MKB Bank Zrt.

Separate Financial Statements and
Independent Auditor's Report

December 31, 2018

Deloitte.

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Registered by the Capital Court of Registration
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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of MKB Bank Zrt.

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of MKB Bank Zrt. (the „Company") for the year 2018 which comprise the statement of financial position as at December 31, 2018 – which shows total assets of mn HUF 1,858,629 –, and the related statement of recognized income, statement of comprehensive income – which shows a net profit for the year of mn HUF 25,274 –, statement of changes in equity and statement of cash flows for the year then ended and notes to the financial statements including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at December 31, 2018 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (the „EU IFRS"), and the financial statements were prepared in all material respects in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (the „Accounting Act") relevant to the entities preparing financial statements in accordance with EU IFRS.

Basis for Opinion

We conducted our audit in accordance with the Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits. Our responsibilities under these standards are further described in the "*The Auditor's Responsibilities for the Audit of the Financial Statements*" section of our report.

We are independent of the Company in compliance with the relevant effective Hungarian regulations and the "Rules of conduct (ethical rules) of the auditor profession and the disciplinary process" of the Chamber of Hungarian Auditors and, in respect of matters not regulated therein, the "Code of Ethics for Professional Accountants" (the IESBA Code) issued by the International Ethics Standards Board for Accountants, and we have fulfilled our other ethical responsibilities in accordance with the same ethical requirements.

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	Related audit procedures
Impairment of the individually impaired loan receivables	
(See Sections 4. k and 10. of the Notes to the Financial Statements for the details) The net value of loans to customers in an amount of HUF 893,144 million comprise 48% of the total assets (gross book value of HUF 949,122 million of loans measured at amortized cost), and the relevant impairment balance at the end of the current year was HUF 63,875 million. The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of determination of individual specific impairment of loans. The most significant assumptions applied in the provisioning calculation are the followings: - valuation of collaterals; - estimated time to realize the collaterals; - estimated future cash-flows expected to be realized. Based on the significance of the above described circumstances the calculation of impairment of the individually impaired loans was identified as a key audit matter.	The relevant audit procedures performed by us included the following: - evaluating internal controls relating to monitoring of loans and calculating and recording of impairment; - evaluating specific loan impairments by selecting a random sample based on risk profiles, including the review of consideration and valuation of collaterals and estimations of expected future cash-flows; - review of subsequent events (sold receivables), and analysis of the possible effect on the year audited; and - evaluating the impairment triggers related to the non-impaired portfolio.
IFRS 9 compliance	
(See Section 4. jj) of the Notes to the Financial Statements for the details) The Bank recognises and measures its financial instruments with the first time application of IFRS 9 in the current financial year, from January 1, 2018. The application of the standard meant significant changes in respect of the methodology of the classification and measurement of the financial instruments. The Bank introduced the model based on the estimation of the expected loss in	The relevant audit procedures performed by us included the following: - understanding and testing of design and implementation of the main internal controls related to the classification and measurement of the financial assets; - evaluating the appropriateness of the classification and measurement of the financial assets, with special respect to the business models applied and application of the test of the

respect of the impairment on assets. At the transition, the Bank performed a large number of one-off tasks, including business model testing of the assets, reclassifications if needed, stage categorisation based on the payment and impairment indicators, and estimation of the risk parameters serving as a basis for impairment. With respect to the items above and as the IFRS 9 standard has a significant effect on the classification and measurement of the majority of the Bank`s assets and liabilities, we consider the application of the IFRS 9 standard as a key audit matter.	- criteria whether the cash-flows are solely payments for principal and interest; - evaluating the appropriateness of stage classifications applied by the Bank; and - evaluating and checking the appropriateness of the Bank`s respective internal policies and their application related to the IFRS 9 impairment models of the Bank. We performed the recalculation of the collective impairment with the involvement of subject matter experts.
Implementation of the new core banking system	
(See Section 13 of the Notes to the Financial Statements for the details) The Bank has replaced its previous core IT system, Globus with the new core IT system Flexcube. Parallel to the core system change, a large amount of data has been migrated from the previous core system to the new core system. The Bank, in order to perform the core system implementation and the data migration, set up a project organisation and designed controls sspecially for this purpose. With regard to the above and as the implementation of the new core system has a significant impact on the control environment of the Bank's operation, we identified the implementation and the related data migration as a key audit matter.	The relevant audit procedures performed by us included the following: - understanding the significant internal controls designed for the migration; - checking the data migration process and its results in connection with the new core system implementation; - testing of general IT controls designed in Flexcube system; - reconciliation of loan and deposit subledger; - review of client complaints, and potential legal issues; - review of the output of functional audits performed by the internal audit department; and - review of the results of the external expert checking the migration.

Other Information: The Business Report

Other information includes the business report of the Company for 2018. Management is responsible for the preparation of the business report in accordance with the relevant provisions of the Accounting Act and other regulations. Our opinion on the financial statements provided in the section of our independent auditor's report entitled „*Opinion*" does not apply to the business report.

Our responsibility in connection with our audit of the financial statements is to read the business report and, in doing so, consider whether the business report is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Furthermore, in accordance with the Accounting Act, our responsibilities also include assessing whether the business report was prepared in accordance with the relevant provisions of the Accounting Act and other regulations, and to express an opinion on the above and on whether the business report is consistent with the financial statements.

In our opinion, the business report of the Company for 2018 corresponds to the financial statements of the Company for 2018 and the relevant provisions of the Accounting Act in all material respects. As the Company is not subject to additional requirements under any other regulation in connection with the business report, we have not formulated an opinion on this matter.

In addition to the above, based on the information obtained about the Company and its environment, we must report on whether we became aware of any material misstatements in the business report and, if so, on the nature of such material misstatements. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

The Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives during the audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue, on the basis of the above, an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits will always detect a material misstatement when it exists. Misstatements can arise from fraud or error, and they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits, we exercise professional judgment and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in the Company's internal control that we identify during the audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

In compliance with Article 10 (2) of Regulation (EU) No. 537/2014 of the European Parliament and the Council, we provide the following information in our independent auditor's report, which is required in addition to the requirements of International Standards on Auditing:

Appointment of the Auditor and the Period of Engagement

We were appointed as the auditors of the Company by the General Meeting of Shareholders on April 19, 2018 and our uninterrupted engagement has lasted for 7 years.

Consistence with the Additional Report to the Audit Committee
We confirm that our audit opinion on the financial statements expressed herein is consistent with the additional report to the Audit Committee of the Company, which we issued on April 10, 2019 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.

Provision of Non-audit Services
We declare that no prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided by us to the Company. In addition, there are no other non-audit services which were provided by us to the Company and its controlled undertakings and which have not been disclosed in the business report.

The engagement partner on the audit resulting in this independent auditor's report is the signatory of the report.

Budapest, April 10, 2019

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Gábor Molnár
on behalf of Deloitte Auditing and Consulting Ltd.
and as a statutory registered auditor

Deloitte Auditing and Consulting Ltd.
1068 Budapest, Dózsa György út 84/C.
Registration number: 000083

Registration number of statutory registered auditor: 007239

MKB Bank Zrt.

10 011 922 641 911 401
statistic code

Separate Financial Statements

Prepared under
International Financial Reporting Standards
as adopted by the EU

Budapest, 10 April 2019

31 December 2018

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Separate Financial Statements as at 31 December 2018 | Data in HUF million except stated otherwise

MKB Bank Zrt.
Statement of Financial Position as at 31 December 2018

	Note	31.12.2018	31.12.2017	01.01.2017
Assets				
Cash reserves	6	19 240	31 599	97 914
Loans and advances to banks	7	63 610	78 005	62 977
Derivative financial assets	8	17 914	19 757	14 372
Securities	9	773 029	955 274	984 776
Loans and advances to customers	10	893 144	858 143	855 290
Non-current assets held for sale and discontinued operations	37	4 238	21 648	-
Other assets	11	16 518	16 957	17 174
Current income tax assets		-	159	31
Deferred tax assets	23	5 771	3 285	3 300
Investments in subsidiaries, jointly controlled entities and associates	12	42 972	49 898	48 905
Intangibles, property and equipment	13	22 193	16 303	15 253
Total assets		**1 858 629**	**2 051 028**	**2 099 992**
Liabilities				
Amounts due to other banks	14	214 153	236 881	374 043
Deposits and current accounts	15	1 380 838	1 552 495	1 528 903
Derivative financial liabilities	16	31 608	43 366	29 983
Other liabilities and provisions	18	38 708	43 581	27 803
Issued debt securities	19	5 696	11 119	12 892
Subordinated debt	20	28 002	22 307	-
Total liabilities		**1 699 005**	**1 909 749**	**1 973 624**
Equity				
Share capital	21	100 000	100 000	100 000
Reserves	22	59 624	41 279	26 368
Total equity		**159 624**	**141 279**	**126 368**
Total liabilities and equity		**1 858 629**	**2 051 028**	**2 099 992**

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

MKB Bank Zrt.
Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2018

	Note	2018	2017
Statement of profit or loss			
Interest income	**24**	52 858	52 149
Interest expense	**25**	16 578	16 720
Net interest income		**36 280**	**35 429**
Net income from commissions and fees	**26**	25 830	27 930
Other operating income / (expense), net	**27**	5 395	10 256
Impairments / (reversal) and provisions for losses	**28**	(1 506)	9 950
Operating expenses	**29**	44 294	43 127
Profit / (Loss) before taxation		**24 717**	**20 538**
Income tax (income) / expense	**30**	(557)	1 384
PROFIT FOR THE YEAR		**25 274**	**19 154**
Other comprehensive income:			
Items that may be reclassified subsequently to profit or loss:			
Revaluation on financial assets measured at FVTOCI		(13 255)	(4 243)
Other comprehensive income for the year net of tax		**(13 255)**	**(4 243)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**12 019**	**14 911**
Net income available to ordinary shareholders		25 274	19 154
Average number of ordinary shares outstanding *(thousands)*		100 000	100 000
Earnings per Ordinary Share *(in HUF)*	**31**		
Basic		253	192
Diluted		253	192

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Data in HUF million except stated otherwise

MKB Bank Zrt.
Statement of Changes in Equity for the year ended 31 December 2018

	Share capital	Share premium	Retained earnings	Revaluation on financial assets measured at FVTOCI	Total equity
At 1 January 2017	100 000	21 729	(1 958)	6 597	126 368
Profit for the year	-	-	19 154	-	**19 154**
Other comprehensive income for the year	-	-	-	(4 243)	**(4 243)**
At 31 December 2017	100 000	21 729	17 196	2 354	141 279
Affect on IFRS 9 implementation	-	-	(1 109)	7 435	**6 326**
At 1 January 2018	100 000	21 729	16 087	9 789	147 605
Profit for the year	-	-	25 274	-	**25 274**
Other comprehensive income for the year	-	-	-	(13 255)	**(13 255)**
At 31 December 2018	100 000	21 729	41 361	(3 466)	159 624

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Data in HUF million except stated otherwise

MKB Bank Zrt.
Statement of changes in equity based on Hungarian Accounting Law for the year ended 31 December 2018

	Share capital	Capital reserve	Retained earnings	Revaluation reserve	Total
At 1 January 2017	100 000	21 729	(1 958)	6 597	126 368
Profit for the year	-	-	19 154	-	**19 154**
Other comprehensive income for the year	-	-	-	(4 243)	**(4 243)**
At 31 December 2017	100 000	21 729	17 196	2 354	141 279
Effect of implementation of IFRS 9	-	-	(1 109)	7 435	**6 326**
Profit for the year	-	-	25 274	-	**25 274**
Other comprehensive income for the year	-	-	-	(13 255)	**(13 255)**
At 31 December 2018	100 000	21 729	41 361	(3 466)	159 624

Reconciliation of share capital registered at registry court and share capital under IFRS adopted by the EU	31.12.2018	31.12.2017
Share capital registered at the registry court	100 000	100 000
Share capital under IFRS adopted by the EU	100 000	100 000

Schedule of the profit reserves available for dividend payment	2018.12.31	2017.12.31
Retained earnings	41 361	17 196
Statutory other reserve/equity	6 624	4 097
Profit reserve available for dividend payment	34 737	13 099

The Board of Directors proposes to the Shareholders of the Bank to pay dividend in the amount of HUF 4,800 million (48 HUF/share).

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Data in HUF million except stated otherwise

MKB Bank Zrt.
Statement of Cash Flows for the year ended 31 December 2018

	Note	2018	2017
Cash flows from operating activities			
Profit before taxation		**24 717**	**20 738**
Adjustments for:			
Depreciation, amortisation and impairment	**13**	4 622	4 546
Impairment on other assets	**11**	274	58
Reversal of provisions for off-BS items and settlement for customers	**18, 32**	(1 436)	(915)
Impairment / (reversal) on loans and advances	**4, 10**	(8 849)	8 802
Impairment on associates	**12**	2 172	-
Reversal of impairment on securities	**4, 9**	(118)	*
Impairment on jointly controlled entities	**12**	978	(992)
Deferred tax movement	**30**	(2 486)	7
Net Interest income	**24, 25**	(44 365)	(43 930)
Dividends on available for sale securities		(152)	(17)
Revaluation of issued securities	**19**	714	(376)
Revaluation and other result on securities measured at FVTOCI		(5 820)	(46 913)
Foreign Exchange movement		89	(335)
Cash flows from operating activities		(29 660)	(59 327)
Change in loans and advances to banks	**7**	14 388	(10 978)
Change in loans and advances to customers	**10, 33, 36**	(26 398)	(8 936)
Non-current assets held for sale and discontinued operations	**37**	17 410	(21 339)
Change in derivative assets	**8**	1 843	2 891
Change in other assets	**11, 23**	166	554
Change in amounts due to banks (short term)	**14**	24 451	(153 969)
Change in current and deposit accounts	**15**	(171 657)	19 271
Change in other liabilities and provisions (without provision charge of the year)	**18**	(3 437)	13 490
Change in derivative liabilities	**16**	(11 758)	13 383
Interest received	**24**	49 250	48 362
Interest paid	**25**	(4 885)	(4 432)
Dividends received		-	17
Income tax	**30**	159	(1 537)
		(110 468)	(103 223)
Net cash used in operating activities		**(140 128)**	**(162 550)**
Cash flow from investing activities			
Disposals of group companies	**12**	3 776	(54)
Purchase and disposals of PPEs and intangible assets	**13**	(10 512)	(5 338)
Purchase and disposals of securities	**9**	182 215	64 093
Net cash generated by investing activities		**175 479**	**58 701**
Cash flow from financing activities			
Change in issued securities	**19**	(6 137)	(1 892)
Change in subordinated liabilities	**20**	5 695	22 307
Change in amounts due to banks (Borrowings)	**14**	(47 179)	17 019
Net cash (used in)/ generated by financing activities		**(47 621)**	**37 434**
Net decrease of cash and cash equivalents		(12 270)	(66 415)
Cash reserves at 1 January		**31 599**	**97 914**
FX change on cash reserve		(89)	100
Cash reserves at the end of period		**19 240**	**31 599**

* Modification of the structure of the Financial Statement

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Notes to the Separate Financial Statements

(from page 9 to page 111)

1 General information

MKB Bank Zrt. ("MKB" or "the Bank") is a commercial bank domiciled in Hungary, organised under the laws of Hungary and registered under the Hungarian Banking Act CCXXXVII of 2013. The address of MKB is Váci u. 38., HU-1056 Budapest, Hungary.

The separate financial statements of the Bank are prepared for the year ended 31 December 2018.

