Kereskedelmi és Hitelbank Zrt.

CONSOLIDATED SEMI-ANNUAL REPORT

30 June 2022

Budapest, 30 August 2022

CONTENT

Statement of the Issuer

K&H Bank Zrt., as the Issuer (represented by Guy Libot, CEO and Attila Gombás, CFO) hereby declare that the Year 2022 Consolidated Semi-annual Report of K&H Bank Zrt. has been prepared to the best of the Issuer's knowledge, in compliance with the applicable accounting laws and regulations, and the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profitability of K&H Bank Zrt. and the companies involved in the consolidation, and the Consolidated Management Report shows a true and fair picture of the position, development and performance of K&H Bank Zrt. and the companies involved in the consolidation, also including the major risks and uncertainties pertaining to the remaining six months of the financial year.

Furthermore, the Issuer hereby declares that the Semi-annual Report has not been verified by an independent auditor, thus the financial details contained therein are not audited figures.

Budapest, 30 August 2022

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Not audited 30 June 2022 MHUF	Audited 31 December 2021 MHUF
ASSETS		
Cash and cash balances with central banks	303 939	266 591
Cash	92 404	63 510
Cash balances with central banks	99 764	91 734
Other demand deposit with credit institutions	111 771	111 347
Financial assets	5 037 895	4 874 940
Held for trading	174 564	86 088
Mandatorily at fair value through profit or loss	236 458	206 014
At fair value through other comprehensive income	42 001	69 152
of which assets pledged as collateral	*0*	*0*
At amortised cost	4 434 773	4 442 173
of which assets pledged as collateral	*649 006*	*615 249*
Hedging derivatives	150 099	71 513
Fair value changes of hedged item under portfolio hedge of interest rate risk	(139 373)	(66 693)
Tax assets	8 197	3 552
Current tax assets	2 294	9
Deferred tax assets	5 903	3 543
Investment property	650	864
Property and equipment	44 990	45 120
Intangible assets	63 581	58 821
Non-current assets held for sale and disposal groups	0	124
Other assets	30 765	28 379
Total assets	5 350 644	5 211 698
LIABILITIES AND EQUITY		
Financial liabilities	5 044 136	4 792 860
Held for trading	135 475	69 476
Designated at fair value through profit or loss	4 078	5 701
Measured at amortised cost	4 694 645	4 619 125
Hedging derivatives	209 938	98 558
Fair value changes of hedged item under portfolio hedge of interest rate risk	(151 170)	(72 738)
Tax liabilities	2 986	4 390
Current tax liabilities	2 986	4 390
Deferred tax liabilities	-	-
Provisions for risks and charges and credit commitments	4 160	2 839
Other liabilities	77 865	43 682
Total liabilities	4 977 977	4 771 087
Share capital	140 978	140 978
Share premium	48 775	48 775
Accumulated profit	191 277	236 022
Other reserves	(8 363)	14 836
Total equity	372 667	440 611
Total liabilities and equity	5 350 644	5 211 698

Budapest, 30 August 2022

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Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital MHUF	Share premium MHUF	Statutory risk reserve MHUF	Revaluation reserve of securities MHUF	Revaluation reserve - Cash flow hedge MHUF	Other Revaluation reserves MHUF	Retained earnings MHUF	Total equity MHUF
Balance as at 1 January 2021	140 978	48 775	31 702	5 756	4 530	64	168 864	400 669
Net profit for the year	-	-	-	-	-	-	37 354	37 354
Other comprehensive income for the period	-	-	-	(1 405)	(11 784)	1	-	(13 188)
Total comprehensive income	-	-	-	(1 405)	(11 784)	1	37 354	24 166
VISA conversion	-	-	-	-	-	-	217	217
Total change	-	-	-	(1 405)	(11 784)	1	35 571	24 383
Balance as at 30 June 2021	140 978	48 775	31 702	4 351	(7 254)	65	206 435	425 052
of which								
revaluation reserve for shares	-	-	-	*1 066*	-	-	-	*1 066*
revaluation reserve for bonds	-	-	-	*3 285*	-	-	-	*3 285*
Balance as at 1 January 2022	140 978	48 775	40 169	(763)	(24 630)	59	236 022	440 610
Net profit for the year	-	-	-	-	-	-	9 655	9 655
Other comprehensive income for the period	-	-	-	(2 421)	(20 773)	(3)	-	(23 197)
Total comprehensive income	-	-	-	(2 421)	(20 773)	(3)	9 655	(13 542)
Dividend paid	-	-	-	-	-	-	(54 400)	(54 400)
Total change	-	-	-	(2 421)	(20 773)	(3)	(44 745)	(67 942)
Balance as at 30 June 2022	140 978	48 775	40 169	(3 184)	(45 403)	56	191 277	372 668
of which								
revaluation reserve for shares	-	-	-	*1 222*	-	-	-	*1 222*
revaluation reserve for bonds	-	-	-	*(4 406)*	-	-	-	*(4 406)*

