197 825	274 473	18 398	20 559	233 165	**814 729**
=>5 to <10 year	14 974	96 917	340 562	5 309	130 989	74 269	**663 020**
=>10 year	34 235	146 669	65 401	14 108	304 017	168 375	**732 804**
Total	**322 214**	**568 995**	**973 868**	**61 448**	**506 223**	**656 133**	**3 088 882**

***56*. Table*:** Lending portfolio broken down by maturity and exposure class (K&H Bank) CRR Article 442(f)

Maturity (Values in HUF million)	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
<1 year	98 296	127 584	293 453	23 633	50 659	192 599	**786 223**
=>1 to <5 year	6 278	197 825	272 534	18 398	20 559	226 295	**741 889**
=>5 to <10 year	5 668	96 917	340 625	5 309	130 989	70 843	**650 351**
=>10 year	578 842	146 669	81 431	14 108	305 063	123 617	**1 249 729**
Total	**689 084**	**568 995**	**988 042**	**61 448**	**507 270**	**613 354**	**3 428 193**

57*. Table*: Lending portfolio broken down by maturity and exposure class (K&H Group) CRR Article 442(f)

Continent (Values in HUF million)	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
Africa	14	-	-	-	-	483	**497**
Australia and Oceania	37	-	-	-	-	-	**37**
Asia	103 270	-	-	-	-	25	**103 295**
North America	23 584	-	-	-	-	86	**23 670**
Middle East	17	-	-	-	-	-	**17**
Central Eastern Europe	77 275	568 995	973 868	61 448	506 223	627 595	**2 815 404**
Western Europe	118 017	0	-	-	-	27 945	**145 961**
Total	**322 214**	**568 995**	**973 868**	**61 448**	**506 223**	**656 133**	**3 088 882**

58*. Table*: Lending portfolio broken down by continent and exposure class (K&H Bank) CRR Article 442(d)

Continent (Values in HUF million)	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
Africa	14	-	-	-	-	483	**497**
Australia and Oceania	37	-	-	-	-	-	**37**
Asia	384	-	-	-	-	25	**409**
North America	2 024	-	-	-	-	86	**2 110**
Middle East	17	-	-	-	-	-	**17**
Central Eastern Europe	578 421	568 995	988 042	61 448	507 270	584 816	**3 288 992**
Western Europe	108 187	0	-	-	-	27 945	**136 131**
Total	**689 084**	**568 995**	**988 042**	**61 448**	**507 270**	**613 354**	**3 428 193**

59*. Table*: Lending portfolio broken down by continent and exposure class (K&H Group) CRR Article 442(d)

Country (Values in HUF million)	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
Singapur	102 886	-	-	-	-	-	**102 886**
France	48 335	0	-	-	-	0	**48 335**
Slovakia	47 455	-	-	-	-	1 783	**49 238**
Great Britain	33 939	-	-	-	-	0	**33 939**
Hungary	25 919	563 373	973 554	61 448	506 223	624 913	**2 755 430**
Other	63 679	5 622	315	-	-	29 437	**99 053**
Total	**322 214**	**568 995**	**973 868**	**61 448**	**506 223**	**656 133**	**3 088 882**

60*. Table*: Lending portfolio broken down by country and exposure class (K&H Bank) CRR Article 442(d)

Country (Values in HUF million)	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
Hungary	577 507	563 373	987 727	61 448	507 270	582 134	**3 279 459**
France	47 091	0	-	-	-	0	**47 091**
Great Britain	28 299	-	-	-	-	0	**28 299**
Spain	15 000	-	-	-	-	-	**15 000**
Ireland	11 952	-	-	-	-	-	**11 952**
Other	9 234	5 622	315	-	-	31 220	46 390
Total	**689 084**	**568 995**	**988 042**	**61 448**	**507 270**	**613 354**	**3 428 193**

61. Table*:* Lending portfolio broken down by country and exposure class (K&H Group) CRR Article 442(d)

Values in HUF million	Country	Exposure
01 [0,00% - 0,10%*]	Hungary	955 681
	Singapur	102 886
	Slovakia	47 434
	Other	38 226
02 [0,10% - 0,20%*]	Hungary	262 962
	France	46 769
	Great Britain	26 724
	Spain	15 000
	Other	16 089
03 [0,20% - 0,40%*]	Hungary	264 232
	Other	6 149
04 [0,40% - 0,80%*]	Hungary	404 420
	Denmark	668
	Other	228
05 [0,80% - 1,60%*]	Hungary	370 812
	Other	27 836
06 [1,60% - 3,20%*]	Hungary	178 220
	Other	5 336
07 [3,20% - 6,40%*]	Hungary	109 162
	Other	107
08 [6,40% - 12,80%*]	Hungary	34 802
09 [12,80% - 100,00%*]	Hungary	46 707
09 [100,00%]	Hungary	128 433
Total		**3 088 882**

