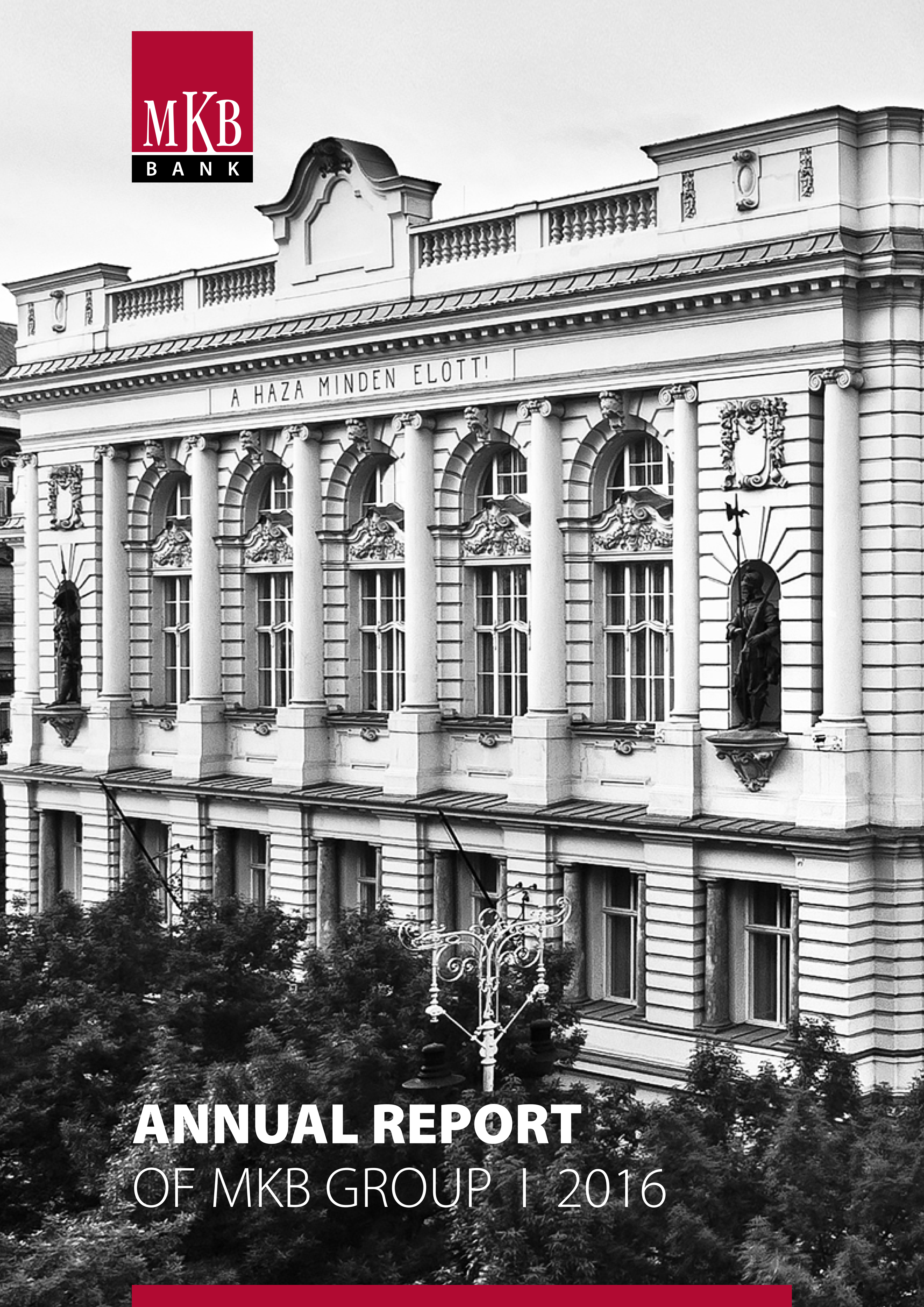
MKB BANK



ANNUAL REPORT
OF MKB GROUP I 2016

CONTENTS

CHAIRMAN'S GREETING

It fills me with great pleasure that the enormous economic potential of MKB could be further consolidated during the 2016 business year. The Bank has been through a challenging period: in addition to a difficult reorganisation process consistently and successfully implemented by the management under the supervision of the Central Bank of Hungary and the European Commission, preparations had to be made for the sale of the Bank as well. We had a highly eventful and successful year. In addition to fully achieving the goal set for 2016, i.e. stabilizing the financial processes and laying the foundation of permanent growth, MKB performed far beyond any plan or expectation.

The management, - firmly supported by the new owners starting from the middle of the year -, introduced reforms based on which we could set a bitious, yet confident goals for the coming years. We would like to regain our position among the Top 3 in terms of corporate banking, in addition to being a dominant investment service provider in the market. In order to be one of the most efficient domestic large banks we introduced digital banking ahead of our peers with an aim to become the leading digital large bank of Hungary. The ultimate goal and essence of our efforts is to provide banking services ensuring the highest level of customer experience.

I am aware that none of these achievements would have been possible without the employees of MKB. The unquestionable professionalism, commitment and customer focus are the key factors which keep the fire burning and encourage further success.

János Jaksa
Chairman of the Board of Directors of MKB Bank

MANAGEMENT REPORT AND REVIEW OF THE 2016 BUSINESS YEAR

2016 was a successful year of revival for MKB. The completion of the reorganisation process lasting over a year and a half had key significance for the Bank, establishing the potential for a new beginning. Additionally, the sales procedure closely monitored by the European Commission resulted in regaining professional ownership through domestic and international investors with several decades of banking experience and global know-how, committed to the growth and profitability of the Bank. Supported by the new ownership, which due to the Employee Stock Ownership Programme (ESOP) established in 2016 includes the Bank's employees as well, there have been new potentials for growth opening up for MKB. In 2016, the year of revival, following a reorganisation process highly successful in international terms as well, MKB has become a profitable, competitive and permanently viable financial institution for the first time in six years, with adequate growth potential and high quality of assets.

The reorganisation process included the spin-off of the 'toxic' commercial real estate loan portfolio and the sale of investments not directly related to commercial banking core activities. The simultaneously implemented significant cost-cutting and efficiency-enhancing measures were also acknowledged by Moody's, the global credit rating agency, upgrading the Bank's rating. It is considered a huge success that during the resolution process no recapitalisation by creditors was required, and the long-term sustainability of MKB could be restored by simultaneously ensuring the maximum protection of all depositor and creditor funds, without any loss incurred.