Budapest, 30 August 2022

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

CONSOLIDATED INCOME STATEMENT

	Not audited 1st half of year 2022 MHUF	Reclassified Not audited 1st half of year 2021 MHUF
Interest and similar income	125 171	65 506
Interest income calculated using the effective interest method	100 975	52 709
Other similar income	24 196	12 797
Interest and similar expense	(54 094)	(14 753)
Net interest and similar income	71 077	50 753
Fee and commission income	49 835	44 548
Fee and commission expense	(12 189)	(11 663)
Net fee and commission income	37 646	32 885
Net gains / (losses) from financial instruments at fair value through profit or loss	73 175	12 956
Foreign exchange differences	(55 542)	(196)
Net realised gains / (losses) from financial assets at fair value through other comprehensive income	(1 869)	8
Dividend income	7	-
Gains on the disposal of assets at amortised cost	(177)	1 149
Gains on the disposal on held for sale instruments	256	-
Other income	1 612	908
Other expense	(424)	(322)
Total income	125 761	98 141
Operating expenses	(102 490)	(60 134)
Staff expenses	(17 670)	(17 033)
General administrative expenses	(68 970)	(29 186)
Depreciation and amortisation of tangible and intangible assets	(7 787)	(7 536)
Bank tax	(8 063)	(6 379)
Impairment on assets	(3 022)	6 487
At amortised cost	(2 955)	6 673
At fair value through other comprehensive income	16	2
Other	(83)	(188)
Modification losses on financial assets at amortized cost	(5 100)	(800)
Profit / (loss) before tax	15 149	43 694
Income tax expense	(5 494)	(6 340)
Profit / (loss) after tax	9 655	37 354

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Not audited 1st half of year 2022 MHUF	Not audited 1st half of year 2021 MHUF
Profit after tax	9 655	37 354
Other comprehensive income		
Items that may be reclassified to the profit or loss		
Revaluation reserve of debt instruments		
Net gain / (loss) from fair value changes	(4 689)	(1 570)
Deferred tax impact on fair value changes	507	170
Transfer from revaluation reserve to net profit:		
(Losses)/gains on impairment	(16)	(2)
(Losses)/ gains on disposal	1 869	(8)
Deferred income tax	(200)	1
Cash flow hedge		
Net gain / (loss) from fair value changes	(22 841)	(12 862)
Deferred tax impact on fair value changes	2 056	1 158
Transfer from cash flow hedge reserve to net profit:		
Ineffective part	5	36
Gross amount	8	(124)
Deferred income tax	(1)	8
Items that will not be reclassified to the profit or loss		
Revaluation reserve of equity instruments		
Net gain / (loss) from fair value changes	121	5
Deferred tax impact on fair value changes	(13)	(1)
Actuarial result on defined benefit plans	-	(1)
Deferred income tax	-	-
Total other comprehensive income	(23 197)	(13 188)
Total comprehensive income	(13 542)	24 166

Budapest, 30 August 2022

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Attila Gombás
Chief Financial Officer