62. Table*:* Credit risk exposures by relevant geographical location (K&H Bank)

Values in HUF million	Country	Exposure
01 [0,00% - 0,10%*]	Hungary	1 643 570
	USA	1 476
	Slovakia	1 042
	Other	1 749
02 [0,10% - 0,20%*]	Hungary	288 407
	France	46 769
	Great Britain	26 724
	Spain	15 000
	Other	15 650
03 [0,20% - 0,40%*]	Hungary	256 647
	Other	6 149
04 [0,40% - 0,80%*]	Hungary	399 835
	Denmark	668
	Other	228
05 [0,80% - 1,60%*]	Hungary	339 084
	Other	27 836
06 [1,60% - 3,20%*]	Hungary	197 074
	Other	5 336
07 [3,20% - 6,40%*]	Hungary	110 205
	Other	107
08 [6,40% - 12,80%*]	Hungary	34 802
09 [12,80% - 100,00%*]	Hungary	46 707
09 [100,00%]	Hungary	128 433
Total		**3 593 497**

63**. Table***:* Credit risk exposures by relevant geographical location (K&H Group)

CRR Article 442(d)

Sector *Values in HUF million*	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
Automotive	-	38 897	-	-	-	44 519	83 416
unknown	14 024	2	19 305	-	1 291	8 032	42 654
Building & Construction	-	47 598	-	-	-	60 097	107 695
Metals Machinery & Heavy Equipment	-	37 755	-	-	-	13 337	51 092
Distribution & Traders	-	147 131	-	-	-	56 571	203 702
Authorities	-	0	954 564	-	-	0	954 564
IT & Electronics	-	22 707	-	-	-	10 258	32 965
Commertial Real estate	-	18 302	-	-	-	66 817	85 119
Private Persons	-	-	-	61 448	504 932	-	566 380
Media & Telecom	-	2 918	-	-	-	1 831	4 749
Agriculture Farming Fishing & Food	-	146 325	-	-	-	61 071	207 396
Finance & Insurance	308 190	5 816	-	-	-	100 328	414 333
Shipping & Aviation	-	11 862	-	-	-	26 117	37 979
HORECA	-	2 898	-	-	-	20 466	23 363
Services	-	50 935	-	-	-	37 010	87 944
Textile Timber & Paper	-	11 885	-	-	-	33 239	45 125
Chemicals	-	17 314	-	-	-	39 276	56 589
Energy Electricity & Water	-	6 652	-	-	-	77 165	83 817
Total	**322 214**	**568 995**	**973 868**	**61 448**	**506 223**	**656 133**	**3 088 882**

Table 57: Lending portfolio broken down by sector and exposure class (K&H Bank) CRR Article 442(e)

Sector *Values in HUF million*	Institutions	SME	Sovereign	Retail Other	Retail Mortgages	Corporates	Total
Automotive	-	38 897	-	-	-	44 826	83 722
Other	565 663	2	7 734	-	2 337	961	576 697
Building & Construction	-	47 598	-	-	-	60 411	108 009
Metals Machinery & Heavy Equipment	-	37 755	-	-	-	13 593	51 349
Distribution & Traders	-	147 131	-	-	-	56 765	203 896
Authorities	-	0	980 308	-	-	0	980 308
IT & Electronics	-	22 707	-	-	-	10 269	32 976
Commertial Real estate	-	18 302	-	-	-	66 817	85 119
Private Persons	-	-	-	61 448	504 932	-	566 380
Media & Telecom	-	2 918	-	-	-	1 835	4 752
Agriculture Farming Fishing & Food	-	146 325	-	-	-	61 071	207 396
Finance & Insurance	123 422	5 816	-	-	-	42 049	171 287
Shipping & Aviation	-	11 862	-	-	-	54 039	65 901
HORECA	-	2 898	-	-	-	20 466	23 363
Services	-	50 935	-	-	-	30 316	81 250
Textile Timber & Paper	-	11 885	-	-	-	33 297	45 182
Chemicals	-	17 314	-	-	-	39 474	56 788
Energy Electricity & Water	-	6 652	-	-	-	77 165	83 817
TOTAL	**689 084**	**568 995**	**988 042**	**61 448**	**507 270**	**613 354**	**3 428 193**

Table 58: Lending portfolio broken down by sector and exposure class (K&H Group) CRR Article 442(e)

Detailed breakdown of the credit portfolio affected by provisions raised for credit losses