The Hungarian government acquired 100% direct ownership in MKB Bank Zrt. on 29 September 2014. On 18 December 2014, the Financial Stability Board of the National Bank of Hungary ordered the reorganization of MKB Bank based on the Act XXXVII of 2014 (Act on the further development of the system of institutions strengthening the security of the individual players of the financial intermediary system). The ownership rights were exercised by the National Bank of Hungary under the reorganization process and NBH together with MKB Bank started restructuring measures aiming at improving profitability. The reorganization of MKB Group has been carried out in compliance with EU directives[1] in each case. The National Bank of Hungary launched the reorganisation plan, which was approved by the European Commission on 16 December 2015. The commitments included in the plan have to be fulfilled by 31 December, 2019, and the process of the completion is controlled regularly by the independent Monitoring Trustee. On 23 July 2015 – continuing the reorganization procedure – the four reorganizational commissioners were recalled, and through the appointment of the new Chief Executive Officer and election as Chairman of the Board, the Board of Directors is capable of exercising its full powers.

At the end of 2015, through the asset-separation major part of the commercial real estate loan portfolio generating significant losses in the previous years was transferred from MKB Bank to MSZVK Magyar Szanálási Vagyonkezelő Zrt. with the approval of the European Commission on real economic value above the market price. In exchange for this allowed state subsidization, MSZVK Magyar Szanálási Vagyonkezelő Zrt. acquired 100 % direct ownership in MKB Bank Zrt., while the ownership rights and obligations were continued to be exercised by the National Bank of Hungary.

The open, transparent and non-discriminatory sales procedure of MKB Bank under close monitoring of the European Commission was successfully closed on 29 June 2016, after the conditions were met, including obtaining permission for the winning consortium members to gain interest and paying the purchase price. The new owners of MKB Bank became members of a consortium established by Blue Robin Investments S.C.A., METIS Private Capital Funds and Pannónia Pension Fund (45 - 45 - 10 % ownership).

On 30 June 2016, the National Bank of Hungary terminated the resolution process of MKB Bank, after the fulfilment of all objectives of the resolution.

[1] BRRD

On 19 July 2016 one of the owners of MKB Bank, Blue Robin Investments sold 15 % stake to the newly established Employee Share Ownership Programme (ESOP, MRP) organisation of the Bank. Further the new owners of the Bank are as follows: METIS Private Capital Funds 45 %, Blue Robin Investments S.C.A. 30 %, MRP Organization 15 %, Pannónia Pension Fund 10 %.

During 2017 there were changes in the indirect ownership structure of MKB Bank. At the end of April 2017 through the change of ownership in Blue Robin Investments S.C.A., BanKonzult Pénzügyi és Gazdasági Tanácsadó Kft. obtained 20.19 %, while Promid Invest Zrt. acquired 9.81 % indirect ownership in MKB Bank. Further, on 1 June 2017 the management of METIS Private Capital Funds was obtained by Konzum Befektetési Alapkezelő Zrt. from Minerva Tőkealap-kezelő Zrt, resulting for the new owner 45 % indirect ownership in the Bank.

On 1 June 2017 RKOFIN Befektetési és Vagyonkezelő Kft. acquired 4 % direct ownership in MKB Bank Zrt. from Blue Robin Investment S.C.A. The Court of Registration registered the transaction on 10 August 2017.

On 28-29 December 2017, Blue Robin Investments S.C.A. and Pantherinae Pénzügyi Zrt. bought 10 million shares at 1 000 HUF face value per share from Pannónia Pension Fund. Due to the transaction Pantherinae Pénzügyi Zrt. acquired 3.1 % ownership in the Bank, interest of Blue Robin Investments S.C.A. increased from 26 % to 32.9 %, while Pannónia Pension Fund has no shares in MKB Bank Zrt. henceforth. The fact of the purchase was entered in the Shareholder Register on 4 January 2018.

On 23 August 2018, EIRENE Private Capital Fund acquired the 9.999999% of MKB shares, while interest of METIS Private Capital Funds decreased to 35.000001%, which was registered in the Shareholder Register by the Directorate.

Two shareholders of MKB Bank Zrt, i.e. RKOFIN Befektetési és Vagyonkezelő Korlátolt Felelősségű Társaság (RKOFIN Investment and Asset Management Ltd., hereinafter: “RKOFIN Ltd.”) and MKB Bank Munkavállalói Résztulajdonosi Program Szervezet (MKB Bank Employee Stock Ownership Plan Organisation, hereinafter “ESOP Organisation) concluded a share purchase agreement on July 17, 2018 on the transfer of a part of the share package issued by MKB Bank Zrt and held by the ESOP Organisation, altogether 9.620.597 pieces of series “A” dematerialised ordinary shares with a face value of HUF 1000 each.

The Board of Directors of MKB Bank Zrt decided on the registration of this change into the Share Registry on 1 October , 2018 subject to the condition. Following the closing of the transaction on the transfer of shares, the previous 4% stake of RKOFIN Ltd. in the Bank increased to 13.620597%, while the former 15% ownership stake of the ESOP Organisation decreased to 5.379403%.

These financial statements are prepared for general purposes as defined in the Act C of 2000 about Accounting and the IFRSs published in the Official Journal of the European Union; they are not intended for the purposes of any specific user or consideration of any specific transactions. Accordingly, users should not rely exclusively on the financial statements when making such decisions.

2 Compliance with International Financial Reporting Standards

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU.

IFRSs comprise accounting standards issued by the IASB and its predecessor body and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

These financial statements are presented in Hungarian Forint (HUF), rounded to the nearest million, except if indicated otherwise. The financial statements are authorised for issue by the Board of Directors on 10 April 2019.

Since 1 January 2018, MKB Bank Zrt. has been applying the International Accounting Standards (IFRSs) adopted by the EU in its bookkeeping as well as the preparation of its separate financial statements.

The 2018 figures in this financial statement have been compiled on the basis of the standards effective from January 1, 2018. The comparative period data are presented in accordance with the standards in force before 1 January.

3 Basis of measurement

The separate financial statements have been prepared on the historical cost basis except for the following:

- derivative financial instruments are measured at fair value
- financial instruments at fair value through profit or loss are measured at fair value
- financial assets at fair value through other comprehensive income are measured at fair value
- other financial instruments are measured at amortised cost

The separate financial statements has been prepared based on going concern assumption.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 33.

Data in HUF million except stated otherwise

4 Summary of significant accounting policies

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by the Bank in preparing and presenting the separate financial statements. The accounting policies set out below have been applied consistently to all periods presented in these separate financial statements. To ensure data consistency the Group made reclassification in supplementary notes in some relevant cases.

a, Financial statement presentation

These financial statements include the accounts of MKB Bank Zrt. The Bank's presentation and functional currency is the Hungarian Forint ("HUF").

Subsidiaries are entities controlled by the Group. These entities are measured at amortised cost by the Bank.

Entities included in MKB Group of consolidation and their activities are as follows:

4.1

2018

Company	Percentage of equity owned	Percentage of voting rights	Country of incorporation	Brief description of activities
Euro - Immat Üzemeltetési Kft.	100,00%	100,00%	Hungary	Intangible assets, license maintenance
Exter-Adósságkezelő Kft.	100,00%	100,00%	Hungary	Collecting receivables
Extercom Vagyonkezelő Kft.	100,00%	100,00%	Hungary	Property investments
MKB-Euroleasing Autóhitel Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities
MKB-Euroleasing Autólízing Szolgáltató Zrt.	100,00%	100,00%	Hungary	Car finance activity
MKB Euroleasing Zrt.	100,00%	100,00%	Hungary	Holding of Euroleasing group, other finance activities
MKB Bank MRP Szervezet	66,32%	0,00%	Hungary	Special purpose entity for the Employee Share Program
MKB Bank Teljesítményjavadalmazási MRP szervezete	100,00%	100,00%	Hungary	Special purpose entity for the Employee Share Program
MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft	100,00%	100,00%	Hungary	Other financial services
MKB Üzemeltetési Kft.	100,00%	100,00%	Hungary	Property operation and maintenance
Retail Prod Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities
MKB-Pannónia Alapkezelő Zrt	49,00%	49,00%	Hungary	Investment fund management activity

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Company	Percentage of equity owned	Percentage of voting rights	Country of incorporation	Brief description of activities
Euro - Immat Üzemeltetési Kft.	100,00%	100,00%	Hungary	Intangible assets, license maintenance
Exter-Adósságkezelő Kft.	100,00%	100,00%	Hungary	Collecting receivables
Extercom Vagyonkezelő Kft.	100,00%	100,00%	Hungary	Property investments
MKB Befektetési Alapkezelő Zrt.	100,00%	100,00%	Hungary	Investment fund management activity
MKB-Euroleasing Autóhitel Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities
MKB-Euroleasing Autólízing Szolgáltató Zrt.	100,00%	100,00%	Hungary	Car finance activity
MKB Euroleasing Zrt.	100,00%	100,00%	Hungary	Holding of Euroleasing group, other finance activities
MKB Jelzálogbank Zrt.	100,00%	100,00%	Hungary	Mortgage loan refinancing
MKB Bank MRP Szervezet	40,34%	0,00%	Hungary	Special purpose entity for the Employee Share Program
MKB Bank Teljesítményjavadalmazási MRP szervezete	100,00%	100,00%	Hungary	Special purpose entity for the Employee Share Program
MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft	100,00%	100,00%	Hungary	Other financial services
MKB Üzemeltetési Kft.	100,00%	100,00%	Hungary	Property operation and maintenance
Retail Prod Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities
MKB-Pannónia Alapkezelő Zrt	49,00%	49,00%	Hungary	Investment fund management activity

b, Intangible assets

Intangible assets are identifiable non-monetary assets without physical substance held for supply of services, or for administration purposes.

Other intangible assets

Intangible assets that have a finite useful life are measured initially at costs and subsequently carried at costs less any accumulated amortisation and any accumulated impairment losses.

Intangible assets are amortised over their estimated useful lives not exceeding 15 years from the date when the asset is available for use, applying the straight-line method.

Intangible assets that have an indefinite useful life, or are not yet ready for use, are tested for impairment annually. This impairment test may be performed at any time during the year, provided it is performed at the same time every year. An intangible asset recognised during the current period is tested before the end of the current year.

Expenditure on internally developed intangible asset (software) is recognised as an asset when the Bank is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and impairment.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

c, Property, plant and equipment

Items of property and equipment including leasehold improvements and investment properties are measured initially at cost, including transaction cost, then subsequently cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

The estimated useful lives of property, plant and equipment are as follows:

- freehold land is not depreciated;
- components of freehold buildings are depreciated over 0-100 years
- leasehold buildings are depreciated over the unexpired terms of the leases, or over their remaining useful lives.

The residual value of some properties are higher than book value, depreciation is not recognised for them.

Equipment, fixtures and fittings (including equipment on operating leases where MKB Bank is the lessor) are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write off the assets over their useful lives, which run to a maximum of 20 years but are generally between 5 years and 10 years.

Depreciation of property, plant and equipment are included in „Operating expenses” line in statement of comprehensive income.

Property, plant and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

Net gains and losses on disposal or retirement of property and equipment are included in “Other income”, in the year of disposal or retirement.

Cost includes expenditures that are directly attributable to the acquisition of the asset. When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

d, Investment property

Investment properties are held by the Bank to earn rentals and for capital appreciation.

The estimated useful lives of investment properties are as follows:

- components of buildings are depreciated over 25-100 years
- connecting equipment are depreciated over 20 years

Depreciation of investment property is included in „Other operating income / (expenses),net" line in statement of comprehensive income.

The fair value of the investment properties shall be supervised yearly by an independent appraiser. Should the fair value be much lower than the carrying amount, impairment loss shall be recognized through profit or losses.

Net gains and losses on disposal or retirement of property is disclosed as the own used properties.

The Bank uses the cost model for investment property, according to which the property is accounted in the Bank's books at the purchases cost and then depreciated. If the Bank determines that the fair value of the property is significantly lower than its carrying amount, the Bank recognizes an impairment loss at the end of the year.

The depreciation charge for investment property is included in the statement of other comprehensive income.

e, Cash reserve

Cash reserve include notes and coins on hand, unrestricted balances held with central bank and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

f, Determination of fair value

All financial instruments measured at Fair Value through Profit or Loss are recognised initially at fair value, other financial assets and liabilities are recognized at fair value plus transaction cost that are directly attributable to the acquisition or issue of financial asset or financial liability. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the initial fair value will be based on other observable current market transactions in the same instrument, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Bank recognises a trading gain or loss on inception of the financial instrument.

When unavailable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the statement of comprehensive income but is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Bank enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. For financial instruments, fair values may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data.

The inputs used by the valuation techniques for determining fair values are classified by the fair value level hierarchy as follows:

- level 1: quoted market price in an active market for an identical instrument
- level 2: valuation techniques based on observable inputs
- level 3: valuation techniques using significant unobservable inputs

Transfer from level 1 to level 2 of fair value hierarchy may occur when prices on active market are no longer available. This is the case when the active market cease to be exists, or there are no publicly available quotations, however observable inputs are still available for valuation purposes on the instrument under question.

Factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when fair values are calculated using valuation techniques. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about interest rate yield curves, exchange rates, volatilities, and prepayment and default rates. Where a portfolio of financial instruments has quoted prices in an active market, the fair value of the instruments are calculated as the product of the number of units and quoted price and no block discounts are made.

If the fair value of a financial asset measured at fair value through profit or loss becomes negative, it is recorded as a financial liability until its fair value becomes positive, at which time it is recorded as a financial asset.

The fair values of financial liabilities are measured using quoted market prices, where available, or using valuation techniques. These fair values include market participants' assessments of the appropriate credit spread to apply to the Bank's liabilities.

g, Initial recognition and measurement of Financial Instruments

Outbound loans and claims, and debt securities are recognized by the Bank when those being issued. All other debt securities are recognized when the Bank commits itself either acquiring the asset, or selling it (trade date accounting).

Through initial measurement, all financial instruments - except for accounts receivables - that were not measured at fair value, are recognized at a modified fair value by the Bank. The modified fair value includes all transaction costs which are directly attributable to the issuance and acquisition of financial instruments.

Financial instruments measured at fair value through profit or loss are recognized at their fair value by the Bank. All related transaction costs incurred at their inception, issuance, and/or purchase accounted as expense through Profit or Loss. If accounts payables do not contain significant financing component, they are recognized at transaction price by the Bank.

h, Classification and subsequent measurement of Financial Instruments

IFRS 9 standard contains three main categories to classify and measure the financial assets: amortised cost (AC), fair value through other comprehensive income (FVOCI) and fair value through Profit and Loss (FVTPL).

The applied business models reflect the purpose that the Bank would like to achieve by holding the group of each financial assets. The business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. The Bank use multiple business models to manage its financial instruments.

The following business model categories have been developed in accordance with IFRS 9 standard:

- Held to Collect (HTC): an instrument is held for the collection of contractual cash flows with which the Bank aims to realize long-term interest income. There is no requirement to hold to maturity, a sale is permitted due to increased credit risk. Sales could be also consistent with the business model if the credit concentration risks change or if close to maturity.
- Both Held to Collect and For Sale (HTCS): an instrument that is held for the collection of contractual cash flows and for the sale of financial assets at the same time. The purpose of the inception or purchase is to collect contractual cash flows, as well as to realize profit from the increase in the fair value and minimize loss from the decrease in the fair value in medium or long term. Compared to the HTC sales occur more frequently and are higher in value.
- Other trading business model (TRADING): mainly trading financial instruments that are purchased for short-term gain. This business model is considered as the “remaining category”.

The listing in the business model reflects the expectations of the Bank, not just the intent, but also the ability. The classification is not based on scenarios that are not reasonably expected ('worst case' or 'stress case' scenario). If the Bank sells a particular portfolio or financial asset in a ‘stress case’ scenario, it does not affect the evaluation of the business model if the Bank expects this event is unlikely to occur.

Classification not only depends on the business model but also on the cash flow related characteristics associated with the financial instrument. The Bank has to examine the cash flows associated with the financial instrument - regarding those debt instruments that will be measured at amortised cost or fair value through other comprehensive income - whether they comply with the requirements of the equity and interest rate definitions according to IFRS 9 (SPPI / Cash Flow Test).

The Bank classifies its financial assets into the following categories based on the examination of the business model and contractual cash flow characteristics (SPPI test):

- financial assets measured at fair value through profit or loss,
- financial assets measured at amortised cost,
- debt instruments measured at fair value through other comprehensive income,
- equity instruments measured at fair value through other comprehensive income.