CONSOLIDATED STATEMENT OF CASH FLOWS

	Not audited 1st half of year 2022 MHUF	Not audited 1st half of year 2021 MHUF
OPERATING ACTIVITIES		
Profit before tax	15 149	43 694
Adjustments for:		
Interest and similar income	(125 171)	(65 506)
Interest and similar expense	54 094	14 753
Net transfer from revaluation reserve of securities	(1 853)	10
Net transfer from cash flow hedge reserve	(13)	88
Depreciation and impairment of property, plant and equipment, intangible assets, financial assets at fair value through other comprehensive income and other assets	7 867	7 709
(Profit)/Loss on the disposal of property and equipment	(444)	(62)
(Profit)/Loss on the disposal of investment property	(195)	(217)
Change of modification result on financial assets at amortized cost	5 100	800
Change in impairment on assets valued at amortised cost*	2 955	(6 673)
Change in other provisions	11	(25)
Unrealised valuation differences	(90 079)	(23 234)
Cash flows from operating profit before tax and before changes in operating assets and liabilities	(132 579)	(28 663)
Changes in financial assets held for trading	(56 355)	23 716
Changes in financial assets mandatorily valued at fair value through profit or loss	(25 566)	(39 299)
Changes in financial assets at fair value through other comprehensive income	21 496	(1 272)
Changes in financial assets valued at amortised cost	36 154	(265 241)
Changes in other assets	46 596	(5 834)
Changes in operating assets	22 325	(287 930)
Changes in financial liabilities held for trading	46 002	(14 668)
Changes in financial liabilities designated at fair value through profit or loss	109 864	5 480
Changes in financial liabilities measured at amortised cost	56 109	5 815
Changes in other liabilities	(40 667)	18 079
Changes in operating liabilities	171 308	14 706
Income taxes paid	(5 503)	(6 204)
Interest received	113 573	45 762
Interest paid	(51 852)	(13 117)
Net cash from/(used in) operating activities	117 272	(275 446)

* Including also provisions on loan commitments.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Not audited 1st half of year 2022 MHUF	Not audited 1st half of year 2021 MHUF
INVESTING ACTIVITIES		
Purchase of securities at amortised cost	(6 750)	(50 321)
Proceeds from the repayment of securities at amortised cost at maturity	66 235	-
Proceeds from the sale of securities at amortised cost	-	-
Dividends received from associated companies	7	-
Purchase of intangible assets	(9 725)	(7 724)
Purchase of property, plant and equipment	(2 989)	(2 352)
Proceeds from the sale of property, plant and equipment	668	100
Proceeds from the sale of non-current assets held for sale and disposal groups	256	-
Purchase of investment property	(54)	(109)
Proceeds from the sale of investment property	455	725
Net cash from/(used in) investing activities	48 103	(59 681)
FINANCING ACTIVITIES		
Proceeds from issuance of mortgage bonds	15 000	(13 500)
Repayment of principal of lease liabilities	(198)	(1 455)
Dividend paid	(54 400)	-
Net cash from/(used in) financing activities	(39 598)	(14 955)
CHANGE IN CASH AND CASH EQUIVALENTS		
Net increase/(decrease) in cash and cash equivalents	125 777	(350 082)
Net foreign exchange difference	2 229	(4 257)
Cash and cash equivalents at beginning of the period	1 322 419	832 398
Cash and cash equivalents at end of the period	1 450 425	478 060

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	Not audited 1st half of year 2022 MHUF	Not audited 1st half of year 2021 MHUF
OPERATING CASH FLOWS FROM DIVIDENDS		
Dividends received	-	-
COMPONENTS OF CASH AND CASH EQUIVALENTS		
Cash and cash balances with central banks and other demand deposits with credit institutions	303 939	454 605
Loans and advances to banks repayable on demand and term loans to banks < 3 months	1 469 948	335 685
Deposits from banks repayable on demand and redeemable at notice	(323 462)	(312 230)
Total cash and cash equivalents	1 450 425	478 060

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

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

Budapest, 30 August 2022

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Management Report

On 30 June 2022, the consolidated total assets of K&H Bank Group (hereunder “the Group”) stood at 5,351 billion. As a financial institution which offers banking and insurance products alike and has a nation-wide branch network of 197 branches (198 branches on 31 December 2021), the Group offers the full range of financial services to its clients.