Sector *Values in HUF million*	SME	Retail Other	Retail Mortgages	Corporates	Total
Automotive	500	-	-	-	500
unknown	-	-	-	-	-
Building & Construction	325	-	-	1	327
Metals Machinery & Heavy Equipment	2 431	-	-	0	2 431
Distribution & Traders	6 784	-	-	465	7 249
IT & Electronics	2 482	-	-	14	2 496
Commertial Real estate	1 762	-	-	1 839	3 602
Private Persons	-	2 149	98 734	-	100 883
Media & Telecom	198	-	-	-	198
Agriculture Farming Fishing & Food	1 757	-	-	470	2 227
Finance & Insurance	-	-	-	2 500	2 500
Shipping & Aviation	302	-	-	-	302
HORECA	49	-	-	3 400	3 450
Services	798	-	-	0	798
Textile Timber & Paper	321	-	-	-	321
Chemicals	609	-	-	-	609
Energy Electricity & Water	2	-	-	539	541
Total	**18 321**	**2 149**	**98 734**	**9 229**	**128 433**

Table 59: Breakdown of the lending portfolio affected by value adjustments and provisions by sector and exposure class (K&H Bank) – original exposure prior to credit conversion factors CRR Article 442(e)

Sector *Values in HUF million*	**SME**	**Retail Other**	**Retail Mortgages**	**Corporates**	**Total**
Automotive	500	-	-	-	500
Building & Construction	325	-	-	1	327
Metals Machinery & Heavy Equipment	2 431	-	-	0	2 431
Distribution & Traders	6 784	-	-	465	7 249
IT & Electronics	2 482	-	-	14	2 496
Commertial Real estate	1 762	-	-	1 839	3 602
Private Persons	-	2 149	98 734	-	100 883
Media & Telecom	198	-	-	-	198
Agriculture Farming Fishing & Food	1 757	-	-	470	2 227
Finance & Insurance	-	-	-	2 500	2 500
Shipping & Aviation	302	-	-	-	302
HORECA	49	-	-	3 400	3 450
Services	798	-	-	0	798
Textile Timber & Paper	321	-	-	-	321
Chemicals	609	-	-	-	609
Energy Electricity & Water	2	-	-	539	541
Total	**18 321**	**2 149**	**98 734**	**9 229**	**128 433**

Table 60: Breakdown of the lending portfolio affected by value adjustments and provisions by sector and exposure class (K&H Group) – original exposure prior to credit conversion factors CRR Article 442(e)

Sector *Values in HUF million*	SME	Retail Other	Retail Mortgages	Corporates	Total
Automotive	394	-	-	-	394
unknown	-	-	-	-	-
Building & Construction	269	-	-	1	270
Metals Machinery & Heavy Equipment	2 301	-	-	-	2 301
Distribution & Traders	3 456	-	-	372	3 828
IT & Electronics	2 163	-	-	-	2 163
Commertial Real estate	323	-	-	1 290	1 614
Private Persons	-	1 216	55 770	-	56 986
Media & Telecom	185	-	-	-	185
Agriculture Farming Fishing & Food	765	-	-	435	1 199
Finance & Insurance	-	-	-	2 465	2 465
Shipping & Aviation	154	-	-	-	154
HORECA	40	-	-	1 287	1 327
Services	413	-	-	0	413
Textile Timber & Paper	190	-	-	-	190
Chemicals	503	-	-	-	503
Energy Electricity & Water	2	-	-	339	341
Total	**11 159**	**1 216**	**55 770**	**6 190**	**74 334**

Table 61: Breakdown of the lending portfolio affected by value adjustments and provisions by sector and exposure class (K&H Bank) – value adjustments and provisions CRR Article 442(e)

Sector *Values in HUF million*	SME	Retail Other	Retail Mortgages	Corporates	Total
Automotive	394	-	-	-	394
Other	-	-	-	-	-
Building & Construction	269	-	-	1	270
Metals Machinery & Heavy Equipment	2 301	-	-	-	2 301
Distribution & Traders	3 456	-	-	372	3 828
IT & Electronics	2 163	-	-	-	2 163
Commertial Real estate	323	-	-	1 290	1 614
Private Persons	-	1 216	55 770	-	56 986
Media & Telecom	185	-	-	-	185
Agriculture Farming Fishing & Food	765	-	-	435	1 199
Finance & Insurance	-	-	-	2 465	2 465
Shipping & Aviation	154	-	-	-	154
HORECA	40	-	-	1 287	1 327
Services	413	-	-	0	413
Textile Timber & Paper	190	-	-	-	190
Chemicals	503	-	-	-	503
Energy Electricity & Water	2	-	-	339	341
Total	**11 159**	**1 216**	**55 770**	**6 190**	**74 334**

Table 62: Breakdown of the lending portfolio affected by value adjustments and provisions by sector and exposure class (K&H Group) – value adjustments and provisions CRR Article 442(e)