The Bank shall measure a financial asset at amortised cost if both of the following conditions are met:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows, and
- the financial asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

The Bank shall measure a debt instrument at fair value through other comprehensive income if both of the following conditions are met:

- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and
- the financial asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

The Bank shall make an irrevocably election to measure the investments in equity instruments at "fair value through other comprehensive income" category at initial recognition, in other case these financial assets should be measured at fair value through profit or loss.

All other financial assets are classified by the Bank as the fair value through profit or loss category.

i, Classification and measurement of financial liabilities subsequent to initial recognition

The Bank classify its financial liabilities into the following categories:

- financial liabilities measured at fair value through profit or loss,
- financial liabilities measured at amortised cost.

Non-trading financial liabilities initially measured at fair value less transaction cost by the Bank. These liabilities subsequently measured at amortised cost calculated by using the effective interest method unless the Bank has measured the financial liability at fair value through Profit and Loss at initial recognition.

The financial liabilities are measured at fair value through Profit or Loss at initial recognition by the Bank, the change in fair value at the subsequent measurement should be recognised as the following:

- changes related to own credit risk is measured through other comprehensive income (OCI),
- all other changes in fair value is measured through Profit or Loss.

The designated financial liabilities that are measured at fair value through Profit or Loss at initial recognition are examined by the Bank whether the recognition of changes in fair value related to own credit risk in the other comprehensive income (OCI) cause recognition inconsistency ('accounting mismatch'). If the measurement at fair value through other comprehensive income cause accounting mismatch the changes in fair value should be recognised in the profit or loss.

The Bank decides according to the terms of the issued instrument's contract whether it is classified as financial liability or equity.

j, Fair Value Option (FVO)

At initial recognition, the Bank may irrevocably recognize a financial asset or liability at fair value through profit or loss if it eliminates or significantly decreases any valuation or recognition inconsistencies that would otherwise have arisen because of the valuation of assets and liabilities or the profits or losses generated on them are shown on different bases.

k, Determination and recognition of the Expected Credit Loss

During classification of the Bank's financial instruments the primary collateral is determined as the ability and intention of the client to pay. Excepting those transactions that are covered by collateral which is independent of the financial and legal position of the client accordingly the return can be unequivocally ensured.

The Bank assigns exposures at each reporting period – in this case monthly – during which the exposures are allocated to the segments and to the so-called 'stages' (stage1, stage2, stage3 and/or POCI) in accordance with the principles of IFRS 9 standard.

The Bank assesses at each reporting date whether the credit risk of the financial asset has increased significantly since the initial recognition.

The Bank recognises lifetime expected credit loss for all financial instruments when the credit risk has increased significantly compared to the credit risk at acquisition – regardless whether assessed on an individual or collective basis - considering all reasonable and supportable information, including that which is foreseeable.

When making the assessment, the Bank evaluate the changes in the risk of a default occurring over the expected life of the financial instrument, considering reasonable and supportable information, that is available without undue cost or effort which indicate the changes in credit risk since initial recognition.

The Bank determines the significant increase in credit risk based on the examination of the following four conditions:

- changes in the clients' rating after the issuance,
- PD change in the master scale compared to the initial value,
- default in payment,
- the amount of the client's exposure classified as Stage 2 exceeds a certain proportion of its gross exposure.

The existence of any of these conditions is assessed by the Bank as a significant increase in the credit risk. If there is no evidence of impairment have to be assigned to Stage 2, the transaction could be displaced from stage 2 to stage 1.

Financial assets whose default risk has increased to such an extent after initial recognition that there is objective evidence of impairment have to be assigned to Stage 3 and a loan loss provision has to be recognised by calculating the Lifetime-Expected credit loss (ECL) Bank defines materiality threshold, exposure that are below that threshold should be considered as a small amount (below the limit). The impairment of those assets which are above the threshold should be estimated individually.

In order to determine the impairment and provision of assessed as class of clients, the expected credit loss (ECL) should be used according to the relevant principles of IFRS 9 impairment and provision of assessed as class of clients calculated on monthly basis, automatically.

Factors taken into account when determining expected credit loss:

- remaining lifetime in years,
- exposure at default (EaD),
- loss given default (LGD),
- probability of default (PD),
- credit conversion-factor (CCF),
- loss rate of the non-default and default transaction,
- discount rate calculated on the remaining lifetime.

The amount of impairment and provision equals to amount of expected credit loss.

In Stage 1 the impairment is equal to the 12-Month expected credit loss.

In Stage 2 and Stage 3 the impairment is equal to the lifetime expected credit loss.

The applied risk parameters are determined on the basis of statistical models for homogeneous groups and transaction groups. The models are validated at least once a year, and if necessary it will be revised. Transactions that are recognised at fair value, the fair value calculation the credit risk component of the discount factor is calculated based on the principles related to determination of ECL as mentioned above.

The Bank calculates the expected credit loss for the remaining lifetime, excepting the following financial instruments for which the loss is calculated for 12 months:

- debt securities with low credit risk at the reporting date,
- financial instruments excepting lease receivables and account receivables, which credit risk do not significantly increased compared to initial recognition.

For account and lease receivables the Bank always calculates the expected loss for the remaining lifetime.

The expected credit loss represents the expected credit losses of a financial asset until maturity in terms of a probability weighted average.

Expected credit losses are probability-weighted estimates of credit losses during the life expectancy of a financial asset. These are assessed by the Bank as follows:

- financial assets not impaired at the reporting date: discounted loss on cash flow (difference between the contractual cash flows and the expected cash flows),
- financial assets impaired at the reporting date: difference between the gross carrying amount and the estimated present value of the outstanding amount,
- undrawn loan commitments: present value of the difference between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan and the cash flows that the entity expects to receive if the loan is drawn down,
- financial guarantee contracts: expected payments to the holder, reduced by the amounts that are expected to be recovered.

If the credit risk of the financial instrument has increased significantly since its initial recognition until the reporting date, the Bank recognises the loss on the asset at the same amount as the expected lifetime credit loss.

If the credit risk of the financial instrument has not significantly increased since the initial recognition until the reporting date, the Bank recognizes loss on the asset at the same amount of the 12-month expected credit loss.

The impairment/expected credit loss calculated for 12 months is the part of the lifetime expected loss results from potential default events within 12 months of the reporting date.

The Bank recognises loss for the expected credit loss on the following financial instruments not measured at fair value through Profit or Loss:

- debt instruments,
- lease receivables,
- accounts receivables,
- financial guarantees, and
- loan commitments.

The expected credit loss should be recognised by the Bank as the following:

- deducted amount from the gross carrying value (impairment) – in case of financial assets measured at amortised cost,
- provision – in case of financial guarantees and loan commitments, if the financial instrument includes both a loan and an undrawn components and the Bank is unable to distinguish the expected credit loss calculated for the loan and for the undrawn components, the Bank will therefore determine the impairment loss on the two components together. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognised as a provision.
- in case of financial assets measured at fair value through other comprehensive income (OCI), the impairment loss is not recognized in the financial statement as part of the assets' fair value. The recognised impairment modifies the cumulative other comprehensive income.

In case of the financial instruments measured at fair value through profit or loss, the Bank shows in a separate statement whether there was any changes in the client's credit risk.

When recognising the change in the credit risk, the Bank reviews the Stage classification based on the clients' risk characteristics (in all aspect the same, hypothetical, credit risk parameters of a transaction measured at amortised cost are applied) and assigns the corresponding risk parameters to the transaction during the valuation. Accordingly, the risk parameters are part of fair valuation and the change in credit risk occurs by isolating and separately recording the effects of these parameters.

For purchased or originated credit-impaired financial assets at the reporting date the Bank recognises the accumulated changes in the lifetime expected credit loss since the initial recognition. In the Bank's practice, typically forint-denominated receivables appear as purchased or originated credit-impaired financial assets.

The Bank assesses provision for contingent liabilities (i.e. contracted but undrawn loan commitments, issued financial guarantees, letter of credits) as follows:

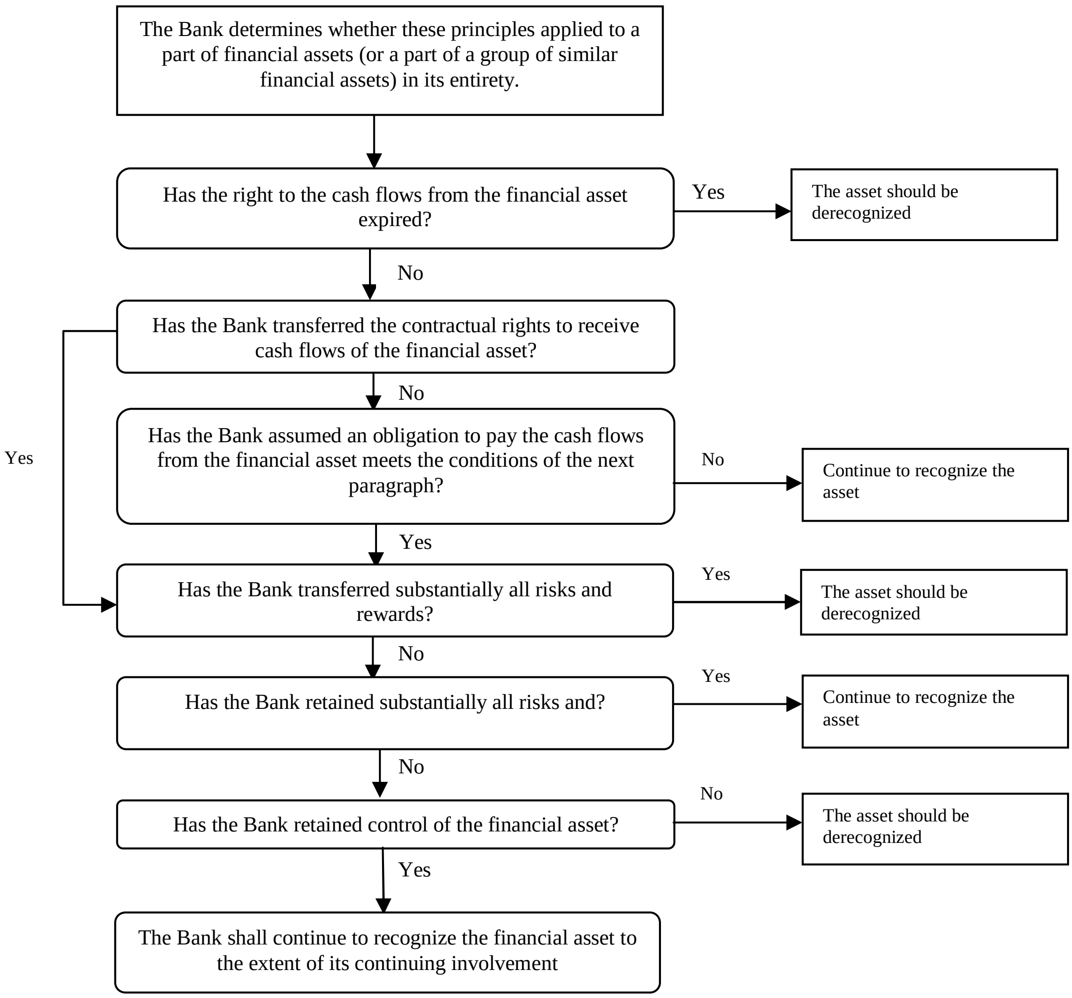
- in the case of clients/debtors subject to individual valuation, the Bank determines the amount of provision individually,
- in other case the Bank calculates provision based on the EAD corrected by CCF.

For transactions accounted as commitments showing loss on the reporting date, the calculated provision is the negative difference between the fair value and the gross carrying amount based on the valuation method.

The provision is based on the amount of loss calculated as above.

I, Derecognition of Financial Assets

The following decision tree illustrates the principles of derecognition of financial instruments by the Bank:



As a result of a contract modification – if the modification does not result in derecognition of the financial asset – the Bank has to recalculate the gross carrying amount of the financial asset and should recognise the difference as a modification gain or loss in profit or loss.

Transfers that qualify for derecognition of financial assets

The Bank derecognises a financial asset when transfer the contractual rights to receive the cash flows of a financial asset (the 'original asset'), or retains the contractual rights to receive the cash flows of a financial asset, but assumes a contractual obligation to pay those cash flows to one or more recipients (the eventual recipients'), the Bank treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met:

- The Bank has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.

- The Bank is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.
- The Bank has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.

When the Bank transfers a financial asset, it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset.

The Bank examines the following before derecognition:

- if the Bank transfers substantially all the risks and rewards of ownership of the financial asset, the Bank shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer,
- if the Bank retains substantially all the risks and rewards of ownership of the financial asset, the Bank shall continue to recognize the financial asset,
- if the Bank neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the Bank shall determine whether it has retained control of the financial asset. In this case:
    - if the Bank has not retained control, it shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer,
    - if the Bank has retained control, it shall continue to recognize the financial asset to the extent of its continuing involvement in the financial asset.

The extent of the Bank's continuing involvement in the transferred asset is the extent to which the Bank is exposed to changes in the value of the transferred asset.

The transfer of risks and rewards is evaluated by comparing the Bank’s exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. The computation and comparison are made using the current market interest rate as discount rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

The Bank has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer.

An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset.

Asset transfers holding all or substantially all of the risks and rewards could be for example repo transactions (for repo transactions, the Bank considers whether the risks and rewards incurred in the transaction are substantially transferred or not).

Derecognition due to significant changes in contractual cash flows

The Bank considers significant change in the contractual cash flows, if the debtor changes or in a single-currency loan contract the currency changed.

The Bank considers it a significant change (sign for derecognition) if the difference between the present value discounted at market interest rate of the modified contractual cash flows and the original (before modification) present value of contractual cash flow exceeds 10% of the book value of the financial asset.

If this condition is met the management may consider and make a formal decision on the necessity of derecognition and recognition as a new asset/liability based on the specific features of the asset. The fulfilment of the condition itself does not result in an immediate, unconditional derecognition of the financial instrument.

Financial assets under legal proceeding

Loans which are under legal proceeding (bankruptcy, liquidation and final proceedings) and in case of enforcement collateral transactions:

- the Bank's contractual right to receive cash flows from the financial asset does not expire,
- the Bank did not transfer the right of collecting cash flows from the financial asset,
- the Bank did not assume any obligation to pay the cash flows from the financial asset,

therefore the Bank does not derecognize such items entirely from its books, but may partially derecognize them.

When the Bank can reasonably not expect to recover part of the financial asset while maintaining the legal claim it is considered as a partial recognition. In such cases, the Bank directly reduces the value of the financial asset.

After the legal waiver of the claim, the Bank may write down the total gross amount of the financial asset if it is not able to be recovered and void according to the relevant internal rules (in this case there is no legal claim).

m, Derecognition of financial liabilities

The Bank removes a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished – when the obligation specified in the contract is fulfilled or cancelled or expires.

Exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The terms are substantially different if the discounted present value of the cash flows that are included under the new terms, including the paid fees reduced by the fees received, is offset by at least 10% discounted at the original effective interest rate by the discounted present value of the remaining cash flows of the original financial liability.

The terms are substantially different if under the new terms the present value discounted at the original effective interest rate of the cash flows – including fees received and paid – is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. If the exchange of debt instruments or the modification of the terms is treated as cancellation, the Bank will recognize any costs or fees incurred as a gain or loss related to the termination of the liability. If the exchange or modification is not accounted for as cancellation, the costs or fees incurred will modify the current amount of the liability and will be depreciated over the remaining maturity of the modified loan.

n, Measurement at amortised cost

The Bank's financial assets are measured at amortised cost if it is consistent with the business model and meet the criteria of the SPPI test.

The Bank assesses its financial liabilities at amortised cost, except for:

- financial liability measured at fair value through Profit or Loss,
- financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies,
- financial guarantee contracts,
- commitments to provide a loan at a below-market interest rate,
- contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies.