2016 was a turning point in the life of MKB: since the reorganisation process laid down the foundation for a stable operation, despite the challenges of the external environment determined by extremely low interest rates, the obvious signs of profitability became apparent as well. MKB took the lead in terms of digital development in Hungary. Conquering the digital financial sector is a top priority for both the owners and the management of MKB. The project aimed at the modernisation of the Bank's core IT system will be completed by 2017, laying down the foundation for further innovative progress over the coming years. It is an ideal springboard for becoming a top player in the domestic digital banking sector. In order to support that goal, a cooperation programme unique on the market was launched along with other already established or promising new actors of the fintech sector. In addition to opening towards digital services in order to ensure high-level customer experience in the retail segment and launching Premium Banking in 2016, the Bank also enhanced its position in the traditionally strong corporate, as well as the treasury and Private Banking business lines. MKB made significant progress in the 3rd phase of the central bank's Funding for Growth Scheme and in the Szechenyi Card programme, while the corporate loan portfolio expanded in spite of the simultaneous phasing out of the unseparated commercial real estate loan portfolio. The cleansing of the retail loan portfolio is also in progress. All this has been achieved by ensuring the steady and significant reduction of the non-performing loan portfolio, a process also sustainable in the long run, along with less than planned additional provisioning for 2016.

The subsidiaries of MKB also had a highly successful year in 2016: MKB-Euroleasing became one of the Top 3 universal leasing companies, while the Fund Manager closed its most profitable year ever.

The management's goal for 2017 is to reposition the Bank: new strategic directions have been set and several projects have been launched in order to make MKB a bank of the future in the medium term.

We are grateful to the employees of MKB Bank and all the members of the Board of Directors and the Supervisory Board for their enthusiastic, successful work and steadfast commitment in 2016. Everyone performed outstandingly in an environment full of extraordinary challenges. Finally, we are grateful to our customers for their never-ending support, and to our owners for their trust and confidence.

Dr. Ádám Balog
CEO, on behalf of MKB Bank's management

THE STRATEGIC PRIORITIES OF THE MKB GROUP

As a dominant universal bank of Hungary, MKB creates lasting value for its customers, and the lending activity of the Bank contributes to the realisation of both retail and corporate customers' goals. The Bank seeks to increase the value for the owners through its business model and profitable operation achieved by manageable - provisioning and high-level of cost-efficiency as a successful player in the domestic financial institution sector. 2019 will present a milestone for the Bank, being the deadline set for MKB's introduction to the stock exchange in accordance with the commitments undertaken toward the European Commission. By this measure another Hungarian financial institution could be involved in stock exchange trading activity.

In the medium term MKB intends to reach Top 3 position within the Hungarian banking sector. The key priority is to become the digital leader in the large bank sector, and accordingly to offer outstanding customer experience. The Bank's aim is to be in the Top 3 in terms of corporate and investment banking services. All these positions are to be achieved by outstanding cost-efficiency.

In terms of services offered for large and medium sized corporate customers the Bank seeks to become a dominant actor in the domestic market by offering outstanding customer experience, reliable customer relations, professional consultancy services, as well as transparency, agility and partnership in addition to high-level sectoral, market and macroeconomic analysis support. As for the small company segment, MKB aims to contribute to the success of companies intending to grow and expand by offering skills, expertise and products in addition to fast standard procedures.

The Bank's aim is to offer outstanding experience and high-level service satisfying the needs of customers through its professional personnel and innovative 21st century digital technology. The priority of the Bank in the retail segment is to further strengthen mortgage lending in view of the high-level activity of the market. By introducing innovative products the aim is to further increase and diversify the customer base.

Regarding investment products, MKB seeks to further enhance personal consulting through its network, while thanks to the digital services, banking is made increasingly convenient, simple, fast and secure for the whole clientele. In the corporate segment, given MKB's foreign trade banking experience and significant foreign exchange market competence, MKB focuses onenhancing the utilisation of investment/treasury products.

Offering high quality customer service is considered a key task for MKB: the members of the Group provide a wide range of services for the customers.

Considering the combined value of its product range, quality of service and customer relations, MKB seeks to remain a dominant service provider of the domestic banking market.

KEY INDICATORS

MKB Group (IFRS consolidated)				
	(million HUF)			(million EUR)[4]
	2015	2016	Change	2016
Balance sheet				
Total assets	1 954 098	2 101 616	7.5%	6 757
Loans and advances to customers, o.w.[1]	802 954	858 072	6.9%	2 759
Corporate loans	404 810	464 992	14.9%	1 495
Loans to private individuals	398 144	393 080	-1.3%	1 264
Investments in securities	859 741	924 137	7.5%	2 971
Customer accounts and deposits, o.w.	1 379 168	1 519 868	10.2%	4 887
Corporate accounts and deposits	834 799	988 805	18.4%	3 179
Accounts and deposits of private individuals	544 369	531 063	-2.4%	1 707
Shareholder's equity	107 985	125 408	16.1%	403
Income statement				
Gross operating income[3]	82 108	67 307	-18.0%	216
General administrative expenses	(52 910)	(38 283)	-27.6%	(123)
Impairments and write-offs	(94 458)	(15 236)	-83.9%	(49)
Banking tax	(13 641)	(6 257)	-54.1%	(20)
Share of jointly controlled and associated companies' profit / (loss) before taxation	728	273	-62.4%	1
Profit /Loss before taxation	(78 173)	7 804	-	25
Profit / Loss for the year	(76 402)	9 496	-	30

MKB Group (IFRS consolidated)		
	2015	2016
Liquidity & self financing		
Loans-to-Deposits (LTD) Ratio[2,3]	58.2%	56.5%
Capital management		
CAR	11.28%	12.04%
Portfolio quality		
Non performing loan ratio[3,5]	19.8%	12.0%
Profitability		
After tax ROAE[3]	-51.5%	6.4%
After tax ROAA[3]	-3.9%	0.5%
Efficiency and operation		
CIR[3]	63.1%	56.8%
Number of average statistical employees	2 080	1 996
Number of branches	76	73

1 net amounts
2 L&A to customers gross amounts/ Deposits and current accounts
3 data not represented in MKB's Financial Statements
4 HUF/ EUR exchange rate: BS: 311,02; PL: 311,46
5 NPL, CRR article 178 - nonconsolidated

AWARDS AND RECOGNITION

HBLF Visionary Leadership Award 2016 – Dr. Ádám Balog

In 2016 the Visionary Leadership Award of the Hungarian Business Leaders Forum (HBLF) established in 2009 was received by Dr. Ádám Balog, the CEO of MKB Bank. The award, donated by the members of the Advisory Board consisting of well-known Hungarian and foreign businessmen and patrons, recognises the achievements of leaders doing their most to make the world a better and more liveable place.