1. Economic environment

The strong economic growth momentum in 2021 has been carried over to the first half of 2022. Both demand from Hungary’s main trading partners and the domestic consumption boosted the economy expansion. Domestic consumption was strongly fueled by the government's loose fiscal policy, with government benefits to households in the first months of the year driving household purchases. However, the economic outlook started to deteriorate significantly in the second quarter. The escalating conflict between Russia and Ukraine exposed Europe's dependence on Russian energy supplies and it was no longer just the spectre of persistently high energy prices that began to threaten European economies, but a possible energy shortage that began to overshadow the economic outlook. Hungary's dependence on Russian energy is high within the European Union, against which existing long-term contracts and high natural gas storage capacity provide some protection, but a European-scale energy shortage could push the Hungarian economy into recession. In addition, domestic purchasing power could be dampened by rising living costs and tightening economic policy. Although gross domestic product levels were significantly above pre-Covid levels by the end of the first half of the year, several sectors have not reached their pre-corona virus crisis growth trends. Uncertainty looms large in the coming quarters, and there is a growing likelihood that the economy will turn into a technical recession by the end of the year and early 2023.

The loose fiscal policy seen at the beginning of the year was replaced by fiscal tightening in the second quarter, with a fiscal adjustment of around 3-3 percent of GDP in 2022 and 2023. The austerity package relies on revenue increases of 40 percent and expenditure restraint of 60 percent. New extra taxes have been introduced on several sectors, including the financial sector, while spending includes postponing public investment and freezing ministries’ spendings. While these measures will help to achieve the budget deficit targets, they may slow economic growth and may have additional inflationary impact.
Hungary has still failed to reach an agreement with the European Union on its recovery fund programmes, so the inflow of EU funds continues to be hampered. Time is running out and the country would face a permanent loss of resources if no agreement is reached in the second half of the year.
Public debt has been significantly reduced in 2021 and the downward trend could continue in 2022 thanks to high inflation and economic growth. This is one of the reasons why the major credit rating agencies have left Hungary's credit rating unchanged (investment grade), but if the government fails to reach an agreement with the EU and fiscal policy is unwound, a downgrade is likely.
The inflation trajectory shifted upwards in the first half of the year due to persistently high energy and commodity prices, distortion in global supply chains and strong domestic demand. The transitory nature of inflation is increasingly being questioned, with the CPI in Hungary approaching 12 percent in June and the trend will accelerate further in the second half of the year.

	2021 actual	2022 forecast*
GDP growth	+7.1%	+5.1%
CPI (average)	+5.1%	+12.6%
Investments	+9.6%	+7.0%
Unemployment rate	3.7%	3.8%
Balance of state budget (in % of GDP)	-6.8%	-4.8%
Balance of payments (in % of GDP)	-3.2%	-5.4%

**source: K&H Bank Zrt*

The world's leading central banks also started monetary tightening in the first half of the year. They started to withdraw their previous stimulus tools and began a cycle of interest rate hikes. A tightening external environment, the proximity of the Russian-Ukrainian conflict and deteriorating economic fundamentals have put the forint under depreciating pressure against both major currencies and regional peers. The National Bank of Hungary was forced to accelerate its rate hike cycle, raising the effective policy rate to 7.75% by the end of June. Further interest rate hikes were done and are expected to continue in the second half of the year, with the tightening cycle ending at around the end of the year. The higher interest rate environment could dampen borrowing appetite and creditworthiness in the coming quarters.

2. The Strategic Objectives of the Group

K&H Bank Group is a universal bank-insurer, providing banking, leasing, asset management and insurance services for individuals and corporate (focusing on SME and Mid-cap) customers with a strong emphasis on introducing innovative solutions.

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

- we put the client at the centre of all our activities
- we provide our clients with easy & smooth access
- we strive to maintain long-term relationship by making the difference through superior service and personal bond
- we combine the best international practice with sound local knowledge.

We want to be the reference in bank-insurance.