Amortized cost is the amount of a financial asset or financial liability at initial recognition, reduced by principal repayments, increased or decreased by the difference between the original amount and amount at maturity cumulative amortization calculated using an effective interest rate method and in case of financial assets adjusted by any financial losses.

The effective interest rate method is the method used to measure the amortised cost of the Bank's financial assets or financial liabilities and the method used to allocate and recognises interest income and interest expense in a given period.

Interest income and interest expense should be determined using the effective interest rate method and then recognized in the Profit or Loss statement.

The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the

- gross book value of the financial instrument, or
- amortized cost of the financial liability.

However, in those cases when it is not possible to reliably estimate the cash flows or the remaining life of a financial instrument (or group of financial instruments), the Bank uses the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

In case of purchased or originated credit-impaired financial assets (POCI) credit-adjusted effective interest rate should be used. The credit adjusted effective interest rate (CAIR) is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset to the amortised cost of a financial asset.

Simplified approach for trade receivables, contract assets and lease receivables

In case of future cash flows of financial instruments cannot be estimated reliably due to the specific features of the product, furthermore the contractual cash flows are not available, the effective interest rate of the instrument cannot be determined.

When interests, commissions and other items arise related to such transactions these are accounted through profit or loss for using a simplified method (ie the effective interest rate is the same as the nominal interest rate).

o, Financial assets measured at Fair Value

Financial assets should be measured at fair value through other comprehensive income, if the business model confirms that and if the SPPI criterias are met.

Investments in equity instrument are measured at fair value through profit or loss unless the Bank make an irrevocably election to present in the other comprehensive income.

Interest income arise from interest-bearing transaction measured at fair value should be calculated using the effective interest method irrespectively, transaction measured at fair value through profit or loss or fair value through other comprehensive income.

The Bank recognises the result from the fair value measurement excepting from the credit loss (difference between the amortised cost and the fair value) against the equity, if it arise from asset measured at fair value through other comprehensive income, and in the profit or loss if measured through profit or loss.

Initially, financial assets and liabilities should be measured at fair value, including transaction costs for assets and liabilities not measured at fair value through profit or loss.

p, Financial guarantees

The Bank does not recognise the financial guarantees as contingent items in the Financial Statement because this could cause recognition such income or expense which may not being realisable.

In case when the realisation of income or expense is substantially sure, the asset does not considered as contingent item and it should be recognised in the Financial Statement items assessed permanently in order to the Bank post the changes up the Financial Statement in time.

Insofar the occurrence of economic benefits inflow or outflow being substantially sure, the relating income or expense should be accounted in that period wherein the probability of the occurrence changed.

The Bank considers the occurrence of economic benefits inflow or outflow as substantially sure when the Client written inform the Bank of the intention to draw on guarantee.

The Bank subsequently recognise the contracts on financial guarantee at the higher of the amount of the accounted loss and the amount initially recognised less cumulative income.

q, Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Bank which are classified as Fair Value Through Profit or Loss or Amortised cost. Loans and advances are recognised when cash is advanced to borrowers (settlement date). They are derecognised when either borrower repay their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred.

If they are measured at amortised cost they are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost, otherwise they are measured at fair value. Where loans and advances are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

r, Assets held for sale

Financial instruments that meet the IFRS 5 standard criteria's are recognized as held for sale by the Bank. The Bank classifies a non-current asset as held for sale, if its carrying amount will be recovered principally through a sale transaction, rather than through continuing use.

A disposal group is a group of assets that are intended to be disposed by sale or in another way, collectively, as a single group, in a single transaction and the liabilities directly attributable to those assets that are transferred during the transaction.

To meet the criteria for classification as held for sale:

- The asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.
- For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated.
- The plan or decision to sell must be approved in accordance with the relevant rules of the Bank in order for the sale to be considered as highly probable and it is also necessary to include it in the report.
- The asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value or the Bank advertise it at the appropriate forum.
- The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.
- Actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Assets held for sale or disposal groups should be recognized separately in the statement of financial position.

A disposal group classified as held for sale may qualify for the definition of the discontinued operations.

Discontinued operations are a part of the Bank that has been disposed of or classified as held for sale and embody a distinct, major industry or geographical area of activity and are part of a coordinated plan for disposing a separate business or geographical area of activity.

The result of the discontinued operation and the gains or losses at sale should be recognized in a separate line in the Profit or Loss Statement and in the Other Comprehensive Income by the Bank.

The Bank measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount or fair value less cost to sell.

If the fair value less cost to sell is less than the carrying amount of the non-current assets or assets or liabilities part of the disposal group at the date of classification as held for sale an impairment loss shall be recognized.

Fair value less cost to sell must be re-determined at each reporting date and, if higher than the carrying amount, the impairment loss should be reversed up to the amount of impairment loss recognized previously.

s, Financial assets and liabilities held for trading

Treasury bills, debt securities, equity shares are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term. These financial assets or financial liabilities are recognised on trade date, when the Bank enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the statement of comprehensive income. Subsequently, their fair values are remeasured, and all gains and losses from changes therein should be recognised in the statement of comprehensive income in ‘Other operating income’ as they arise.

Interest earned on trading debt securities is reported as trading result among the other operating income when it becomes due. The dividends earned on trading equity instruments are disclosed separately among the interest income when received. Interest payable on financial liabilities acquired for trading purposes is reported as other operating expense.

Long-term deposit

The interest payable on certain fixed rate long-term deposits from investment funds has been matched with the interest on ‘receive fixed/pay variable’ interest rate swaps and cross-currency swaps as part of a documented interest rate risk and FX risk management strategy. An accounting mismatch would arise if the deposits were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the statement of comprehensive income. By designating the long-term deposits at fair value, the movement in the fair value of the long-term deposits is also be recognised in the Statement of comprehensive income.

Structured Bonds

MKB issues structured bonds for its retail and institutional clients since 2008. The Bank eliminated its interest and foreign currency risk arising from the above mentioned options by entering into offsetting option transactions. To eliminate valuation inconsistencies, these structured bonds are designated at fair value to profit or loss in their entirety and as a consequence the embedded derivatives are not separated.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when the Bank enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken directly to the statement of comprehensive income. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in "Interest income".

t, Securities

Investments in securities are classified as asset held for liquidity purposes if there was a decision made previously about possible disposal in case of the changes in market conditions or the securities have not been classified into the other categories. By these assets the objective is to achieve both collecting contractual cash flows and selling financial assets. Financial investments are recognised on trade date, when the Bank enters into contractual arrangements with counterparties to purchase securities, and are derecognised when either the securities are sold or the borrowers repay their obligations.

The liquid securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in the equity. Relating to these assets impairment loss should be accounted in the equity. When these securities are sold, cumulative gains or losses previously recognised in equity are recognised in the statement of comprehensive income as "Other operating income / (expense), net".

u, Derivatives

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments. Embedded derivatives are treated as separate derivatives according to the IFRS 9 standard.

Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

v, Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When the Bank is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The finance income receivable is recognised in "Interest income" over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When the Bank is a lessee under finance leases, the leased assets are capitalised and included in 'Intangibles, property and equipment' and the corresponding liability to the lessor is included in 'Other liabilities and provisions'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in "Interest expense" over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, the Bank includes the assets subject to operating leases in ‘Intangibles, property and equipment’ and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the equipment is thereby impaired. When the Bank is the lessee, leased assets are not recognised on the statement of financial position. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in “Other operating income / (expense), net” and “Operating expenses”, respectively.

w, Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities issued and subordinated liabilities are the Bank’s sources of debt funding.

When the Bank sells a financial asset and simultaneously enters into a “repo” or “stock lending” agreement to repurchase the asset (or a similar asset) at a fixed price on a future date, the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the Bank’s financial statements.

Deposits, debt securities issued and subordinated liabilities are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method, except for the items which at initial recognition are designated by the Bank to fair value through profit or loss category.

The Bank carries some deposits, debt securities and subordinated liabilities at fair value, with fair value changes recognised immediately in profit or loss.

x, Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Contingent liabilities, which include certain guarantees, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Bank, and present obligation that arises from past events but is not recognised, because it is not probable that an outflow of resources embodying economic benefits will be require to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability.

Contingent liabilities are not recognised in the financial statements but are disclosed in the additional notes.

y, Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

The Bank applies the corporate income tax as income tax.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the financial position method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.
Deferred tax is not recognised for the following temporary differences:

- the initial recognition of goodwill,
- the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit,
- and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the end of the reporting period.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at the end of each reporting period and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are offset when they arise in the same entity and relate to income taxes levied by the same taxation authority, and when a legal right to offset exists in the entity.

Deferred tax relating to fair value remeasurement of available-for-sale investments which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the statement of comprehensive income when the deferred fair value gain or loss is recognised in the statement of comprehensive income.

z, Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading and kept in trading book are recognised in 'Interest income' and 'Interest expense' in the statement of comprehensive income using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

aa, Fees and commission income

Fee and commission income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example the arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example asset management and service fees); and
- income that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate (for example, certain loan commitment fees).

bb, Other operating income / (expense), net

Other operating income / (expense), net comprises gains less losses related to trading and investment assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

cc, Dividends

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities.

dd, Segment reporting

MKB formed its reporting segments in line with IFRS 8 “Operating Segments” which requires operating segments to be identified on the basis of internal reports about components of the entity that are regularly reviewed by the chief operating decision-maker, in order to allocate resources to a segment and to assess its performance.

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Segment revenue, segment expense, segment assets and segment liabilities are determined as those that are directly attributable or can be allocated to a segment on a reasonable basis, including factors such as the nature of items, the conducted activities and the relative autonomy of the unit. The Bank allocates segment revenue and segment expense through an inter-segment pricing process. These allocations are conducted on arm’s length terms and conditions. Please find further details on segment reporting in Note 36.

ee, Foreign currencies

Items included in the financial statements of each of the Bank’s entities are measured using the currency of the primary economic environment in which the entity operates (‘the functional currency’).

Transactions in foreign currencies are translated to the respective functional currencies of Bank entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the end of the reporting period are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition and equity put options, are translated to HUF at exchange rates at the end of the reporting period. The income and expenses of foreign operations are translated to HUF at exchange rates at the dates of the transactions. Foreign currency differences are recognised directly in equity, in the Currency translation reserve. When a foreign operation is disposed of, in part or in full, the relevant amount in the foreign currency translation reserve is transferred to profit or loss.

ff, Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially and subsequently recognised at their fair value in accordance with IFRS 9.

gg, Share capital

Shares are classified as equity when there is no contractual obligation to deliver cash or other financial assets to the holders. Incremental costs directly attributable to the issue of equity instruments are presented in equity as a deduction from the proceeds, net of tax.

hh, Treasury shares

The cost of the Bank’s repurchased equity instruments ('treasury shares') is deducted from equity. Gain or loss is not recognised on the purchase, sale, issue, or cancellation of treasury shares. Treasury shares may be acquired and held by the Bank or by other members of the Group. Consideration paid or received is recognised directly in equity.

ii, Earnings per share

The Bank presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares. For further information about basic and diluted EPS, please see Note 31.

jj, The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2018

The following amendments to the existing standards and new interpretation issued by the International Accounting Standards Board (IASB) and adopted by the EU are effective for the current reporting period:

IFRS 9 "Financial Instruments" - adopted by the EU on 22 November 2016 (effective for annual periods beginning on or after 1 January 2018)

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 Financial Instruments, and in November 2016 the EU has adopted it. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Bank has been applying IFRS 9 from 1 January 2018. The implementation of IFRS 9 had significant impact on the separate financial statements.

Classification – Financial assets

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost (AC), fair value through other comprehensive income (FVTOCI) and fair value through profit or loss (FVTPL). The standard eliminates the existing IAS 39 categories of held to maturity (HTM), loans and receivables (L&R) and available-for-sale (AFS).

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments.

The Bank determined the following business models based on the requirements of IFRS 9:

HTC – Held to collect: Financial assets that are held within a business model whose objective is to hold assets in order to collect contractual cash flows are managed to realise cash flows by collecting contractual payments over the life of the instrument. Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future. The business model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an increase in the assets' credit risk.

HTCS - Both Held to Collect and for Sale: An entity may hold financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. The objective of the business model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and value of sales.

Data in HUF million except stated otherwise

Other (TRADING) business model: Typically financial instrument held for trading the entity's objective will typically result in active buying and selling in short-term. This business model is a residual category.

The business model assessment reflects to the Bank's expectations, not just its intention but its ability. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the business model for those assets if the entity reasonably expects that such a scenario will not occur.

4.2

	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
Amortised cost				
Cash and balances with central banks	**31 599**	**-**	**-**	**31 599**
Loans and advances to banks	**78 005**	**-**	**-**	**78 005**
Loans and advances to customers	**858 143**	**(7 641)**	**(38)**	**850 464**
Opening balance under IAS 39	858 143			
Addition: to mandatory FVTPL (IFRS 9)		(7 641)		
Remeasurement: ECL allowance			(38)	
Closing balance under IFRS 9				850 464
Investment securities - Held to maturity	**559 319**	**(308 723)**	**(354)**	**250 242**
Opening balance under IAS 39	559 319			
Addition: to FVTOCI - debt instruments		(308 723)		
Remeasurement: ECL allowance			(354)	
Closing balance under IFRS 9				250 242
Total financial assets measured at amortised cost	**1 527 066**	**(316 364)**	**(392)**	**1 210 310**
Fair value through profit or loss (FVTPL)				
Trading assets	**52 562**	**20 585**	**-**	**73 147**
Opening balance under IAS 39	52 562			
Addition: from FVTOCI - debt instruments		20 585		
Closing balance under IFRS 9				73 147
Loans and advances to customers	**-**	**7 641**	**32**	**7 673**
Opening balance under IAS 39	-			
Addition: from amortised cost (IAS 39)		7 641		
Remeasurement: from amortised cost to FV			32	
Closing balance under IFRS 9				7 673
Investment securities - FVTPL (mandatory)	**19 757**	**-**	**-**	**19 757**
Total financial assets measured at FVTPL	**72 319**	**28 226**	**32**	**100 577**
Fair value through other comprehensive income				
Investment securities - FVTOCI (debt instruments)	**342 915**	**288 138**	**7 436**	**638 489**
Opening balance under IAS 39	342 915			
Addition: from amortised cost (IAS 39)		288 138		
Remeasurement: from amortised cost to FV			7 436	
Closing balance under IFRS 9				638 489
Investment securities - FVTOCI (equity instruments)	**478**	**-**	**(1)**	**477**
Opening balance under IAS 39	478			
Remeasurement: ECL allowance			(1)	
Closing balance under IFRS 9				477
Total financial assets measured at FVTOCI	**343 393**	**288 138**	**7 435**	**638 966**

The Bank typically holds its financial assets in HTC business model, except certain securities, that are held in HTCS business model. The reclassification reflects the change in the business models.

Data in HUF million except stated otherwise

In the assessment of the SPPI criteria's the Bank analyses whether the interest of loan commitments only contains solely payments of principal and interest. The cash flows of the Bank's financial assets typically solely payments of principal and interest, therefore the pass the SPPI test.

Those loans which did not passed the SPPI test's criteria have been reclassified to 'Fair Value through profit or loss' at HUF 7,641 million amount and the Bank recognise HUF 32 million as revaluation profit.

The discounted government bonds have been reclassified to 'Fair Value through profit or loss from Fair Value through other comprehensive income' which carrying amount at the year-end was HUF 20,585 million.

The government bonds have been reclassified to 'Fair Value through other comprehensive income' amounted to HUF 308,723 million. The revaluation profit on financial assets measured at Fair Value through other comprehensive income was HUF 7,435 million.

Impairment – Financial assets and contract assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. This will require considerable judgement as to how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis. The new impairment model will apply to financial assets measured at amortised cost or FVTOCI, except for investments in equity instruments, and to contract assets.