Hungarian Banking Association Ambassador of Financial Culture Award

The Hungarian Banking Association presented the Ambassador of Financial Culture Award to MKB for its activity in the Money Week (Pénz7) Financial Culture Development Programme in Hungary. According to the reasoning, MKB Bank showed exemplary and committed performance during the programme series in terms of developing and disseminating financial skill and culture. Last year the Bank provided high-quality training conditions for hundreds of school teachers and assisted the Pénz7 Programme by involving an outstanding number of volunteers. During the programme 42 MKB volunteers took part in the educational activities of 45 schools.

Mastercard – Bank of the Year Competition 2016 – 3rd place in the 'Retail Loan Product of the Year' category

The commercial banks offering retail banking service in Hungary had an opportunity to participate in nine categories of the Mastercard – Bank of the Year Competition 2016. A total of 79 applications were submitted by 13 financial institutions. The Bank received 3rd place in the 'Retail Loan Product of the Year' category.

Forbes – Ildikó Katona **named the 4th most influential female executive of Hungary's economy**

Forbes listed the 50 most influential women of Hungary's economic, public, media, industrial and cultural sectors in 2016 as well. In the ranking of economic players the position of the candidates and the business performance, size and number of staff of the organisations led by them had been considered, based on which Ildikó Katona, Deputy Chief Executive of MKB Bank was named the 4th most influential female executive of Hungary's economic sector.

Blochamps Private Banking Hungary 2016 – Senior Private Banker of the Year Award – Zsuzsanna Major

The Blochamps Capital Financial Consulting Ltd organised its conference for the seventh year, an annual event for the top private banking and asset management professionals of Hungary. In 2016 Zsuzsanna Major of the Bank's Private Banking business line was named Senior Private Banker of the Year.

National Association of Entrepreneurs and Employers, (VOSZ) – Hungarian Commercial Grand Prize 2016 – András Lakatos

The European Day of Commerce launched by Brussels-based EuroCommerce was organised for the 12th time in 2016. The event is focused on commerce. The Bank has traditionally strong positions in serving companies in the commercial sector. The Hungarian Commercial Grand Prize, considered as one of the most prestigious awards of the profession, was given to the Bank's corporate relationship manager, András Lakatos.

OPERATING ENVIRONMENT OF MKB GROUP

INTERNATIONAL MACROECONOMIC ENVIRONMENT

2016 was an eventful year for the global economy. At the beginning of the year, following the turbulence caused by fears of setback of the Chinese economic growth, the investors' risk appetite typically increased in the global money and capital markets, also supported by the main central bank's measures (BoJ, ECB). The improving macroeconomic indicators reduced the recession fears, and the forward-looking confidence indicators took a positive turn in the spring after a start-of-the-year setback. Q2 2016 was dominated by delayed expectations over Fed rate hike, as well as the uncertainty caused by the British referendum over Britain's EU membership at the end of H1. After the referendum on 23rd June the safe haven currency role of the US dollar strengthened, and the stock market momentum slowed down temporarily.

In H2 the released macro data indicated steady economic growth in the developed countries, and the investors' mood was additionally determined by positive expectations for central bank measures. Towards the end of the year the focus turned to the US presidential election. Following the victory of Donald Trump optimism over a US economic expansion increased, also causing rising inflation expectations and a surge in government bond yields. The US dollar also picked up prior to the Fed rate hike and strengthened against the euro by 7% in just over a month. The failure of the Italian constitutional referendum and the renewed difficulties of the Italian banks also contributed to the weakening of the euro. In the meantime the oil exporting countries announced measures aimed at reduced extraction, which supported the end-of-year increase in oil prices; the crude oil price almost doubled in 2016.

In addition to the rate hike implemented in December 2016, the Fed projected a higher interest rate path for 2017, while the ECB announced the extension of its asset purchase programme. Although the beginning of 2016 was characterised by growing deflation fears, 2017 will be dominated by increasing inflation which may influence the monetary policy decisions of the central banks as well. Tightening may only be expected from the Fed, although the extent and pace of further rate hikes remain a question.

The IMF forecast updated in January 2017 projected global economic growth of 3.4% in 2017 and 3.6% in 2018. While the expectations for the United States are more favourable, the growth prospects of several emerging markets are more modest. For the eurozone growth rate the projected values are 1.6% in 2017 and 2018. In 2017 elections will take place in France and Germany, which may raise further questions regarding the future of European integration.

In January 2017 the decision on the Basel bank reform was postponed. There were many who encouraged the finalisation of rules before the inauguration of the US president due to potentially more looser regulation. Donald Trump announced the revision of the financial regulation act (Dodd-Frank) in early February. New banking rules may be expected in March at the earliest. The delay is favourable for the European banks, unlike the uncertainty: the standardised capital adequacy calculation (tightening for the EU) would worsen the position of the banks, while the economies of Europe are more reliant on the banks' lending activity. At the same time Moody's is optimistic; according to the credit rating agency 2017 could be the healthiest year for the European banking sector over the past ten years. With a steeper yield curve the banks could generate increasingly higher margins over longer terms. Overall, non-performing loan portfolios the credit institutions have to cope with are decreasing, although the high non-performing exposure of the Italian banks continues to present a risk, and the impact of Brexit on the financial sector is still a question.

Hungarian economic environment

Economic growth was slightly more modest in 2016 than in 2015. The annual growth rate was 3.1% in 2015, followed by 2% in 2016. While the construction sector held back growth, the agricultural and service sectors supported expansion. As regards the construction industry, the impacts of the measures adopted to boost the economy (Family Housing Allowance, VAT cut on homes) were already visible in 2016, although the sector made no substantive contribution to economic growth. Due to the favourable spring and summer weather conditions agricultural production was at a record high, or close to it, which encouraged GDP-growth. On the other hand, growth was also driven by consumption in 2016. The permanent increase in household consumption was supported by the historically high level of financial assets, the positive income developments and the increase in household lending. 2016 was characterised by dynamically growing employment and tighter labour market conditions. The unemployment rate decreased to a 10-year low, i.e. 4.5% in 2016. Labour shortage became an increasing obstacle to growth with an impact on every sector of the economy.