Customer strategy:

We help our clients realise their dreams and protect them.

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

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

Product strategy:

Retail:

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

Small and medium-sized enterprises (SME):

- Reliable and convenient transactional banking services.
- More standard products fitting client needs with simple, easy to access services.
- Fast and simple lending process to support financing SME businesses.

Corporate:

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

Strategy on distribution channels:

Omni-channel distribution approach – best fit combination of:

- e-bank, mobile bank
- extensive branch network with high level of cash automation and focus on advisory
- TeleCenter, remote advisory
- tied agents and brokers.

Key differentiators of the Bank Group:

- being close to our clients: easy access both physically (via our large branch network) and digitally (via remote channels)
- K&H Group acts as a full service provider for our clients in banking and insurance (universal financial institution)
- expertise and advice in the whole spectrum of financial services

- innovation: we continuously adopt to the changes in client behaviour and in the environment, continuing our digital transformation to be the best innovator in the market.

3. The Group's consolidated activities

3.1 Balance sheet

The Group's total assets amounted to 5,351 bln at 30 June 2022.

HUF Bln	30 Jun 2021	31 Dec 2021	30 Jun 2022	Variance (Jun 22/ Jun 21)
Total assets	4,430	5,212	5,351	+20.8%
Loans and advances to customers	1,875	2,007	2,100	+12.0%
Deposits from customers	3,182	3,599	3,663	+15.1%
Equity	425	441	373	-12.3%

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

- *Loans and advances to customers:* with a yoy growth rate of 12%, the main categories are: corporate, retail, sme and general government. K&H Bank increased its loan portfolio in both retail and corporate segments compared to the same period in last year. The 20% yoy growth in corporate loans was driven by the bank's successful participation in state subsidizied loan programmes (NHP Hajrá!, Exim's Compensation Loan Programme, Széchenyi Card Programme, MNB's Bonds for Growth Programme). In retail segment the bank has strengthened its market share further (H1 2021: 10.4%, H1 2022: 10.5%).
- *Deposits from customers* increased by 15% compared to June 2021, both corporate and retail segments contributed to this growth.
- *Shareholders' equity* decreased by 68 bln (-15.4%) compared to 31 Dec 2021, main components: dividend payment (-54.4 bln), net profit of 2022H1 (+9.7 bln), lower cash flow hedge reserves (-20.8 bln) and revaluation reserve of securities (-2.4 bln).

	30 Jun 2021	31 Dec 2021	30 Jun 2022
Guarantee capital (bln HUF)	407	410	402
Capital adequacy ratio (%)	17.9	18.2	16.8

3.2 Profit & loss

HUF Bln	2021 H1	2022 H1
Profit after tax	37.4	9.7

The Bank Group's profit was impacted by several government measures and partially the Russian-Ukraine conflict in 2022:

- New windfall tax for financial institutions: 26 bln for this year (booked in H1 2022).
- Both the financial moratorium and the interest rate cap for short term retail mortgage loans with floating interests were extended until 31 December 2022 (resulting in 5.1 bln modification loss in 1H 2022).
- Extra payment to the Deposit Guarantee Fund related to Sberbank Hungary (8.9 bln in 1H22).

The evolution of the main P&L items in the first half of 2022:

- *Net interest income* increased by 40.0% yoy (1H21: 50.8 bln, 1H22: 71.1 bln) due to the combined impact of increasing loan and deposit volumes and impact of higher interest rate environment.
- Growth in *net fee and commission income* (1H21: 32.9 bln, 1H22: 37.6 bln) was supported by transactional income and FX conversion income.