Under IFRS 9, loss allowances will be measured on either of the following bases:

- 12-month ECLs. These are ECLs that result from possible default events within the 12 months after the reporting date; and
- lifetime ECLs. These are ECLs that result from all possible default events over the expected life of a financial instrument.

4.3

Measurement category	Loan loss allowance under IAS 39/Provision under IAS 37	Reclassification	Remeasurement	Loan loss allowance under IFRS 9
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Loans and advances to banks	19	-	3	22
Loans and advances to customers	104 897	-	14 089	118 986
Total	**104 916**	**-**	**14 092**	**119 008**
Held to maturity (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Investment securities (HTM)	-	-	212	212
Available-for-sale financial instruments (IAS 39)/Financial assets at FVTOCI (IFRS 9)				
Investment securities (AFS)	33	50	65	148
Loan commitments and financial guarantee contracts				
Loans and advances to customers (loan commitments)	2 708	-	(578)	2 130
Total	**2 741**	**50**	**(301)**	**2 490**

Data in HUF million except stated otherwise

4.4

Assets to be measured at Amortised cost	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	POCI Purchased or originated credit-impaired	Total
Gross carrying value per asset type					
Property loans to customers	126 860	5 437	19 166	19 501	170 964
General purpose loans to customers	43 274	5 042	27 386	29 133	104 835
Investment loans	156 946	20 612	4 944	-	182 502
Loans for current assets to customers	220 410	8 678	18 432	-	247 520
Overdrafts	67 139	4 632	6 261	-	78 032
Other loans to customers	76 883	22 475	30 310	-	129 668
Securities and shares for investment purpose	264 122	190	-	-	264 312
Other financial assets	32 636	-	69	-	32 705
Other receivables	42 443	94	2 839	302	45 678
Placements with, and loans to, other banks	78 027	-	-	-	78 027
Credit cards	2 424	157	194	-	2 775
Total gross carrying value	**1 111 164**	**67 317**	**109 601**	**48 936**	**1 337 018**
Loss allowance under IFRS 9 per asset type					
Property loans to customers	700	269	13 106	8 508	22 583
General purpose loans to customers	1 039	319	19 652	12 943	33 953
Investment loans	834	2 343	4 131	-	7 308
Loans for current assets to customers	726	3 264	15 542	-	19 532
Overdrafts	301	178	4 762	-	5 241
Other loans to customers	1 189	3 670	28 941	-	33 800
Securities and shares for investment purpose	207	5	-	-	212
Other financial assets	137	-	64	-	201
Other receivables	611	2	2 221	133	2 967
Placements with, and loans to, other banks	22	-	-	-	22
Credit cards	201	46	181	-	428
Total loss allowance under IFRS 9	**5 967**	**10 096**	**88 600**	**21 584**	**126 247**

Impairment on loans and debt instruments measured at amortised cost have been increased with HUF 14,369 million because of the IFRS 9 implementation. Furthermore the provision on the off-balance sheet items has been decreased with HUF 578 million.

Classification – Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, under IAS 39 all fair value changes of liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

The Bank's equity increased with HUF 6 326 million as a result of implementation of IFRS 9 standard.

Standards and Interpretations issued by IASB and adopted by the EU

- **IFRS 15 "Revenue from Contracts with Customers"** and amendments to IFRS 15 "Effective date of IFRS 15" - adopted by the EU on 22 September 2016 (effective for annual periods beginning on or after 1 January 2018),

- **Amendments to IFRS 2 "Share-based Payment" -** Classification and Measurement of Share-based Payment Transactions – adopted by the EU on 26 February 2018 (effective for annual periods beginning on or after 1 January 2018),

- **Amendments to IFRS 4 "Insurance Contracts" -** Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – adopted by the EU on 3 November 2017 (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 "Financial Instruments" is applied first time),

- **Amendments to IFRS 15 "Revenue from Contracts with Customers" -** Clarifications to IFRS 15 Revenue from Contracts with Customers – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2018).

- **Amendments to IAS 40 "Investment Property" -** Transfers of Investment Property – adopted by the EU on 14 March 2018 (effective for annual periods beginning on or after 1 January 2018),

- **Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014 - 2016)"** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 7 February 2018 (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),

- **IFRIC 22 "Foreign Currency Transactions and Advance Consideration"** – adopted by the EU on 28 March 2018 (effective for annual periods beginning on or after 1 January 2018).

The adoption of these amendments to the existing standards has not led to any material changes in the Bank's financial statements.

kk, New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective

At the date of authorisation of these financial statements the following standards, amendments to the existing standards and interpretations issued by IASB and adopted by the EU were in issue but not yet effective:

IFRS 16 "Leases" – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2019),

The Bank shall apply IFRS 16 Leases standard for annual reporting periods begins from 01 January 2019. The impacts of adopting IFRS 16 on the Bank's Financial statements are summarised below. Final impacts of adopting the standard could be different as the Bank has not finished the implementation, testing and evaluation of controls related to the new IT solutions, also might be changes in IFRS 16 accounting policies until the date, those financial statements are authorised for issue which contains the transition impacts.

IFRS 16 introduces a single lease accounting model for lessees which requires to recognise right-of-use asset and lease liability on balance sheet. A lessee presents interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. In some cases (e.g when there is a change in the lease term or if there is a change in future lease payments arising from a change in an index or rate) lessee shall remeasure the lease liability. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset. The standard elects to apply recognition exemptions for leases of short term and low value assets. Lessor accounting remains similar to the current requirements, thought a lessor classifies leases as either a finance lease or an operating lease.

Data in HUF million except stated otherwise

IFRS 16 replaces the current leasing standards, IAS 17 *Leases*, IFRIC 4 Determining whether an Arrangement contains a Lease , SIC-15 *Operating Leases - Incentives*, SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. Furthermore, IFRS 16 requires more detailed disclosures, than previously made under IAS 17.

Leases in which the Bank is a lessee

For leases of assets, which were classified as operating lease under IAS 17, the Bank recognises a right-of-use asset and a lease liability at the date of the initial application. Based on the requirements of IAS 17 lease payments under operating lease are recognised as an expense on a straight-line basis over the lease term. As a consequence of transition to IFRS 16 total lease expense will generally be front-loaded. The front-loaded effect arises from the combination of straight-line depreciation coupled with a declining interest expense as the lease liability is drawn down over the lease term.

In case of real estate lease contract that contains a lease and non-lease component, the Bank allocates the consideration in the contract to each component on the basis of their relative stand-alone prices. However, for the leases of real estates in which it is a lessee, the Bank has elected to separate non-lease components and account for the lease and non-lease components as a separate component.

The Bank has elected not to recognise right-of-use assets and lease liabilities for short-term leases of machinery that have a lease term of 12 months or less and leases of low-value assets (e.g including printers, IT equipment).

Expected effect of implementation of IFRS 16:

4.5

	01.01.2019	Year ended 31.12.2019
Right-of-use asset	18 548	
Lease liability	18 548	
Expected impact on statement of comprehensive income:		
- Increase of depreciation		2 138
- Increase of interest expense		314
- Decrese of other expenses		(2 316)

Based on the currently available information the Bank will recognise right-of-use asset on balance sheet in the amount of HUF 18,548 million, and the carrying amount of lease liability will increase by HUF 18,548 million at the date of the initial application as the result of transition to IFRS 16. The depreciation will increase by HUF 2,138 million and the interest rate expense on lease liabilities will increase by HUF 314 million in 2019 because of the new regulations.

At the date of the initial application the Bank has only a few leases that is previously classified as finance lease, for which transition to IFRS 16 will have no significant impact.

Leases in which the Bank is a lessor

The Bank leases personal and commercial vehicles, leases and sub-leases office spaces.

On transition, the Bank reassessed the classification of a sub-lease contract, in which it acts as a lessor. Based on the currently available information, the Bank expects no changes in the classification of these contracts, as a consequence there will be no significant impact on transition to IFRS 16.

Transition

The Bank has applied IFRS 16 with a date of initial application of 1 January 2019. The Bank applies IFRS 16 using the modified retrospective approach as a transition method, under which the cumulative effect of initial application is recognised in retained earnings at the date of initial application.

The Bank used the following practical expedients on transition to IFRS 16:

- At the date of the initial application the Bank assesses whether a contract is, or contains, a lease.
- For leases of assets, which were classified as operating lease under IAS 17, the Bank recognises a right-of-use asset and a lease liability at the date of the initial application. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted by the amount of any prepaid or accrued lease payments made at or before the date of initial application.
- Applied a single discount rate to a portfolio of leases with similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).
- The Bank has applied the practical expedient to rely on its assessment that the lease was onerous under IAS 37 Provisions, Contingent Liabilities and Contingent Assets and therefore adjust the right-of-use asset at the date of initial application by the onerous lease provision rather than conduct an impairment test. Based on the assessment the Bank has identified onerous contracts related to closure of branches and the adjustment for those right-of-use assets accordingly.
- The Bank applied the exemption not to recognise right-of-use assets and liabilities for leases with less than 12 months of lease term.
- The Bank excluded initial direct costs from measuring the right-of-use asset at the date of initial application.

Standards and Interpretations issued by IASB and adopted by the EU but not yet effective

- **Amendments to IFRS 9 "Financial Instruments" -** Prepayment Features with Negative Compensation – adopted by the EU on 22 March 2018 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IAS 19 "Employee Benefits" -** Plan Amendment, Curtailment or Settlement – adopted by the EU on 13 March 2019 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IAS 28 "Investments in Associates and Joint Ventures" -** Long-term Interests in Associates and Joint Ventures – adopted by the EU on 8 February 2019 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to various standards due to "Improvements to IFRSs (cycle 2015 - 2017)"** resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 14 March 2019 (effective for annual periods beginning on or after 1 January 2019),

- **IFRIC 23 "Uncertainty over Income Tax Treatments"** – adopted by the EU on 23 October 2018 (effective for annual periods beginning on or after 1 January 2019).

The Bank has elected not to adopt these new standards and amendments to existing standards in advance of their effective dates. The Bank anticipates that the adoption of these standards and amendments to existing standards will have no material impact on the financial statements of the Bank in the period of initial application.

ll, Standards and Interpretations issued by IASB but not yet adopted by the EU

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except for the following new standards, amendments to the existing standards and new interpretation, which were not endorsed for use in EU as at 10 April 2019 (the effective dates stated below is for IFRS in full):

- **IFRS 14 "Regulatory Deferral Accounts"** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,

- **IFRS 17 "Insurance Contracts"** (effective for annual periods beginning on or after 1 January 2021),

- **Amendments to IFRS 3 "Business Combinations"** - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period).

- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),

- **Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors"** - Definition of Material (effective for annual periods beginning on or after 1 January 2020),

- **Amendments to References to the Conceptual Framework in IFRS Standards** (effective for annual periods beginning on or after 1 January 2020)

The Bank anticipates that the adoption of these new standards, amendments to the existing standards and new interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

5 Risk management

a, Introduction and overview

All the Bank's activities involve a certain degree of risk assumption. The measurement, evaluation, acceptance and management of these risks are integral parts of the Bank's daily operative activity.

Risk management is an integral part of the Bank's operations and a crucial component of its business and overall financial performance. The MKB Bank's risk management framework has been designed to support the continuous monitoring of the changes of the risk environment and is supported by the strong commitment to a prudent risk management culture both on the strategy and business line levels.

The main principles and priorities of the Bank's risk management function include the ultimate oversight by the Board of Directors (the approval of the Supervisory Board is also required for some specifically defined risk decisions), the importance of independent review of all risk-taking activities separately from business lines, and the proper evaluation, diversification, limitation, monitoring and reporting of all risks. Decisions in respect of major risk principles are approved at group level, and are implemented individually by the own decision making boards of the Bank members.

The effective communication on risk and risk appetite, the on-going initiatives to better identify, measure, monitor and manage risks, the improvement of efficiency, user-friendliness and awareness of key risk processes and practices, and the employment of highly-skilled staff are the bases of running an effective risk management function in the Bank.

The Bank has exposure to the following risks from its use of financial instruments:

- credit risk:
  The risk of lending comprises the potential risk of the business partner failing to fulfil its payment obligations or failing to do so on time as well as the risk of the value of the receivable diminishing because the business partner's credit rating decreases. Risks originated from loans or other loan type commitments extended to associated enterprises are also included in the Bank's credit risk managing mechanism.

- country risk:
  The country risk generally refers to a potential loss triggered by an economic, political or other event which takes place in the particular country and cannot be controlled by MKB, as creditor or investor. As a result of such an event(s), the obligor cannot fulfil his obligation in time or at all, or the Bank is unable to enforce its rights against the obligor. The components of the country risk are transfer risk, sovereign risk and collective debtor risk.

- participations risk:
  The participations risk is defined as the risk related to the following events:
  - Potential losses from providing equity / equity financial products or subordinated loan capital; This involves potential losses realised during the sale of participation or loss occurring as a result of a participation's bankruptcy, the (partial) write-off of the participations (also including write-off settled on business or company value or goodwill value), i.e. loss suffered on the book value of the investment

- Potential losses from a possible commitment/liability extended in addition to equity investment (i.e. profit/loss transfer agreements), letters of comfort, capital contribution commitments, additional funding obligations)
- Potential losses originating from other risks associated with the participation such as reputation risk, operational risk, exchange rate risk.

- market risks (including foreign exchange and interest rate risks):
  Market price risk comprises potential losses from changes in market prices in both the trading and banking books.

- liquidity risk:
  MKB defines liquidity as the ability to serve its payment obligations entirely as they fall due and to fund new business at all times without having to accept unplanned liquidation losses on the asset side or increased refinancing rates on the funding side.

- operational risks:
  Operational risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk, conduct risk, reputational risk, model risk and information and communication technology (ICT) risk. Operational risk does not include business and strategic risks.

- conduct risk:
  The conduct risk is part of the legal risks, classified among the operational risks and reflects any risk in the supply of financial services originated from an inadequate supply of services or deliberately exhibited impermissible conduct. This includes legal risks arising from fraud and unfair trading practices harmful to consumers (e.g., unilateral interest rate increase, fees punishing product termination or switch between service providers, unfair fees and commissions), unethical practices, inadequate handling of customer complaints, erroneous sales, aggressive sales, forced cross-selling, etc.). In addition, the risk of certain fraud committed by the institution also belongs here, such as manipulation of the applicable interest rates, currency exchange rates, indices or other financial instruments.

- legal risk:
  Legal risk is the risk of losses due to the non-observance of the scope set by legal provisions and jurisdiction caused by ignorance, lack of diligence in applying law or a delay in reacting to changes in legal framework conditions (including non-observance which is unavoidable or not attributable to one’s own fault).

- reputational risk:
  Reputational risk is defined as the risk of a bank’s reputation falling short of expectations, reputation being a bank’s public image in terms of its competence, integrity and reliability as perceived by groups with a legitimate interest.

- model risk:
  Model is the risk of loss resulting from using insufficiently accurate models to make decisions. Mistakes in models are not necessarily, or not primarily occur due to limitations of knowledge, not enough data, or changes that cannot be read from past data: simply the fact that the models are never perfect.

In the frame of operational risk management, then Bank solely considers the risk of losses relating to the development, implementation or improper use of any other models for decision-making (e.g. product pricing, evaluation of financial instruments, monitoring of risk limits, etc.).

- information and communication technology (ICT) risk:
  ICT risk means the current or prospective risk of losses due to the inappropriateness or failure of the hardware and software of technical infrastructures, which can compromise the availability, integrity, accessibility and security of such infrastructures and of data. ICT risk also includes risks occur from outsourcing of ICT relevant systems.

- real estate risk:
  Real estate risk covers potential losses that could result from fluctuations in the market value of real estate owned by MKB Bank. Real estate risks arising from collateral provided for real estate loans are covered under credit risk.

- strategic risk:
  Strategic risk is defined as the negative impact on capital and income of business policy decisions, deficient or unsatisfactory implementation of decisions, or slow adjustment to changes in the economic environment.