Economic growth in 2016 was held back by a lower influx of EU funds than in 2015. The calls for tenders progressed well for the 2014-2020 budget period, but due to delays in announcing the winners, the impact of payments and project implementation is likely to be felt mostly from 2017.

Fitch Ratings upgraded Hungary's sovereign debt rating to investment grade on 20 May 2016, with similar decisions made by S&P on 16 September and Moody's on 4 November. The decisions of the three credit rating agencies in 2016 made Hungary a more attractive investment target, and simultaneously with the more favourable financing opportunities the Government's room for manoeuvre increased in terms of procyclical economic policy.

After two negative years consumer prices increased by an average of 0.4% year on year in 2016.

The Central Bank Hungary implemented 15 bp reference rate cuts three times between March and May, thus reducing the reference rate to 0.90%. As an important momentum in terms of monetary policy measures, the commercial banks' 2-week deposits had been terminated by the end of April, and the limit for 3-month deposits at the end of 2016 was established at HUF 900 billion.

In 2016 the sentiment of the domestic money market was primarily influenced by international processes. Larger fluctuations in the HUF exchange rate occurred early in the year and in the second half of April. At the beginning of autumn, along with positive credit rating expectations, the HUF reached its annual peak against the EUR. The forint weakened in November, due partly to the monetary easing of the central bank implemented through unconventional measures, and partly to the capital outflows experienced in the emerging markets. The yield curve steepened during the year: while on the short side the unconventional moves of the MNB permanently reduced the yields below the 0.90% reference rate, on the long side increase was encouraged by international events. The 5-year government bond yield decreased by 87 bp from 2.54% at the start of the year, while the 10-year government bond yield decreased by 16 bp from 3.32% by the end of 2016. The 3-month BUBOR rate began to decline after July, and then finished the year at 0.37% following a significant break from the reference rate in November. In March 2017 the interbank rates are already around the technical minimum.

The growth rate expected by the Bank for 2017 is 3.5%, with a potential for over 3% expansion in the subsequent two years as well. In 2017 growth could be supported by domestic consumption and investments, and as a result of capacity enhancing investments implemented this year the industrial sector may also have a larger contribution to growth from 2018. Furthermore, growth is supported by the expansion of the family housing allowance programme and the acceleration of EU payments under the new cycle, and therefore in 2017 a take-off in the construction sector can be expected. The inflation pressure will gradually increase in the economy from 2017, with the Bank expecting an average inflation rate of 2.3% in Hungary. The extension of the ECB asset purchase programme until December 2017 also indicates a loose monetary policy to remain in place, creating larger room for Hungary's monetary policy as well.

The situation of the Hungarian banking sector*

The Hungarian banking system reached a turning point in the period following the recession: not only the banking system as a whole, but the majority of the once permanently loss-making banks closed a profitable year as well. The loan portfolio began to increase in most segments and products. The banks' lending activity significantly increased in terms of retail unsecured loans, particularly in providing personal loans, while the segmented recovery of the housing market further supported by government incentives had a positive effect on housing loan market. The reduced bank tax also contributed to a stable operating environment.

The lending process of the credit institutions is characterised by favourable trends. New lending volumes of corporates and households increased. In 2016 the proportion of new retail mortgage loans increased by approximately 27%. Based on preliminary data the total assets of the credit institutions increased by 4% compared to the end of 2015. The net corporate loan portfolio expanded by 3.9%, while households lending portfolio stagnated; the securities portfolio increased by 10.7%. The ratio of more than 90 days overdue loans improved further by the end of 2016: in the household segment the ratio decreased from 17.6% to 12.7%, and in the non-financial corporate segment it dropped from 9.6% to 5.4%. In 2016 the credit institutions generated a total of HUF 510.3 billion profit before taxation (in 2015: HUF 34.3 billion), thus improving the average return on equity to 15.4%. Of the 111 credit institutions 76 generated a total profit of HUF 527.2 billion, while 35 produced a total loss of HUF 17.0 billion over the year. The significantly improved profitability was supported by substantial specific, more volatile and cyclical elements such as the release of provision, the reduced bank tax and the VISA transaction.

In 2017 further strengthening in the banking sector is expected by MKB; the growth will be supported by recovering retail consumption, the improving labour market trends, the expanding volume of real wages encouraged by low inflation and the drawdown of EU funds. At the same time, similarly to the whole European banking system, the management of the permanently low interest rate environment will provide a major challenge for the domestic banks as well due to the fact that the increasingly narrow margins may put a pressure on the banks' profitability. The impact of the low interest rate environment will be mitigated by improved lending activity, although the 0% bottom limit of retail deposit interest rates and the ever growing competition may further reduce the available margins.

* Source: MNB, unconsolidated preliminary data (Hungarian Accounting Standards, HAS)

MKB GROUP'S PERFORMANCE IN 2016

The financial and business fundamentals of the Group are sound, including capitalisation, liquidity, self-financing capacity, balance sheet structure and performance of different business units.

MKB Group's profitability improved significantly in 2016: it posted HUF 7.8 billion in profit before tax, comaperd to HUF 78.2 billion in 2015. A nine-year high after tax profit amounted to HUF 9.5 billion in 2016. After-taxed profit exceeded profit before taxation due to the impact exerted by group members' deferred tax.

Net interest income declined by 8.6%, due, basically, to a low-inflation environment and a slimmer loan portfolio of the massive downsized commercial real estate loan portfolio. MKB managed to improve it's fee and commission income in 2016. The 7.2% increase was a combined result of the change of the Bank's pricing policy, an expansion of specific business volumes and changes in the terms and conditions of certain products.

In addition, to a lesser degree though, items, which were not planned also contributed to the outstanding performance: lower bank tax as well as profit realised on the central bank's Market-based Lending Scheme and on a one-off financial transaction (VISA) also contributed to the Group's performance.

Impairments and provisions dropped by HUF 79.2 billion relative to the previous year. Decrease is attributable, in part, to a high base, which was the outcome of the spin-off of the commercial real estate loan portfolio at the end of 2015, and, in part, a more benign macro-economic environment and marked improvement in portfolio quality. The portfolio of non-performing loans shrank substantially from HUF 259 billion to HUF 161 billion, with the NPL rate* slowing down to 12.0% in 2016 from 19.8% in 2015.

In 2016, the Bank downsized its commercial real estate loan portfolio by HUF 140 billion. The Bank managed to achieve this alongside lower-than-planned additional provisions for 2016 and a consistently high rate of decrease in the non-performing loan portfolio sustainable over the long term.