- *Net gains from financial instruments at fair value & foreign exchange differences* increased (1H21: 12.8 bln, 1H22: 17.6 bln) primarily due to higher income on volatile market activites.
- 1.9 bln negative result was reported under the heading of *net realised gains from financial assets measured at fair value through other comprehensive income* (1H21: 0.0 bln).
- The *operating expenses* of the Group amounted to 102.5 bln in the first half of 2022. The growth compared to 1H 2021 (60.1 bln) is driven by the previously mentioned measures (windfall tax: 26 bln, extra payment to the Deposit Guarantee Fund: 8.9 bln). Disregarding these the remaining increase is primarily due to higher IT costs (significant digitalization and regulatory investments).
- There was a 3.0 bln negative P&L impact of impairment on financial assets at amortised cost. In H1 2022 the Group released the full remaining amount of Covid-19 related IFRS9 based collective impairment (13.2 bln) created in 2020, while 15.2 bln overlay was created for geopolitical and other emerging risks. Portfolio quality remained stable in all segments.

Non-performing loans ratio	31 Dec 2021	30 June 2022
Retail	3.6%	3.1%
Corporate & SME	1.7%	1.8%
Total	**2.6%**	**2.4%**

The financial performance of the Bank Group is illustrated by the following indicators:

	2021 H1	**2022 H1**	**variance**
Cost / income	61.3%	81.5%	+20.2%
Non-interest type income/ total income	48.3%	43.5%	-4.8%
Fee and commission income / total income	33.5%	29.9%	-3.6%
Operating income / average headcount	29.9	38.9	+30.1%
Credit cost ratio	-0.9%	0.3%	+1.1%
Non-performing loans	2.3%	2.4%	+0.1%
Loan / deposit ratio	61.7%	62.9%	+1.2%
Capital adequacy ratio (consolidated)	17.9%	16.8%	-1.1%
LCR	205%	209%	+4%
NSFR	161%	169%	+8%
ROE (based on average balance of equity)	18.5%	4.6%	-13.9%
ROA (based on average balance sheet total)	1.8%	0.4%	-1.4%

4. Introduction of the important subsidiaries

Leasing operation

At the end of June 2022, the Leasing operation consisted of two legal entities next to the leasing operations performed by the bank (three entities were merged with K&H Bank Zrt. in previous years).

Name	**Main profile**
K&H Autópark Kft.	Operative leasing, fleet management
K&H Ingatlanlízing Zrt.	Financial leasing (real-estate)

On 30 June 2022 the **Group's leasing** portfolio stood at 83 bln (remained at the level of the end of the previous year).

K&H Tanácsadó Zrt.

By the decision of KBC Group, the business activity of K&H Alapkezelő Zrt. (former name of K&H Tanácsadó Zrt.) was transferred into KBC Asset Management NV Hungarian Branch from 1 July 2020, since then the company did not conduct any real business activity. The liquidation process of the company was closed in Q1 2022.

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

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

The company takes out service level agreements and contracts with individual group members for each individual services.

As part of the K&H group strategy, K&H+ app started in September 2020. This application provides digital solutions and offers beyond banking services through K&H mobile bank application, which operation is managed in close cooperation with K&H Bank.

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

The K&H Factor Zrt's main activity is factoring (purchase of receivables, financing, discounting). The company's business activities have started in 2010, factoring turnover has been continuously increasing since then (2022 1H: 109 bln, +20.97% yoy). The amount of trade receivables towards debtors increased by 10.8% yoy, to 19.95 bln (18 bln on 30 June 2021).

K&H Jelzálogbank Zrt. (K&H Mortgage Bank Zrt.)

As from April 1st 2017 MNB implemented a new indicator (Mortgage Financing Adequacy Ratio) to constrain the banking sector level systemic risk of maturity transformation related to the long term HUF retail mortgage loan portfolio. According to the current rules, at least 25% of the retail HUF mortgage loan portfolio is to be financed by long-term sources with maturity of at least 3 years (be it mortgage bonds or refinancing loans taken out from mortgage credit institutions).
K&H Mortgage Bank was established in 2016. The core business activity of the Mortgage Bank is refinancing of retail mortgage loan portfolios of K&H Bank Zrt. and mortgage bond issuance, started in Q1 2017.