- business risk:
  Business risk is defined as unexpected changes in the economic environment that cause negative changes in business volume or margins and are not attributable to other types of risk. It quantifies the difference between planned and actual costs and income.

Below information is presented about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

b, Risk management governance

The Bank's Risk Strategy was set up in consistence with the Business Strategy and the regulations of the National Bank of Hungary. The tasks incorporated in the Risk Strategy aiming at ensurance a balanced risk/return relationship, development of a disciplined and constructive control environment, defining the Bank's risk assumption willingness, risk appetite and the ongoing ability of the Bank to manage its risks and the maintenance of its funds to cover risk exposures in the long term. This will also ensure the capital preservation and guarantee the solvency of the Bank at any time.

Committees	Main responsibilities
Supervisory Board	- Control on the highest level of the harmonized and prudent operation of the Bank and the credit institutions, financial enterprises and investment companies under its controlling influence; - Management of the company, and steers the company's internal audit organization; - Analyzing of the regular and ad-hoc reports prepared by the Board of Directors.
Risk Committee	- In the frame of continuous monitoring of the MKB Bank's risk strategy and risk taking appetite, previously comment the Risk Strategy, the Remuneration policy and the Quarterly Risk Report.
Board of Directors	- As the company's operative managing body it carries out management-related tasks and ensures the keeping of the company's business books in compliance with the regulations; - Tasks related to the shares and dividend; - Tasks related to the company's organization and scope of activities; - Tasks related to strategic planning (preparation of the business policy and financial plan, and approval of the risk strategy); - Approves the policies related to risk assumptions; - Evaluation of regular and ad-hoc risk reports.
Managing Committee	- Highest level operational decision preparation and decision making body; - It operates as the supporting organisation to the general director in decision preparation of general executive cases. In affairs relating to operation of the MKB Group or the organisation of the company, or cases relevant to compliance and protection against money laundering, and supervision it operates as decision making body.
Credit Committee	- Permanent body with the highest delegated decision-making authority under the Board of Directors; - Make decisions on credits case-by-case according to the Risk Decision Competence Regulation, except of the customers handled by Restructuring and Debt management Directorate.
Restructuring and Debt Management Committee	- Organization with the highest level risk decision authority regarding the customers handled by Restructuring and Debt management Directorate; - Decision-making competency for credit decisions on deals handled by the Directorate according to the Risk Decision Competence Regulation; - Authority regarding decision making in terms of debt-to-asset and debt-to-equity conversation as it is determined in the Risk Decision Competence Regulation Assumption.
ALCO	- The asset and liability management and management of the Group's liquidity, funding, capital adequacy and market risks; - Elaboration of policies in principle for the management of liquidity risk, interest rate risk, exchange rate risk (foreign exchange and securities), capital adequacy risk, and the submission of this policy to the Board of Directors at MKB and Group level, including: ▪ measurement guidelines and limit system for the above risks; ▪ competence and decision-making mechanism; ▪ guideline for managing limit excess.
Strategy, Innovation and Development Committee	- Determine the strategic and development orientations for company units according to the strategy of the Bank Group; - Assesses the position of the banking group through industry and competition analyzes; - Embracing new business, digital and other innovative initiatives, as well as product development proposals; - Also responsible for the plans and target figures in properly reflected in the bank's strategy goals.
Banking and Costcontrol Committee	- Is responsible for ensuring the bank's overall cost structure and control over its revenue; - Development needs, programs, investments and costs associated with IT developments, projects and other initiatives, and the decision-making body responsible for the related resource allocation, the task of which is to ensure consistency between the development needs and the strategic objectives of the banking group; - Develop and adopt the bank's product development processes associated with the pricing principles in accordance with the bank's business model and the risk management strategy, control the product and service palette profitability.
Audit Committee	- The Audit Committee assists the Supervisory Board in the audit of the financial reporting system and in the selection of the auditor and in cooperation with the auditor.

c, Credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from the Bank's lending, trade finance and leasing business, but also from certain off-financial position products such as guarantees, and from assets held in the form of debt securities.

For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

Credit risk management

The Bank has standards, policies and procedures dedicated to the effective monitoring and managing risk from lending (including debt securities) activities. The risk management of the MKB Bank controls and manages credit risks at high standards, in a centralised manner. Its responsibilities include:

- Formulating the Bank's credit policy in consultation with business units by establishing credit approval policies, standards, limits and guidelines that define, quantify, and monitor credit risk.

- Establishing the authorisation structure for the approval and renewal of credit facilities. In order to establish an adequate credit decision-making system in which decisions are made on time, the limit amounts are established differently according to the customer segment, the customer quality and the business line, for the delegated credit decision authorities and the boards and individual decision-makers of the Business and Risk Units.

- Monitoring the performance and management of retail and wholesale portfolios across the Bank.

- Supervising the management of exposures to debt securities by establishing controls in respect of securities held for trading purposes.

- Establishing and maintaining the Bank's concentration risk management policies ensuring that the concentration of exposure does not exceed the limits stated in the internal and regulatory limit systems and concentration risks are effectively managed without any need for additional capital requirements if possible.

- Developing and maintaining the Bank's risk assessment systems in order to categorise the exposures according to the degree of the risk of financial loss faced and to manage the existing risks adequately. The purpose of the credit (deal) classification system is to define when impairment provisions may be required against specific credit exposures. The risk categorisation system consists of several grades which reflect sufficiently the varying degrees of risk of default and the availability of collateral or other credit risk mitigation options with regard to a specific exposure.

- Providing position statements, guidance and professional support to the business units of the Bank members in credit risk management.

The control systems applied by the Bank enable to control and monitor exposures by customer and retail product segment.

In order to comply with the prudential requirements, MKB Bank developed and operates its borrower group forming concept. As part of that, the borrower group-level monitoring concept is to be highlighted. According to the processes, the complete risk assumption process must be executed at the level of borrower groups: in the case of the individual groups the limit proposal and monitoring process for each individual group members takes place at the same time based on the collective analysis and consideration of risks.

Data in HUF million except stated otherwise

With regards to the management of concentration risks, MKB Bank implemented the global concept of concentration risk limits. As part of the concept, the Bank set up bank and sector level KPI's (key performance indicator) set and product limits, in order to restrain the assumption of further risks arising from the characteristics/risks rooted in different sectors and the assumption of risks of products representing high or special risk. Aiming at avoid high risk concentration within the portfolio, the concentration risk limit value has been established for the total bank portfolio, with the stipulation that the limits of the individual customers/customer groups may exceed this target value only in extraordinary and justified cases, based exclusively on the strategic guidelines approved by the relevant Committee.

The tables required by CRR, but not presented in this Note are available in the Disclosure according to Regulation (EU) No. 575/2013 prepared by MKB Bank, available on our website www.mkb.hu.

The table below shows the Bank's maximum exposure classified as credit risk at the end of the reporting period:

5.1

2018	Cash reserves	Loans and advances to banks	Loans and advances to customers	Securities*	Derivative financial assets	OFF B/S exposures
Individually impaired						
Non-default	-		-	-	-	-
Default	-	-	32 897	-	-	467
Total individually impaired gross amount	-	-	32 897	-	-	467
Total individually impaired allowance for impairment	-		(27 102)	-	-	(99)
Total individually impaired carrying amount	**-**	**-**	**5 795**	**-**	**-**	**368**
Collectively impaired						
Non-default	9	62 790	698 466	-	-	325 098
Default	-	-	42 134	-	-	376
Total collectively impaired gross amount	9	62 790	740 600	-	-	325 474
Total collectively impaired allowance for impairment		(15)	(36 774)	-	-	(2 492)
Total collectively impaired carrying amount	**9**	**62 775**	**703 826**	**-**	**-**	**322 982**
Past due but not impaired						
Non-default	-	-	3	-	-	-
Default	-	-	50	-	-	-
90 days past due but not impaired carrying amount	**-**	**-**	**53**	**-**	**-**	**-**
Past due comprises:						
up to 30 days	-	-	2	-	-	-
30 to 90 days	-	-	42	-	-	-
over 90 days	-	-	53	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**97**	**-**	**-**	**-**
Neither past due nor impaired						
Non-default	19 231	835	183 359	711 551	17 914	109 436
Default	-	-	111	-	-	112
Total neither past due nor impaired carrying amount	**19 231**	**835**	**183 470**	**711 551**	**17 914**	**109 548**
Includes receivables with renegotiated terms						
Total gross amount	**19 240**	**63 625**	**957 020**	**711 551**	**17 914**	**435 489**
Total allowance for impairment	**-**	**(15)**	**(63 876)**	**-**	**-**	**(2 591)**
Total carrying amount	**19 240**	**63 610**	**893 144**	**711 551**	**17 914**	**432 898**

* Debt securities and other fixed income securities (excl. shares and other non fixed income securities)

Data in HUF million except stated otherwise

2017	Cash reserves	Loans and advances to banks	Loans and advances to customers	Securities*	Derivative financial assets	OFF B/S exposures
Individually impaired						
Non-default	-	-	2 525	-	-	2 020
Default	-	-	94 706	-	-	1 050
Total individually impaired gross amount	-	-	97 231	-	-	3 070
Total individually impaired allowance for impairment	-	-	(65 578)	-	-	(1 585)
Total individually impaired carrying amount	**-**	**-**	**31 653**	**-**	**-**	**1 485**
Collectively impaired						
Non-default	-	19 094	622 840	-	-	438 208
Default	-	-	0	-	-	-
Total collectively impaired gross amount	-	19 094	622 840	-	-	438 208
Total collectively impaired allowance for impairment	-	(8)	(7 769)	-	-	(2 442)
Total collectively impaired carrying amount	**-**	**19 086**	**615 071**	**-**	**-**	**435 766**
Past due but not impaired						
Non-default	-	-	84	-	-	-
Default	-	-	123	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**207**	**-**	**-**	**-**
Past due comprises:						
up to 30 days	-	-	176	-	-	-
30 to 90 days	-	-	1	-	-	-
over 90 days	-	-	30	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**207**	**-**	**-**	**-**
Neither past due nor impaired						
Non-default	31 599	58 920	210 575	902 010	19 757	127 443
Default	-	-	68	-	-	1 948
Total neither past due nor impaired carrying amount	**31 599**	**58 920**	**210 643**	**902 010**	**19 757**	**129 391**
Includes receivables with renegotiated terms						
Total gross amount	**31 599**	**78 014**	**930 921**	**902 010**	**19 757**	**570 669**
Total allowance for impairment	**-**	**(8)**	**(73 347)**	**-**	**-**	**(4 027)**
Total carrying amount	**31 599**	**78 006**	**857 574**	**902 010**	**19 757**	**566 642**

* Debt securities and other fixed income securities (incl. shares and other non fixed income securities)

Offsetting of financial assets and liabilities

This disclosure represents the financial instruments that are set off or that are subject to an enforceable master netting agreement or similar agreement, irrespective whether they are set off.

As of 31 December 2018 the Bank had no enforceable master netting agreement or similar agreement which should be set off in accordance with IAS 32.42.

The below table presents all the amounts that could potentially have been subject to an enforceable master netting agreement or similar agreement that are recognized financial instruments. As these agreements and the amounts related to them as financial collateral do not meet some or all offsetting criteria in IAS 32.42., the Bank does not apply offsetting to either of them. This is because the agreements constitute rights for an offset that is enforceable only in case of the following events such as a default, insolvency or bankruptcy of the Bank or its counterparties. In addition the Bank or the counterparties do not intend to settle on a net basis or realize the assets and settle the liabilities simultaneously.

Similar agreements include derivative clearing agreements, global master repurchase agreements. Similar financial instruments include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements. Financial instruments such as loans and deposits are not disclosed in the tables below unless they are offset in the statement of financial positions.

The Bank receives and gives collateral in the form of cash and marketable securities in respect of following transactions:

- derivatives
- sale and repurchase agreements, reverse sale and repurchase agreements.

Data in HUF million except stated otherwise

Such collateral is subject to standard industry terms, including an ISDA Credit Support Annex.

The table below presents the potential effect of the not implemented offsetting as well.

5.2

31 December 2018 Offsetting financial assets	IAS 32.42			similar netting arrangement			Net amount of financial assets after offsetting/ similar agreement /collaterals
	Gross carrying amount before offsetting	Gross amounts of offsetting	Recognised net carrying amount set off	Carrying amounts of accompanied liabilities	Received collaterals	Carrying amounts + receivabl. collaterals	
	debit	credit		credit	credit		
Derivatives							
Derivate financial assets	21 873	-	21 873	-	570	570	21 303
Receivables concerning repos							
Loans and advances to customers	23 767	-	23 767	-	-	-	23 767
Financial assets under netting agreements	**45 640**	**-**	**45 640**	**-**	**570**	**570**	**45 070**

31 December 2018 Offsetting financial liabilities	IAS 32.42			similar netting arrangement			Net amount of financial liabilities after offsetting/ similar agreement /collaterals
	Gross carrying amount before offsetting	Gross amounts of offsetting	Recognised net carrying amount set off	Carrying amounts of accompanied assets	Pledged collaterals	Carrying amounts + pledged collaterals	
	credit	debit		debit	debit		
Derivatives							
Derivate financial liabilities	-	-	-	-	-	-	-
Liabilities concerning repos							
Deposit and current accounts	-	-	-	-	-	-	-
Financial liabilities under netting agreements	**-**	**-**	**-**	**-**	**-**	**-**	**-**

31 December 2017 Offsetting financial assets	IAS 32.42			similar netting arrangement			Net amount of financial assets after offsetting/ similar agreement /collaterals
	Gross carrying amount before offsetting	Gross amounts of offsetting	Recognised net carrying amount set off	Carrying amounts of accompanied liabilities	Received collaterals	Carrying amounts + receivabl. collaterals	
	debit	credit		credit	credit		
Derivatives							
Financial assets measured at FVTPL	11 543	-	11 543	7 152	1 057	8 209	3 334
Receivables concerning repos							
Loans and advances to customers	-	-	-	-	-	-	-
Financial assets under netting agreements	**11 543**	**-**	**11 543**	**7 152**	**1 057**	**8 209**	**3 334**

31 December 2017 Offsetting financial liabilities	IAS 32.42			similar netting arrangement			Net amount of financial liabilities after offsetting/ similar agreement /collaterals
	Gross carrying amount before offsetting	Gross amounts of offsetting	Recognised net carrying amount set off	Carrying amounts of accompanied assets	Pledged collaterals	Carrying amounts + pledged collaterals	
	credit	debit		debit	debit		
Derivatives							
Financial liabilities measured at FVTPL	17 205	-	17 205	7 152	7 077	14 229	2 976
Liabilities concerning repos							
Deposit and current accounts	489	-	489	-	490	490	(1)
Financial liabilities under netting agreements	**17 694**	**-**	**17 694**	**7 152**	**7 567**	**14 719**	**2 975**

The gross amounts of financial assets and liabilities presented in the table above measured in the financial statements on the following bases:

- Financial assets measured at FVTPL – fair value (please refer to Note 4.o))
- Derivative financial instruments – fair value (please refer to Note 4.u))
- Loans and advances to customers – amortized cost, pledged collateral – fair value
- Deposits and current accounts – amortized cost, pledged collateral – fair value

Data in HUF million except stated otherwise

The table below reconciles the Net amount after offsetting to the related individual line items of the Statement of Financial position.

5.3

31 December 2018 Line item of Statement of Financial Position	Net amount after offsetting	Carrying amount in the statement of financial position	Financial assets not in scope of offsetting disclosure
Derivate financial assets	21 873	17 914	(3 959)
Loans and advances to customers	23 767	893 144	869 377

31 December 2018 Line item of Statement of Financial Position	Net amount after offsetting	Carrying amount in the statement of financial position	Financial liabilities not in scope of offsetting disclosure
Derivate financial liabilities	-	31 608	31 608
Deposits and current accounts	-	1 380 838	1 380 838

31 December 2017 Line item of Statement of Financial Position	Net amount after offsetting	Carrying amount in the statement of financial position	Financial assets not in scope of offsetting disclosure
Financial assets measured at FVTPL	11 543	72 319	60 776
Loans and advances to customers	-	858 143	858 143

31 December 2017 Line item of Statement of Financial Position	Net amount after offsetting	Carrying amount in the statement of financial position	Financial liabilities not in scope of offsetting disclosure
Financial liabilities measured at FVTPL	17 205	43 366	26 161
Deposits and current accounts	489	1 552 495	1 552 006

Credit risk classification system

The Bank's credit risk classification systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss.