Thanks to the cost-cutting and efficiency improving measures taken in 2015 and 2016, operating costs decreased by 27.6%, or HUF 14.6 billion, amounting to HUF 38.3 billion at the end of 2016. Decrease was attributable to HUF 3.7 billion reduction in personnel related expenses, HUF 4.8 billion reduction in depreciation and HUF 6.1 billion reduction in other operating and administration expenses.

MKB Group's (consolidated) total assets under IFRS was HUF 2,101.6 billion at the end of 2016, representing a 7.5% increase. Thanks to a favourable dynamics of new lending, net value of the customer loan portfolio rose by 6.9% amounting to HUF 858.1 billion, while customer deposit portfolio rose by 10.2% amounting to 1,519.9 billion at the end of 2016.

By end-2016, the Group's IFRS regulatory capital under Basel III had risen by HUF 12.5 billion to HUF 112.8 billion in line with the applicable regulatory requirements. Risk-weighted assets including operating and market risks rose by 5.5%, from HUF 888.2 billion in 2015 to HUF 936.8 billion. The consolidated Basel III capital adequacy ratio had risen to 12.04% (non-consolidated HAS: 14.62%) by the end of the reporting period. The robust capitalisation of the owners contributes to the Bank's safe operation, strengthens customer trust and helps handle events triggered by potential macro-economic turbulences potentially adversely affecting the Bank's profitability.

* NPL according to CRR Art. 178 , also containing off-balance sheet exposures

THE PERFORMANCE OF THE INDIVIDUAL BUSINESS LINES*

Retail customers

Revamped procedures and dynamic product development (e.g. the revision of the retail product portfolio and the housing loan schemes and the introduction of new products, interest periods and a new pricing structure) offered customers more complex offers and a broader array of products. A number of new products were introduced, and the Bank carved out sizeable shares in segments where it had had no presence before. One such segment is personal loans, where the Bank's market share reached 2% in new lending in December 2016. Traditionally, the Bank has a highly positioned clientèle; however, it is addressing all customer segments through its digital services and development. The success of a strategic change is reflected by the fact that customer churn declined, and new acquisitions grew, as a result of which the number of the Bank's customers was close to 190 thousand at year end.

As at end-2016, retail loans, in which the total share of housing and home-equity loans was 96%, amounted to HUF 393 billion. The Bank's retail lending grew significantly in 2016. The contracted amount of home loans, to which a new all-purpose mortgage loan was introduced during the year also contributed, more than doubled. As a result, the Bank's market share in mortgage lending (disbursements) rose to 4.1% and 4.4% respectively, which translates into growth in excess of 2 percentage points within one year. Regarding the housing loan market, MKB also participated actively in the subsidised loan programmes launched by the government. The Bank was among the first to join "Családi Otthonteremtési Kedvezmény" ("Home Creation Grants"), as a result of which the Bank accepted close to 1,000 loan applications representing over HUF 3 billion in 2016. The Bank opened towards the unsecured loan market: it had transformed its personal loan products, which were selling five times higher at the end than at the beginning of the year.

Regarding the savings products offered by banks (bank deposits, bank accounts, bonds, investment funds and government securities) to households increased last year in response, mainly, to an improving economic environment. Households' assets managed by the Bank amounted to HUF 861.2 billion at the end of 2016. The Bank's market share in household savings is 4.9%. In keeping with a low inflation environment, the structure of savings is changing. Time deposits and bonds have been declining in importance; by contrast, assets managed in investment funds and government securities have been playing an increasingly important role.

Corporate and institutional customers

The Bank's position in the corporate segment is traditionally strong; at the same time, SMEs have been given greater focus. In 2016, the Bank launched projects aimed at product and procedure development. The Bank fine-tuned its business strategy, the two cornerstones of which are digitalisation and the concept of relationship banking. Within this, the Bank developed new value offers and a new product and service portfolio and strengthened its consultancy profile. The structure of customer management was transformed as part of the development of its small enterprise segment and the foundations of digital services were laid down. As a combined result, the Bank offers better customer experience and better quality services.

In the summer of 2016, despite the Bank's downsizing of its commercial real estate loan portfolio, reverse of a decline in corporate lending was succeeded: the net value of corporate loans had grown by nearly 15% by the end of 2016; the Bank's market share stood at 8.2% and the number of its corporate customers exceeded 44 thousand at the end of 2016.

The Bank also actively participated in the public programmes in the market of corporate lending. The Bank's share in the third phase of the Funding for Growth' Scheme launched by the National Bank of Hungary is nearly 14%. Since the start of phase III of the FGS, the Bank has committed approximately HUF 65 billion in loans, of which HUF 53 billion were committed in pillar I and HUF 11 billion in pillar II. Key components of financing include the products available in the Export Promotion Credit Programme launched by EXIM. In 2016, the Bank lent its corporate customers a total of approximately HUF 20 billion in loans aimed at boosting exports bringing up its end-of-year closing portfolio to HUF 41 billion, up by 57% over the previous year's HUF 27 billion. Financing products include card, working capital and investment loan facilities offered in the Széchenyi Programme. The participant banks lent a total of HUF 165 billion within the framework of the programme in 2016. Based on the amount lent, the Bank's market share was 19%. A new product, the Agrarian Széchenyi Card was launched in 2016; this had added another 1.9% to its market share by the end of 2016. A further important tool of corporate financing is factoring. With its 12% share, and having posted a 20% increase in factoring, MKB remained one of the major market actors in the factoring sector.

MKB's market share in the total corporate deposit portfolio amounted to10.7%. In addition to lending and deposit collection, a wide selection of other financial services is also provided by the Bank through the involvement of other group members. They include MKB Consulting's consultancy services in respect of EU projects, MKB Euroleasing's complex vehicle financing facilities including insurance products (for both businesses and owners), up-to-date solutions for the management of fringe benefits and the services provided by the MKB Pension Fund.

Money and capital markets, investment services

In response to an environment of consistently low yields in 2016, an increasingly high number of the Bank's customers opted for investment services. From a broad selection of investment products available, customers decided to channel their savings into retail government securities. Concurrently, investments into investment funds also picked up considerably, the most popular of them being actively managed mixed funds, absolute return funds and their FX-denominated combinations. The rearrangement of customer portfolios also led to a marked increase in the Bank's market share in both government securities and investment funds.

The Bank also undertook major product development in this business line in 2016; as a result, it introduced and launched its premium banking services in 28 branches. Since 2016, the Bank has been offering dedicated services to customers who are, though below the private banking threshold, positioned higher than average. Premium investment services include customised sample portfolio-based investment consultancy, a broad array of products, customised products and personal consultancy with highly qualified experts.