Starting in March 2017, K&H Jelzálogbank issued several mortgage bonds, initially in the framework of private placements, then during public placements. On June 30, 2022, K&H Jelzálogbank's stock of mortgage bonds was 187 bln, of which 160 bln were publicly issued on the Budapest Stock Exchange.
In August 2021, the MNB launched its Green mortgage bond program, within the framework of which it purchased forint-based mortgage bonds with a green rating in accordance with international standards, fixed interest rates, and issued with an original term of at least 5 years, at a discount on the primary and secondary markets. On April 12, 2022, Jelzálogbank announced to the MNB its intention to participate in the MNB's Green Mortgage Bond Program, and on April 27, it issued a 10-year green mortgage bond (15 bln nominal).

5. Risk Management

Banks are exposed to several types of risks due to their operations. K&H Bank has a system in place for the accurate measurement and appropriate management and limitation of these risks. The system has been adjusted to the risk management system of the shareholder KBC Group both in terms of methodology and work organisation.

5.1 Risk management governance model

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

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

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 – amongst others the quarterly risk reports, annual review of remuneration and risk based pricing policies – ensures that there is an ample flow of information to the members of the Board over the course of the year. Moreover, through the involvement of the Board in the annual round of approvals of risk appetite and risk-tolerance limits, the Board is able to take informed decisions on the degree of risk it finds acceptable for the Group and on the adequacy of the risk management structure.

5.2 Risk types

- **Credit risk** means the potential loss sustained by the bank if a customer becomes insolvent or cannot perform their payment obligations in due time. Credit risks are managed by risk mitigating techniques approved by the management of the Bank. Regulations cover the entirety of the lending process. The bank continuously monitors the credit portfolio and prepares reports on the findings to the senior management of the Bank. The Bank uses IRB Advanced methodology for regulatory capital calculation.

  As a response to the evolving covid crisis situation, management reports were redesigned to focus on the impact analysis, identification and monitoring of the vulnerable portfolios (necessitated also by the fact that usual risk metrics were not useable in the same way as in the past, for example days past due data lost its information value during the moratorium).
  Looking at the figures of 2020, 2021 and first half of 2022 no perceptible worsening in the portfolio quality (such as PD migrations or other risk metrics) was observed that can be linked to the crisis. The effects of the crisis will most likely be shifted to a later period partially due to the extensions of the moratorium and also because some time needs to pass before any changes in the portfolio can be observed.
  The Bank instated numerous restriction in acceptance and underwriting criteria in order to minimize risk. These restrictions are being reviewed regularly as portfolio evolutions require it.

  The main conclusions for 2022H1 are:
  - The performance of the corporate and SME portfolio remained stable during 2022H1. Although some deterioration can be observed in some more vulnerable sectors, no trendlike worsening can be seen at this time. The bank continuously evaluates the evolution of the portfolio and if necessary makes the needed risk decisions/advises to mitigate credit risk be they new limits, or other restrictions.
  - Retail portfolio remained stable. NPL volume remained at stable level. The bank creates an RWA and TTC EL add-on to the retail PD model to counterbalance the technical improvement of retail PDs caused by the moratorium (increasing savings, frozen late days). As with the corporate, the monitoring of retail portfolio is continuous.
  - The opt-in moratorium portfolio is continuously assessed from risk perspective.

It is expected that the current Russian-Ukraine crisis situation and other emerging risks (inflation, energy prices, supply chain problems, etc.) will have an impact on the portfolio, therefore the bank prepared simulations and stress tests to quantify the possible effects on ECL (Expected Credit Loss). The impact of these calculations are reflected in the Bank's consolidated financial position.

- **Market risk** means the potential loss suffered by the Bank upon a change in the value of foreign currency and interest positions. Both the asset-liability management and market risk management are based on the methodology applied by the shareholder KBC Group. Accordingly, the Capital and Risk Oversight Committee continuously monitors banking and trading book risks and controls them by setting limits (in compliance with the limit policy of KBC). Interest risks are measured and controlled by the joint application of various methods and limits (gap analysis, interest sensitivity, duration, BPV, NII, stress tests). There is also sovereign exposure monitoring in place.

  The banking book is characterized by decreasing interest rate risk taking, at decreasing sovereign limit utilization. KBC group level Internal Capital Calculation Method was underpinned by the regulatory 200bp as well as EBA stress test scenarios. ICM is also compared to MNB's ICAAP handbook capital model.