For individually significant wholesale financial assets, the classifications are reviewed regularly and amendments, where necessary, are implemented at least monthly in terms of provisions and exposure classification.

Exposures below specific amounts are assessed on a collective basis, in relation to which the credit risk parameters are reviewed at least yearly or, more frequently if required, in line with the changes of the main economic conditions.

The Bank for each balance sheet closing date (the last day of the month) evaluates the changes in the credit risk that have occurred since the initial recognition of the financial assets and allocate the appropriate stage categories.

During the valuation the Bank assesses the change in the risk of default over the life of the financial instrument using all reasonable and supportable information, which is available without undue cost or effort and without exhaustive search of information. The Bank represents lifetime credit losses in the case where credit risk increased significantly.

The financial assets are initially in the stage 1 category, and they can be returned from stage 2 or from stage 3 if the necessary conditions are performed.

The credit risk of the deals are determined by the extent of change between the initial and the actual PD level, the duration of the delay, the client rating and the client handling method. In case of significant credit risk increase the deal is reclassified to stage 2 and lifetime credit losses are recognised on these financial assets.

If the credit risk of a financial asset increases to the point that it is considered credit-impaired (defaulted), the financial asset is transferred to stage 3.

Collective valuation

According to the credit risk characteristics, similar (homogeneous) financial assets are subject to collective valuation. The basis for the formation of homogeneous groups is the client segmentation and the credit risk product type.

The collectively allocated impairment and provisioning methodology is applied to all retail clients, to the wholesale customers in stage 1 and stage 2 and to the wholesale customer in stage 3 below the client exposure limit.

Determining the collective loss allowance the expected credit loss (ECL) method is applied according to the IFRS 9. The expected credit loss is determined on the basis of the probability of default (PD), actual losses realized on non-performing transactions the actual losses realized on non-performing deals (LGD) and the credit conversion factor probability of becoming a balance sheet item (CCF). The risk parameters are determined based on statistical models. The models are validated at least once a year and reviewed if necessary.

The expected credit loss for financial assets in stage 1 is determined on the basis of a 12-month expected credit loss. Lifetime expected credit losses are recognised on the financial assets in stage 2 and stage 3.

The purchased or originated credit-impaired (POCI) at the reporting date represents the cumulative changes in lifetime credit risk from the initial recognition. In the Bank's practice, the loans originally disbursed in foreign currency have been converted to forint, and therefore appear as POCI assets. Typically mortgage loans were involved.

In the case of financial assets recorded at fair value, the Bank calculates the credit risk component of the discount factor on the basis of the principles used in determining the expected credit loss.

Individual-based valuation

Financial assets in the stage 3 are assessed individually over the exposure limit level.

In determining the level of allowances on individually significant financial assets in stage 3, the Bank applies the scenario-based discounted cash flow method. The amount and timing of expected receipts and recoveries, the value of collateral and the probability of realization are considered in estimating the allowance in each scenario. The scenario weights are used in the calculation of the loss allowance.

The credit conversion factor is taken into account in loss allowance calculation for contingent liabilities.

In case of financial assets are measured individually at fair value the expected loss calculation uses the cash-flow scenarios.

Debt securities valuation

The debt securities in accordance to the business model are booked at amortized cost or at fair value through profit or loss. The determination of expected credit losses for securities is based on the methodology, staging rules and procedures applied for the credit instruments.

Write-off policy

The Bank, in compliance with the stipulations of legal regulations, writes off a loan / security balance (and any related allowances for impairment losses) when there is documented evidence that no further recovery can be expected. This determination is reached on the basis of a final statement in case of liquidation or upon establishment that after ceasing the debtor and/or collateral provider to exist, and/or after using all proceeds from collaterals there is still unrecovered exposure remaining.

Collateral structure

The Bank applies the basic principle, whereby it extends loans primarily in relation to and based on the customer's repayment capacity, instead of relying too much on the available collateral. Depending on the customer's paying capacity and rating, as well as the product type, unsecured loans may be extended only in strictly regulated and controlled cases. Nevertheless, collateral could mitigate the credit risk.
The main collateral types are as follows:

- primarily mortgages on residential properties in the retail sector;
- pledge on business assets, such as real estates, stock and debtors, in the commercial and industrial sector;
- mortgages on the financed properties in the commercial real estate sector; and
- securities, guarantees,
- money, securities deposited as collateral.

The Bank establishes the coverage ratio required for individual exposures and makes its decisions on the basis of the so-called collateral value of the collateral items instead of their market value. This value is adjusted by conservative estimation, which assists the prudent management of occurring risks, taking into consideration the relevant order of accountability and resolution making during the action. In case of collaterals of non-performing clients the Bank apples so-called liquidation value, which is established by the revaluation of the collateral, involving additional costs arising during the forced sale in relatively short period.

Taking into account the EU and Hungarian regulatory environment and legal practices, and relying on its own experiences and known Hungarian experiences in the enforcement of the collateral items, the Bank restricted, as much as possible (within the limits of the economies of scale) the rules of acceptability of the various collateral items and the calculation of the collateral and liquidation values assigned to them. The regular monitoring and revaluation of the collateral items securing the individual exposures is an important pillar in the Bank's monitoring system.

Data in HUF million except stated otherwise

The values of collaterals held at the end of the reporting period were as follows:

5.4

2018	Loans and advances	Guarantees and contingencies	Letter of credit	Undrawn credit
Cash deposit	14 223	12 734	99	3 596
Debt securities issued by				
Central governments	-	-	-	-
Companies	61 330	432	-	89
Mortgage				
Building (incl. plot)	270 049	9 087	2 783	18 788
Other (ship, patent, chattel, goods stock, lien on assets over total assets, etc.)	11 978	10 677	32	1 928
Guarantees from				
Central governments	98 250	47 873	11 581	14 349
Other banks	27 636	787	-	-
Companies	7 607	889	-	9 140
Others	18 444	-	-	-
Total collateral	**509 517**	**82 479**	**14 495**	**47 890**

2017	Loans and advances	Guarantees and contingencies	Letter of credit	Undrawn credit
Cash deposit	10 290	13 396	54	604
Debt securities issued by				
Central governments	4 280	178	-	-
Companies	23 770	215	-	6 294
Mortgage				
Building (incl. plot)	300 306	9 976	690	23 901
Other (ship, patent, chattel, goods stock, lien on assets over total assets, etc.)	29 358	6 642	65	5 272
Guarantees from				
Central governments	105 817	50 986	10 166	21 637
Other banks	1 274	1 021	-	-
Companies	10 994	7 302	-	4 109
Others	54 708	-	-	23 104
Total collateral	**540 797**	**89 716**	**10 975**	**84 921**

Valuation methods

The aim of collateral valuation is to conduct advisable and stable evaluation of value, taking into consideration the fluctuation of market prices.

The basis of the collateral valuation is provided by the collateral value (reflecting the value that can be realized on its own, independently from the course of business).

Data in HUF million except stated otherwise

Cash deposits:
In case of bails, if the type of the currency of commitments and collaterals is the same, the amount of bail can be taken into account in 100%.

Securities embodying credits:
The value of securities equals with the latest accessable market value. Revaluation is done in every sixth month.

Mortgage:
In case of real estates the calculation of the collateral value is done on the basis of individual evaluation of the real estate on the occasion of reception, taking into account minimum correction factors determined by the Bank.

The Bank applies 3 main revaluation methods:

- evaluation by experts involved in the list;
- evaluation by the Bank's own experts involving relevant information provided by the 'list' experts;
- statistical method mostly in case of residential real estates

Guarantees:
In course of definition of collateral value, the probability of non-performance of the guarantee (depending on the quality of the guarantor), the Bank's outstanding relevant to guarantee and the empirical value on possibility of calling in guarantees are taken into considerations.

The Bank didn't obtain any assets by taking possession of collateral held as security, or exercising other credit enhancement options.

The management and processes of such assets obtained are regulated in the Bank's Debt to Asset Policy.

Concentrations

The Bank monitors and analyses the concentration of credit risk in term of sector and risk classification. An analysis on the gross exposures of credit risk concentration in terms of sector and risk classification at the end of the reporting periods is shown below:

5.5

2018	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Category I - without country risk	-	22 774	10 209	-	1 469	4 006
Category II - with low to medium country risk	-	8 981	1 211	882	1 581	2 163
Category III - with medium to high country risk	-	96	186	-	34	6
Total exposure	**-**	**31 851**	**11 606**	**882**	**3 084**	**6 175**

* Debt securities and other fixed income securities (excl. shares and other non fixed income securities)

2017	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Category I - without country risk	-	17 945	9 142	-	3 296	7 186
Category II - with low to medium country risk	-	4 050	37 828	702	6 582	4 982
Category III - with medium to high country risk	-	463	2 147	111 573	78	179
Total exposure	**-**	**22 458**	**49 117**	**112 275**	**9 956**	**12 347**

* Debt securities and other fixed income securities (excl. shares and other non fixed income securities)

- Category I comprises the EMU countries
- Category II comprises countries with Moody's rating AAA - Baa3
- Category III comprises countries with Moody's rating Ba1 or worse

Data in HUF million except stated otherwise

5.6

2018	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Sovereign	27	28 641	54 885	681 766	7 665	74 764
Private	-	-	246 564	-	296	10 925
Financial institution	-	34 984	203 880	20 526	5 668	3 235
Real estate	-	-	36 397	-	55	7 150
Other	19 213	-	415 293	9 259	4 230	339 415
Total exposure	**19 240**	**63 625**	**957 019**	**711 551**	**17 914**	**435 489**

* Debt securities and other fixed income securities (incl. shares and other non fixed income securities)

2017	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Sovereign	10 153	43 738	13 958	846 609	79	58 650
Private			246 330		902	10 331
Financial institution		23 981	176 844	40 136	11 462	56 866
Real estate			76 018		4 122	11 092
Other	21 447	10 294	417 770	15 968	3 192	429 703
Total exposure	**31 600**	**78 013**	**930 920**	**902 713**	**19 757**	**566 642**

* Debt securities and other fixed income securities (incl. shares and other non fixed income securities)

The major sectors included in other are food and beverages, oil and gas, construction, agriculture, logistics, manufacturing and engineering sectors.

d, Liquidity risk

Liquidity risk is the risk that the Bank's cash flows may not be adequate to fund operations and meet commitments on a timely and cost-effective basis. This risk arises from mismatches in the timing of cash flows.

Management of liquidity risk

The Bank’s approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the MKB’s reputation.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to approval by the Board of Directors following the prior review and approval by the ALCO.

Contractual maturity of liabilities

5.7

2018	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(214 153)	(219 167)	(38 614)	(6 682)	(34 999)	(83 571)	(55 301)
Deposits and current accounts	(1 380 838)	(1 382 323)	(1 147 219)	(101 959)	(76 364)	(56 781)	-
Issued debt securities	(5 696)	(5 696)	(146)	(1 442)	(3 774)	(334)	-
Subordinated debt	(28 002)	(35 387)	(674)	-	(1 230)	(4 922)	(28 561)
Financial liabilities measured at FVTPL							
Trading: outflow	-	(409 520)	(117 583)	(119 218)	(97 729)	(51 521)	(23 469)
Trading: inflow	-	353 110	113 921	109 260	48 863	55 641	25 425
Loan commitments	-	(250 648)	(17 808)	(7 999)	(71 333)	(72 857)	(80 651)

Data in HUF million except stated otherwise

2017	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(236 881)	(249 055)	(11 658)	(843)	(23 497)	(99 154)	(113 903)
Deposits and current accounts	(1 552 495)	(1 541 577)	(1 332 696)	(61 062)	(69 275)	(78 485)	(59)
Issued debt securities	(11 119)	(11 096)	-	(2 665)	(3 367)	(5 064)	-
Subordinated debt	(22 307)	(28 701)	-	-	(1 042)	(3 965)	(23 694)
Financial liabilities measured at FVTPL							
Trading: outflow	-	(424 750)	(159 728)	(112 393)	(95 030)	(39 262)	(18 337)
Trading: inflow	-	398 468	152 696	98 280	78 618	44 833	24 041
Loan commitments	-	(299 848)	(5 114)	(32 285)	(151 456)	(81 542)	(29 451)

The above table shows the undiscounted cash flows of the Bank's financial liabilities and loan commitments based on their earliest possible date of maturity. The Gross nominal inflow / (outflow) disclosed in the previous table is the contractual, undiscounted cash flow of the financial liability or commitment. The disclosure for derivatives shows the gross inflow and outflow amount for derivatives (e.g., forward exchange contracts and currency swaps).

The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and loan commitments are not all expected to be drawn down immediately. Due to the significant difference between the expected and the contractual cash-flows, the Bank's risk management department use both analyses to manage liquidity risk. The expected, undiscounted cash-flows of the Bank's financial liabilities were as follows:

Expected maturity of liabilities

5.8

2018	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(214 153)	(219 167)	(38 614)	(6 682)	(34 999)	(83 571)	(55 301)
Deposits and current accounts	(1 380 838)	(1 383 663)	(100 935)	(9 759)	(8 449)	(16 619)	(1 247 901)
Issued debt securities	(5 696)	(5 696)	(146)	(1 442)	(3 774)	(334)	-
Subordinated debt	(28 002)	(35 387)	(674)	-	(1 230)	(4 922)	(28 561)
Financial liabilities measured at FVTPL							
Trading: outflow	-	(409 520)	(117 583)	(119 218)	(97 729)	(51 521)	(23 469)
Trading: inflow	-	353 110	113 921	109 260	48 863	55 641	25 425
Loan commitments	-	(40 404)	(14 337)	(26 067)	-	-	-

2017	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(236 881)	(249 055)	(11 658)	(843)	(23 497)	(99 154)	(113 903)
Deposits and current accounts	(1 552 495)	(1 543 279)	(118 361)	(4 911)	(10 268)	(9 734)	(1 400 005)
Issued debt securities	(11 119)	(11 096)	-	(2 665)	(3 367)	(5 064)	-
Subordinated debt	(22 307)	(28 701)	-	-	(1 042)	(3 965)	(23 694)
Financial liabilities measured at FVTPL							
Trading: outflow	-	(424 750)	(159 728)	(112 393)	(95 030)	(39 262)	(18 337)
Trading: inflow	-	398 468	152 696	98 280	78 618	44 833	24 041
Loan commitments	-	(48 698)	(17 280)	(31 418)	-	-	-

The decision of the Management of the Bank, however, is also based on the liquidity gap (net position) between contractual expected in- and outflows, therefore both financial assets and liabilities are grouped into liquidity buckets.

Data in HUF million except stated otherwise

The following table shows the gross amounts of financial current and non-current assets:

5.9

	2018	
	Up to 1 year	Over 1 year
Loans and advances to banks	62 526	1 100
measured at AC	62 526	1 100
Loans and advances to customers	78 131	878 888
measured at AC	78 063	871 059
measured at FVTPL	68	7 829
Derivative financial assets	2 278	15 636
Securities	151 133	621 896
measured at AC	987	410 290
measured at FVTPL	59 419	2 059
measured at FVTOCI	90 728	209 546

	2017	
	Up to 1 year	Over 1 year
Loans and advances to banks	65 567	12 446
Loans and advances to customers	131 628	799 293
Financial assets measured at FVTPL	52 398	19 921
Investments in AFS securities	158 465	184 929
HTM Debt securities	152	559 167

The table above represents the gross amounts expected to be recovered or settled within time categories. Impairment on loans and advances to customers has an amount of HUF 63,875 million (2017: HUF 72,777 million).

e, Market risk

Market risk is the risk that changes in market prices, such as interest rate (interest rate risk), equity prices (equity risk), and foreign exchange rates (foreign exchange risk) will affect the Bank's income or the value of its holdings of financial instruments.