Wealth management saw dynamic growth in 2016. Both the number and value of the managed portfolios and the number of consultants grew at a spectacular pace. The majority of the managed portfolios outperformed benchmarks, with the largest portfolio (representing approximately HUF 93 billion) posting over 7.3% in returns. At the end of the reporting period, wealth managed for institutional and private investors exceeded HUF 157 billion and wealth managed

* Source of market shares: MNB (MKB calculations)

under consultancy arrangements exceeded HUF 90 billion, with growth exceeding 40% in the latter case. In addition, MKB also performs asset management for the MKB Pension Fund and the MKB-Pannónia Health and Mutual Fund.

Private Banking

The number of private banking customers was close to 2,000 at the end of 2016. The business line managed to add another HUF 23 billion to assets managed, which exceeded HUF 340 billion. Managed assets per customer was outstandingly high in the Hungarian market.

Portfolio quality

The aggregate value of the Bank's non-performing loans decreased by HUF 75 billion in 2016, representing a 52% improvement relative to 2015. There was also marked reduction in defaulted corporate loans owing to consistent improvement in portfolio quality during the year. A 56% decrease in the exposure of the commercial real estate financing segment surpassed both the expectations of the European Commission and the Bank's plans. Coverage ratios for problem loans improved further. A considerably lower-than-planned amount of provisions had to be set aside for expected loan losses in connection with problem and non-performing loans. The amount of problem loans is now at a level where no systemic risk related additional capital buffer is required .

A major project aimed at reducing non-performing retail loans was launched in 2016. As a result, in addition to key measures to improve efficiency, major portfolio downsizing materialised as well, with less than planned additional provisions.

All-bank NPL rate* dropped from 19.8% as at end-2015 to 12.0%. This was attributable, mainly, to the deliberate downsizing of the non-performing loan portfolio. A stronger restructuring focus as a result of increased organisational and procedural efficiency also contributed to improvement. Furthermore, the quality indicators of the new loans are also good: nearly all the retail housing loans and personal loans extended in 2016 are non-defaulting, which is an excellent example of the Bank's efforts to create quality portfolios as its most urgent priority.

Branch network and alternative sales channels

The sales network developed in line with the Bank's efforts towards digitalisation. In order to improve efficiency, the Bank also rationalised its branch network. As a consequence, MKB operated 73 branches at the end of 2016. The market share in the bankcard market remained unchanged in the third quarter of 2016 compared with the one in 2015. With nearly 200 thousand bankcards issued, the Bank's market share in the retail and corporate sector was 2.2% and 5.4%, respectively. The number of retail users of the NetBankár services exceeds 151 thousand. At the end of 2016, there were nearly 8,900 users of the PC Banker services designed mainly for companies. The Bank's Telebanker services are also very popular. The number of retail users was over 140,000 at the end of 2016. User needs having been surveyed, the range of products distributed by external sales partners was expanded to include retail mortgage and unsecured loans as well as account management and credit facilities for small-size enterprises. 89 external sales partners are involved in selling MKB products.

Digitalisation

Customers expect fast and efficient services irrespective of where they are. Responding to their needs, the management of MKB decided to launch digitalisation develpoment projects. Digitalisation supports both corporate and retail business and reduces costs, improves the Bank's operational efficiency and, more importantly, offers new products and services to customers.

* CRR Art. 178, also comprising off-balance sheet exposures

The flagship of these efforts is what is called the transformation project (with the scope of replacing the Bank's core system with Oracle Flexcube, one of the most state-of-the art solutions). The upgrade of the core system will create a new sector standard. A major milestone of MKB's digitalisation efforts in 2016 was that on-line access to the Bank improved. Used by 15,000 costumers, MKB's mobile application was also rolled out. The application is upgraded continuously. Its functions that went live last year, are related to account and bankcard management. MKB's new website was also launched last year, and new functions will be added to it in 2017. Further digitalisation projects are being prepared and developed. These projects are scheduled to go live in a number of phases. Market-driven sales channels and products supported by state-of-the art technologies contribute to improved customer experience and ensure that services are provided at a high professional standard.

In 2016, the Bank launched Fintech Akadémia (Fintech Academy), an initiative that is the only one of its kind in Hungary. The occasion enabled over 600 participants to gain an insight into the most recent financial and technological trends. Concurrently, a contest was announced, where the winning teams were provided facilities and resources, e.g. offices, mentors, financing and technological support to realise their ideas. The Bank also seeks to identify opportunities of cooperation with national and international fintech companies.

MKB SUBSIDIARIES/ STRATEGIC PARTNERS

MKB- Euroleasing Autólízing Zrt.

MKB-Euroleasing Autólízing Zrt., which had been engaged exclusively in vehicle financing before launched asset financing operation in 2016, and is now a universal leasing company. The Company firstly introduced agricultural and large goods vehicle financing involving a number of sales partners in distribution. In addition, the Bank now offers a general machinery financing facility mainly to MKB Bank's customers. As a result, there has been a major shift in the Bank's clientele to the entrepreneurial segment.

Thanks to the development of the company group's IT systems, MKB-Euroleasing was able, already in the first quarter of 2016, to introduce large goods vehicle, agricultural machinery and general asset financing products in addition to retail car financing. HUF-denominated facilities were complemented with EUR-based financing, as a result, 2016 saw record sales of financing products.

New financing by MKB-Euroleasing Autólízing Zrt. more than doubled in 2016 compared with 2015; this was well above the overall growth in Hungary's lease market. New operations are not the exclusive contributors to significant growth, as retail car financing also grew by over 30%, securing a firm second place. Due to hugely successful agricultural machinery financing, the company became a key actor in the segment in the very year of the launch of the service. As a result, MKB-Euroleasing Group is among the first three major actors in the leasing market in Hungary.

MKB Fund Manager

As at end-2016, the funds offered by MKB Fund Manager to investors comprised 25 (HUF-, EUR- and USD-denominated) open-end funds and 20 closed-end investment funds. As a combined result of the Bank's successful sales activity and good fund returns, the funds managed by the Fund Manager rose by 18% to HUF 253, well above market growth.

Open-end funds stood at HUF 203 billion as at end-December 2016, compared with HUF 165 a year earlier. Closed-end funds stood at HUF 50 billion as at end-December 2016, similar to a year earlier.

MKB Fund Manager can look back on a successful 2016 business year, with its market share rising from 3.8% at end-2015 to 4.4% at end-2016.