  Trading risk taking was stable at around 30% of the available VaR limit. There was no limit overrun in the examined period. Under GTH concept local market risk positions are collected in KBC group container leaving residual risk position on low level. Automatic mirroring mechanism works fluently on deal level. Local risk position is mostly due to retail Hungarian Bonds warehousing between AKK's monthly purchases.
  From 2020 Q2, K&H Bank reports its trading risk capital requirement applying CRR. Art.94 – Derogation of Small Trading Book (STB), as a result of compliance with regulatory requirements. National Bank of Hungary (MNB) accepted that K&H Bank was going to use STB. Position risk' capital requirement is henceforth calculated under the credit risk framework, thus the trading risk capital requirement decreased significantly. There is continues daily monitoring and strong control environment in place which was accepted by MNB to provide STB compliance and regulatory requirements.

- **Liquidity risk** means the risk of the inability of an institution to comply with net financing requirements. Liquidity risk may be caused by disturbances on the market, credit downgrading, which may result in the constant cessation of certain financing sources. On process level the bank is managing interest rate risk as part of the ILAAP framework through the cooperation of the affected departments. Management seeks to diversify the financing sources and manages assets with due regard to liquidity requirements, maintaining a healthy balance between cash, liquid funds and promptly marketable securities. Short term liquidity risk is measured by the operational liquidity limit which establishes whether there is sufficient coverage for the 30-day cumulative liquidity gap. Structural liquidity is monitored through Basel III liquidity ratios (LCR, NSFR) as well as FFAR (DMM) indicator and by liquidity stress tests and liquidity early warning signals. The department prepares regular reports to the K&H Bank Capital and Risk Oversight Committee on the various liquidity indicators and limits.

	30 Jun 2021	30 Jun 2022	Regulatory requirement
NSFR (%)	161	169	100
LCR (%)	205	209	100
FFAR* (DMM) (%)	234	275	100

* Foreign exchange funding adequacy ratio

- K&H Bank group manages **operational risks** (the potential loss that may arise as a result of inappropriately operating systems, processes, human errors or external events) based on uniform principles and methodology. The methodology includes various techniques of risk identification and risk analysis such as self-assessments (top-down and bottom-up), root cause analysis of incurred losses and the assessment of key risks and implementation of key control objectives defined by KBC group. The risk mitigation measures (or risk acceptance) are decided according to the uniform accountability rules (decision-making authority).
  The identified exposures and the management of these risks are followed up by the Capital and Risk Oversight Committee and analyzed in details by the Operational Risk Councils that cover the entire organization. K&H Bank group applies the standardized method to calculate the Pillar I. capital requirement for operational risk. Additionally, K&H also calculates the Pillar I. capital requirement according to the new SMA method, which will be introduced in the near future.

6. Operating Conditions of the Bank

Capital investments in the branch network:

- During the first half of 2022 the set-up, full or partial reconstruction of 11 branches was started or completed.
- By mid 2022, altogether 479 ATMs were serving our customers (incl. 217 cash-in ATMs).

The number of branches at the end of June 2022 was 197.

The most important IT development projects in first half of 2022 were the followings:

- Several project size developments were initiated or completed to align with legal regulations (such as: PSD2, HitReg, Pandemic loan moratorium, SRD2 legislation, Keler upgrade, MIFID 2, MNB Green Loan, Anti Money Laundering (AML) and Embargo related project, Interest stop, MNB 2022 new and changing reports, Basel Committee on Banking Supervision’s standard number 239, SWIFT message update, Datel - Personal Data Protection Regulation).
- Within the Digitalization programme the following major developments were in progress or delivered:
  - the expansion of onboarding Mobile journey (online account opening)
  - Development of API Gateways - application programming interface connection points - to ensure compliance with PSD2 requirements
  - Xiaomi Pay
  - kh.hu site personalization
  - Corporate customer web system redesign

Budapest, 30 August 2022

Guy Libot
Chief Executive Officer

Attila Gombás
Chief Financial Officer