MKB Consulting Kft.

EU funds play a key role in Hungary's economy. In its capacity as a member of the Group, MKB Consulting Kft. provides consultancy services to SMEs and large companies to help them use EU and national funds efficiently and effectively. Its aim is to provide high quality complex services during the entire lifetime of a project, thereby contributing to the efficient use of funds in compliance with the applicable rules.

In order to be able to provide services at a high professional standard and in order to maximise customer experience, MKB Consulting works in cooperation with the Bank in a number of areas. Working in cooperation with the Bank's capital market and transaction operations, it participated in the execution of two major transactions and provides consultancy services for start-up enterprises selected in the MKB Fintech Programme. MKB Consulting's 2016 performance was outstanding in both the SME and the large corporate sectors. Regarding project tendering, the company sold 135 small-enterprise packages in 2016. Within that, 110 contracts for project tendering were signed. MKB Consulting drafted and submitted a total of 80 project tendering documents for its VIP customers with sales turnover of over HUF 1 billion, with HUF 26 billion as their combined budget and HUF 12.8 billion as the total amount of requested financial resources provided by the EU. Of them, 14 applications were granted, as a result of which the company's customer received HUF 6.5 billion financial resources provided by the European Union.

MKB Funds and SZÉP Card Programme

MKB Voluntary Pension Fund is one of the leading voluntary pension funds in terms of both the number of its members and their assets. As at 31 December 2016, its membership reached 85.6 thousand and the total value of the assets managed by the fund amounted to 122 billion. The assets managed by the voluntary pension fund secure MKB an approximately 10% market share; based on its membership, its market share is 7.5%. As at 31 December 2016, MKB Pension Fund had 3,936 members and HUF 18 billion in assets in its private arm.

The general meeting approved Pannónia Health and Mutual Fund's merging into MKB Health and Mutual Fund, which led to the foundation of MKB-Pannónia Health and Mutual Fund. Heath or mutual services continue to be provided in an unchanged form and at a high standard to members of the fund. The Fund's membership rose from 175 thousand to 187 thousand in 2016. With that, the Fund is now the 3rd largest actor in the market. Compared with end-2015, the assets managed by the Fund grew by 17% to HUF 12.4 billion. The Fund has posted its highest membership fee income so far. Case-based payments were sizeable in terms of both their amount (HUF 4.1 billion) and percentage (42.7%). The Fund serves its customers and business partners at a consistently high professional standard. Contracts with 11 thousand service providers and over 8 thousand points of sale provide it with a solid background.

Széchenyi Pihenőkártya (Széchenyi Recreation Card) (SZÉP Card) has been one of the most dynamicaly-ly growing fringe benefits recently. MKB SZÉP Cards are issued and the related system is operated by MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft., which has issued over 187 thousand so far. Employers transferred HUF 13.6 billion in fringe benefits to the cards and cardholders purchased services in the amount of HUF 13 billion.

HUMAN RESOURCES

In 2016, with reorganisation having been completed and a new ownership structure having come into existence, the final cornerstones of the Bank's organisation were laid down. Meeting the expectations of the new owners and management, the “Corporate Culture Project” contributed to more efficient operation and supported changes in the organisational and governance structure to a large extent.

In the wake of a comprehensive employee engagement survey covering the entite bank conducted in 2016, the most important focus areas had been identified. Based on this, the Bank pays special attention to recognition (both financial and moral), cooperation (team and sharing of information) and top management (accessibility, transparency and recognition of staff).

MKB Sports Association promoting health among the staff was founded in mid-2016. A programme called Internal Customer Dialogue launched in the summer is to facilitate cooperation between the individual organisational units.

The foundation of the ESOP, as a key component of the Bank's incentive scheme was a major event in 2016 affecting the entire organisation.

Main priorities include, inter alia, retaining and motivating highly qualified staff members and ensuring the supply of a quality labour force. In order to ensure a continuous supply of employees and attract talented staff, the Bank's internship programme also underwent revision. The Bank employed 37 interns in 2016 and joined dual university training programmes. As a result, another 2 students began their university studies by professional support of the Bank.

Furthermore, great attention is paid to making sure that the principle of equal opportunities is observed. We support the idea that women with a high degree of expertise and strong managerial skills should enter executive positions. Accordingly, every 3rd executive officer at the Bank is a woman.

The key message of the new HR strategy makes it clear also for potential employees that the Bank’s significant and remarkable presence on the labour market is ensured by presenting stability and computability again.

CORPORATE RESPONSIBILITY AT MKB BANK

The objective of the Bank, relying on its nearly 70-year old tradition and employee engagement is to operate as a responsible financial institution in the Hungarian banking sector. During its daily operation the Bank pays close attention to the long-term interest of Hungarian society as well as sustainability and environmental protection.

It strives to make sure that the principles of corporate responsibility are increasingly strongly embedded in its products, services, organisation and day-to-day operation.

Founded 10 years ago, the Professors' Club, an association of Hungarian scholars, university lecturers and researchers representing the crème de la crème of their metier is a unique initiative offering these outstanding personalities preferential terms and conditions and services. Mentoring talented young people, the Club of Outstanding Personalities is a forum for representatives of public life, goodwill causes, culture, sports and business, and other public personalities.

The cornerstones of MKB's corporate responsibility are as follows:

MKB Scholarship Programme

MKB Bank launched a scholarship programme in 1997 in order to support talented, socially disadvantaged young persons and children excelling at school. Consistently excellent academic achievement ensures eligibility for scholarship up to graduate level. The first student to receive such stipend overarching various levels of education from primary to tertiary education graduated in 2007. The number of graduates including engineers, economists, IT experts, physicians and ballet dancers is now over 20. There are 100 persons participating in the programme. The Bank, involving the Hungarian Association of the International Children's Rescue Service, publishes invitations for applications each year in order to fill vacancies.

MKB Bank for Hungarian Sports

In the world of sports achievement hinges on tough training, perseverance and the spirit of competition. When supporting sports, MKB Bank is driven by its mission to preserve traditional values and create new ones. Therefore, it targets sport clubs and associations that embrace such values and the athletes of which all sports lovers and MKB can be proud.

In 2016, the Bank provided support to both athletes and sports associations including the Hungarian Swimming Association, MKB-MVM Veszprém Reserve Handball Team, the Hungarian Volleyball Association, the Hungarian Sports Association of Persons with Hearing Impairments, the Equestrian and Leisure Centre in Kiskunhalas, Csaba Orbán, a visually impaired marathon runner and Péter Makk, junior tennis player.

The Bank's executive officers are involved in the activities of a number of sports associations: Ádám Balog is member ofthe executive committee of Budapesti Vasutas Sport Club (BVSC), Benedek Sándor is the chairman of the Hungarian Cycling Federation and Márk Hetényi is member of the executive committee of the Hungarian Volleyball Association.

THE MANAGEMENT BOARDS OF MKB BANK

Supervisory Board

chairman:

DR MIHÁLY BARCZA
partner, Oppenheim Law Office

members:

DR ÁDÁM LOVÁSZI-TÓTH
attorney-at-law, Lovászi-Tóth Law Office

FERENC SMOHAY
ABT Treuhand Group Head of Risk Management

TIBOR LADOS
general manager, Mátrai Erőmű Zrt.

JÁNOS NYEMCSOK
Executive Director, MKB Bank Zrt.

FERENC MÜLLER
Director, MKB Bank Zrt.

ALBERT GODENA
Director, MKB Bank Zrt.

Board of Directors

chairman:

JÁNOS JAKSA
CEO, Minerva Tőkealap-kezelő Zrt.

members:

IMRE KARDOS
Deputy CEO, Minerva Tőkealap-kezelő Zrt.

RAKESH KUMAR AGGARWAL
Investor, Blue Robin Investments S.C.A.

BALÁZS BENCZÉDI
CEO, Pannónia CIG Alapkezelő Zrt.

DR ÁDÁM BALOG
CEO, MKB Bank Zrt.

ILDIKÓ KATONA
Deputy CEO, MKB Bank Zrt.

MÁRK HETÉNYI
Deputy CEO, MKB Bank Zrt.

THE OWNERS OF MKB BANK

45% METIS PRIVATE EQUITY FUND

METIS Private Equity Fund was launched by Minerva Tőkealap-kezelő Zrt. (Minerva Private Equity Fund Manager) and Hungarian investors in February 2016. The initial capital of the Fund was EUR 100 million. Now it is EUR 135.5 million. MINERVA purchases for METIS Private Equity Fund ownership shares in business undertakings established in the European Union that develop and produce innovative products and services, and use the Fund to secure a broader market for their products and services. MINERVA Private Equity Fund's own experts, strategic partners and key sector consultants provide extensive expertise required by sectoral diversity and needed for diversification.

30% BLUE ROBIN INVESTMENTS S.C.A.

An international private investment fund managed by Blue Robin Management investing in European financial markets. Blue Robin Management is supported by a group of international financial experts.

15% ESOP – EMPLOYEE STOCK OWNERSHIP PROGRAMME

With effect from end-2015, the amended Act XLIV of 1992 on Employee Stock Ownership Plan (ESOP) allows financial institutions to launch ESOPs enabling employees to acquire ownership shares in the company employing them. With support from its owners, MKB Bank availed itself of the opportunity and decided to launch its own ESOP. The ESOP launched by the Bank allowed employees to join the plan on a voluntary basis, which, in turn, enables them to benefit from shared work.

10% PANNÓNIA PENSION FUND

Based on its assets, the Fund established in 1994 and operating in Hungary is the 6th largest market actor in Hungary. It has 35 thousand customers. Retaining its defining role among pension funds, it strives to achieve further growth and share its outstanding returns with its members. Pannónia Pension Fund is a member of CIG Partnership. The members of CIG Partnership are market leader companies with a clear future mission and a substantial market share.

MKB GROUP'S FINANCIAL INDICATORS

Data in HUF million except stated otherwise

Statement of profit or loss and other comprehensive income of MKB Bank Group

	2015	2016
Statement of profit or loss		
Interest income	73 971	62 476
Interest expense	31 642	23 804
Net interest income	**42 329**	**38 672**
Net income from commissions and fees	26 732	28 664
Other operating expense, net	(594)	(6 286)
Impairments and provisions for losses	94 458	15 236
Operating expenses	52 910	38 283
Share of jointly controlled and associated companies' profit	728	273
Profit /(Loss) before taxation	**(78 173)**	**7 804**
Income tax expense / (credit)	(1 771)	(1 692)
Profit (loss) for the year	**(76 402)**	**9 496**

Statement of financial position of MKB Bank Group

	2015	2016
Assets		
Cash reserves	41 494	97 914
Loans and advances to banks	51 740	67 039
Financial assets measured at FVTPL	93 569	75 210
Investments in securities	859 741	924 137
Loans and advances to customers	802 954	858 072
Non-current assets held for sale and discontinued operations	32 635	309
Other assets	20 857	28 081
Deferred tax assets	2 567	3 320
Investments in jointly controlled entities and associates	1 529	1 651
Intangibles, property and equipment	47 012	45 883
Total assets	**1 954 098**	**2 101 616**
Liabilities		
Amounts due to other banks	324 651	376 262
Deposits and current accounts	1 379 168	1 519 868
Financial liabilities measured at FVTPL	20 751	29 983
Other liabilities and provisions	35 018	37 197
Deferred tax liabilities	900	6
Issued debt securities	85 625	12 892
Total liabilities	**1 846 113**	**1 976 208**
Equity		
Share capital	225 490	100 000
Treasury Shares	-	(5 550)
Reserves	(117 505)	25 368
Total equity attributable to equity holders of the Bank	**107 985**	**119 818**
Non-controlling interests	-	5 590
Total equity	**107 985**	**125 408**
Total liabilities and equity	**1 954 098**	**2 101 616**

Capital adequacy ratio of MKB Bank Group

	2015 Basel III IFRS	2016 Basel III IFRS
Share capital	225 490	100 000
Outstanding share capital	**225 490**	**100 000**
Reserves	(117 400)	21 899
Intangible assets	(6 904)	(8 446)
AVA - additional valuation adjustments	(957)	(689)
Additional Tier 1	-	-
Tier 1: Net core capital	**100 229**	**112 764**
Subordinated debt	-	-
Tier 2: Supplementary capital	-	-
Regulatory capital	100 229	112 764
Risk-weighted assets (RWA)	754 539	758 269
Large loan limit	212	-
Operational risk (OR)	126 892	165 167
Market risk positions (MR)	6 530	13 368
Total risk weighted assets	**888 173**	**936 804**
Regulatory capital / Total assets	5,13%	5,37%
Tier 1 ratio	11,28%	12,04%
Capital adequacy ratio	**11,28%**	**12,04%**

The table contains the MKB Bank's consolidated capital adequacy ratio. Unconsolidated capital adequacy ratio is 14,62% (HAS).

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