Management of market risks

As part of the Risk strategy, the Board of Directors approves the maximum amount and scope of market risks incurable by the Bank, ensured by a comprehensive limit structure broken down by relevant portfolios. The main market risk limit is arising from the annual capital allocation process based on ICAAP requirements.

The Asset and Liability (ALCO) committee is responsible for developing and monitoring the Bank's market risk management policies. ALCO has the overall responsibility for establishing and managing market risk policies for the Bank, within the framework of internal policies, covering risk management, assessment of risk and related limits, competence and decision-making mechanism, and regulation for breaches of limits, approved by the Board of Directors. The members of the ALCO are senior executives who have principal decision-making responsibilities for businesses throughout the whole Bank. At the operational level, market risk is managed by the Money and Capital Markets Managing Directorate on a bank-wide basis.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Bank separates its exposure to market risk between trading and non-trading portfolios.

Trading portfolios include those positions arising from market-making, customer business driven proprietary position-taking and other marked-to-market positions as designated. According to the risk strategy of the Bank there is no own account activity (proprietary trading) with the purpose of short term profit arising from market changes. Trading activities include transactions with debt and equity securities, foreign currencies, and derivative financial instruments.

Non-trading portfolios include positions that arise from the Bank’s retail and commercial banking activity and the interest rate management of the Bank’s retail and commercial banking assets and liabilities. The Bank's non-trading activities encompass all activities other than accounted for as trading transactions, including lending, accepting deposits, and issuing debt instruments.

Exposure to market risks – trading portfolios

The Bank manages exposure to market risk by establishing and monitoring various limits on trading activities. These limits include:

- Product volume limits define maximum aggregate amounts of trading products and contracts that the Bank may hold at any time.
- FX position limits restrict the long and short position for each currency and the total net amounts of FX positions that can be held in the trading and banking books.
- VaR limits: The VaR limit of a trading portfolio is the estimated maximum loss that will arise on the portfolio over a specified period of time (holding period) from an adverse market movement with a specified probability (confidence level). MKB Bank applies historical and parametric VaR method with 1-day holding period at 99% confidence level.
- PLA (Potential Loss Amounts) limits define maximum amount of loss that the Bank is willing to assume.

The VaR model used is based mainly on historical data. Taking account of market data from the previous one year (250 business days in case of historical VaR and and 187 business days in case of parametric VaR), and observed relationships between different markets and prices, the model calculates both diversified and undiversified total VaR, and VaR by risk factors such as interest rate, equity and currency VaR.

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based do give rise to some limitations, including the following:

- A 1-day holding period assumes that it is possible to hedge or dispose of positions within that period. This is considered to be a realistic assumption in almost all cases but may not be the case in situations in which there is severe market illiquidity for a prolonged period.
- A 99 percent confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a one percent probability that losses could exceed the VaR.
- VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the trading day.
- VAR only covers “normal” market conditions.

Data in HUF million except stated otherwise

- The VaR measure is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position reduces if the market price volatility declines and vice versa.

The overall structure of VaR limits is subject to review and approval by ALCO. VaR limits are allocated to trading portfolios. VaR is measured on a daily basis. Daily reports of utilisation of VaR limits are prepared by the Bank's Risk Unit and regular summaries are submitted to ALCO.

A summary of the VaR position of the Bank's trading portfolios (i.e. only its trading book) as at 31 December and during the period is as follows:

5.10

2018	Average	Maximum	Minimum	Stress (15%)
Foreign currency risk	26	102	2	154
Interest rate risk	87	206	14	-
Equity risk	1	1	-	-
Overall market risk of trading book	**114**	**309**	**16**	**154**
Credit spread risk of trading book	37	67	(4)	-

2017	Average	Maximum	Minimum	Stress (15%)
Foreign currency risk	38	126	4	414
Interest rate risk	41	79	8	-
Equity risk	-	1	-	-
Overall market risk of trading book	**79**	**206**	**12**	**414**
Credit spread risk of trading book	50	92	17	-

Important notes in connection with the table above:

- MKB applies historical and parametric VaR for general market risk:
  - Historical VaR: (1 day holding period; 99% confidence level, number of observation: 250 business days)
  - Parametric VaR: Risk metrics methodology (1 day holding period; 99% confidence level, 0.94 decay factor, number of observation: 187 business days)
- MKB calculates specific interest rate risk (credit spread risk) separately from general interest rate risk based on the swap and bond yield curve spread.
- There is no commodity in MKB position.
- MKB does not have a significant open position from options therefore there is no volatility VaR calculation.

A potential adverse 15% change in the FX rates (HUF appreciation for long position and HUF depreciation for short position) would cause HUF 154 million losses based on the year-end FX open position.

Exposure to interest rate risk – non-trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows of financial instrument because of a change in market interest rates.

The management of interest rate risk is supplemented by monitoring the sensitivity of the financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 200 basis point parallel fall or rise in all yield curves worldwide.

ALCO is the monitoring body for compliance with approved limits and is assisted by Risk Controlling in its monitoring activities. A summary of the Bank's interest rate gap position on non-trading portfolios is as follows:

At the end of the reporting period the interest rate profile of the Bank's interest-bearing financial instruments was:

5.11

As at 31 December 2018

Fixed rate instruments	in HUF millions
Financial assets	784 115
Financial liabilities	(526 439)
Total fixed rate instruments	**257 676**

Variable rate instruments	Denominated in				
	HUF	CHF	EUR	USD	Other currencies
Financial assets	802 479	2 518	196 106	8 204	3 289
Financial liabilities	(780 032)	(3 779)	(242 510)	(67 159)	(8 770)
Total variable rate financial instruments	**22 447**	**(1 261)**	**(46 404)**	**(58 955)**	**(5 481)**

As at 31 December 2017

Fixed rate instruments	in HUF millions
Financial assets	737 133
Financial liabilities	(528 412)
Total fixed rate instruments	**208 721**

Variable rate instruments	Denominated in				
	HUF	CHF	EUR	USD	Other currencies
Financial assets	979 756	7 384	233 583	3 944	2 407
Financial liabilities	(950 676)	(4 672)	(241 953)	(86 260)	(10 334)
Total variable rate financial instruments	**29 080**	**2 712**	**(8 370)**	**(82 316)**	**(7 927)**

MKB revised its interest rate risk modelling of sight deposits in 2018 using longer (10 years long) data history, taking into account the new Basel and EBA recommendations. As a result of the review the modelled maturity of core sight deposits increased significantly which mainly explains the changes in the results of the EUR interest rate risk scenarios.

An analysis of the Bank’s sensitivity to an increase or decrease in market interest rates is as follows:

5.12

As at 31 December 2018

2018	Effect on equity	Effect on P/L
HUF		
200 bp increase	(8 097)	(9 325)
200 bp decrease	(5 241)	(6 988)
CHF		
200 bp increase	(7)	(1)
200 bp decrease	-	(14)
EUR		
200 bp increase	6 364	(181)
200 bp decrease	(124)	(1 015)
USD		
200 bp increase	1 910	427
200 bp decrease	(2 130)	(1 121)
Other currencies		
200 bp increase	6	(14)
200 bp decrease	(3)	(61)

2018			in HUF millions
FCY	Yield curve stress + 200 Bp	Yield curve stress - 200 Bp	Adverse case
EUR	6 364	(124)	(124)
USD	1 910	(2 130)	(2 130)
CHF	(7)	-	(7)
GBP	4	(2)	(2)
JPY	-	-	-
Others	(8 096)	(5 242)	(8 098)
Total	**175**	**(7 498)**	**(10 361)**

As at 31 December 2017

2017	Effect on equity	Effect on P/L
HUF		
200 bp increase	(15 729)	(1 261)
200 bp decrease	8 743	(10 966)
CHF		
200 bp increase	(10)	(242)
200 bp decrease	-	(58)
EUR		
200 bp increase	(274)	(40)
200 bp decrease	(266)	(1 514)
USD		
200 bp increase	1 090	213
200 bp decrease	(1 167)	(1 222)
Other currencies		
200 bp increase	12	(19)
200 bp decrease	(5)	(98)

2017			
			in HUF millions
FCY	Yield curve stress + 200 Bp	Yield curve stress - 200 Bp	Adverse case
EUR	(274)	(266)	(274)
USD	1 090	(1 167)	(1 167)
CHF	(10)	-	(10)
GBP	3	(1)	(1)
JPY	3	-	-
Others	(15 723)	8 749	(15 723)
Total	**(14 911)**	**7 315**	**(17 175)**

The amount of change, during the period and cumulatively, in the fair value of the financial liabilities designated as at fair value through profit or loss, that is attributable to changes in the credit risk of that liabilities are the followings:

5.13

Effect of credit risk changes of liabilities measured at Fair Value Through Profit or Loss	2018	2017
Changes during the reporting period	15	235
Changes cumulatively (since designation of the financial liabilities)	(134)	(151)
Difference between the financial liability's carrying amount and the amount contractually required to pay at maturity	157	30

Data in HUF million except stated otherwise

The amount which reflects on changes in market conditions for these liabilities as changes in interest rate, is estimated as follows:

(a) First, computing the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (base rate of the relevant market) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

(b) Next, calculating the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (base rate of the relevant market) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).

(c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (base rate in the relevant market) interest rate.

Exposure to other market risks – non-trading portfolios

The Bank is exposed to foreign exchange risk through its holdings of financial instruments denominated in foreign currencies. Exchange risk management aims to reduce the adverse impact of potential changes in the market value of foreign currency financial instruments induced by exchange rate fluctuations. The Bank's financial position in foreign currencies at the end of the reporting periods was as follows:

5.14

2018	In functional currencies	In foreign currencies				Total
		USD	EUR	CHF	Other	
Financial assets except for derivatives	1 529 607	10 197	311 912	2 408	4 506	1 858 630
Financial liabilities except for derivatives	1 359 363	93 021	387 847	5 459	12 940	1 858 630
Net derivative and spot instruments (short) / long position	(169 734)	82 441	75 771	3 124	8 398	-
Total net currency positions	**510**	**(383)**	**(164)**	**73**	**(36)**	**-**

2017	In functional currencies	In foreign currencies				Total
		USD	EUR	CHF	Other	
Financial assets except for derivatives	1 676 810	11 236	351 490	8 214	3 278	2 051 028
Financial liabilities except for derivatives	1 540 731	120 740	366 822	7 417	15 318	2 051 028
Net derivative and spot instruments (short) / long position	(137 072)	111 300	14 609	(771)	11 934	-
Total net currency positions	**(993)**	**1 796**	**(723)**	**26**	**(106)**	**-**

Data in HUF million except stated otherwise

f, Encumbered assets

Encumbered assets according to 680/2014/EU Commission Implementing Regulation at the end of the periods were the follows:

5.15

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets of the reporting institution				
Loans on demand	291	291	431	431
Debt securities	202 562	200 935	144 905	144 905
Loans and advances other than loans on demand	47 083	-	53 901	-
Total encumbered assets	**249 936**	**201 226**	**199 237**	**145 336**

5.16

		Non-encumbered	
	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance	Nominal value of collateral received or own debt securities issued non available for encumbrance
31 December 2018			
Collateral received by the reporting institution			
Loans on demand	-	749	-
Loans and advances other than loans on demand	-	25 571	-
Other collateral received	-	-	268 682
Collateral received and own debt securities issued	**-**	**26 320**	**268 682**
31 December 2017			
Collateral received by the reporting institution			
Loans on demand	-	1 842	-
Loans and advances other than loans on demand	-	-	-
Other collateral received	-	-	375 218
Collateral received and own debt securities issued	**-**	**1 842**	**375 218**

5.17

	2018		2017	
	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	*73 640*	*249 937*	*166 769*	*199 237*
Derivatives	5 179	48 652	29 828	95 680
Deposits	68 461	201 285	136 941	103 557
Repurchase agreements	-	-	489	484
Collateralised deposits other than repurchase	68 461	201 285	136 452	103 073
Total Sources of encumbrance	**73 640**	**249 937**	**166 769**	**199 237**

At the end of 2018 the total size of encumbered assets was 11.61 % of the total balance sheet. The majority of MKB Bank's encumbered assets belonged to MKB Bank. The main sources and types of encumbrance were arising from having secured refinancing and money market deposits as well as collateralized derivative transactions. Encumbrance due to repo transactions, collateral requirement of used clearing systems and central counterparties was not significant. MKB did not have covered bond issues or securitization.

One of the two significant secured refinancing facilities was participating in the „Funding for Growth Scheme" refinancing loan program of the National Bank of Hungary. The other significant secured liability item is connected to the refinancing loan facility of the European Investment Bank. Secured money market deposits were provided by the National Bank of Hungary which supported the active liquidity management of the bank in line with the self-financing program of the National Bank of Hungary. The majority of collateralized derivative transactions were concluded to hedge on balance sheet FX position.

g, Credit spread risk

Credit spread risk is the risk of changing market price of the bonds due to change in spread of bonds' issuer which may have negative impact on the Bank's performance.

Managing and monitoring credit spread risk

The framework of credit spread risk management is defined in the risk strategy. According to this risk strategy credit spread risk may be taken only within the approved limits. Credit spread risk is managed on operative level by the Money and Capital Market Managing Directorate. Bank's Risk Unit is responsible for measuring credit spread risk, controlling limit utilisations and reporting it to ALCO.

Risk measurement

Similar to the general interest rate risk measurement the Bank establishes the credit spread risk figures based on the present value of the future cash flows.

The applied credit spread stress test values are revised regularly, but at least semi-annually. The length of liquidation periods used for the calculations are matched to the required liquidation time of the products.

h, Operational risks

Operational risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk, conduct risk and reputational risk. Operational risk does not include business and strategic risks.

Procedure

The principles, rules and procedures that serve to properly identify, manage and monitor operational risk are defined in the Risk Strategy and in the OpRisk policy.

Risk measurement

The operational risk capital requirement of MKB Bank Zrt. is calculated by using The Standardised Approach (TSA) both at single and group level since January 1st 2008. According to the Standardised Approach the operational risk capital requirement is the average of the preceding three years' total of the weighted governing indicators of the business lines (gross income).

Risk management and monitoring

The system that serves to evaluate operational risk is fully integrated in the Bank's risk management process and in the work processes.

The centralised unit of the Bank's operational risk management is the Centralised OpRisk Management that is responsible for the establishment and maintenance of the internal regulation and organisation of operational risk management and for the establishment and coordination of the oprisk management methods and tools. Besides, its task is to ensure proper loss data collection and in connection with that the reporting obligations.

Besides the Centralised OpRisk Management, Decentralized OpRisk Units (extended to the whole organisation) were established that identify, report and manage operational risks and their tasks and responsibilities are included in the oprisk regulations. The Centralised OpRisk Management keeps independent control over the Decentralised OpRisk Managers that are assigned in the various units and responsible for managing operational risk and reporting of loss events.

At group level the Centralised OpRisk Management of MKB determines the operational risk regulations required from the subsidiaries, and also the framework for operational risk management at group level and in this respect supervises the subsidiaries as well. The centralised and decentralised operational risk management units have also been established in the subsidiaries that have loss data collection and reporting obligation towards the Centralised OpRisk Management of MKB.

The Oprisk Forum started its operation in 2016, where the most significant oprisk events and the relevance and necessity of setting up risk reducing action plans are discussed on quarterly basis.

The Centralised OpRisk Management of MKB prepares a report on the current status of the operational risk management of the Bank and of the subsidiaries for the Board of Directors on a quarterly basis. The Bank fulfils oprisk COREP data delivery to National Bank of Hungary on half-yearly basis.

Risk management methods and tools

Loss data collection
MKB Bank Zrt. has been performing operational risk loss data collection continuously which includes the electronic reporting and managing of operational risk loss events.

OpRisk Self-Assessment – ORSA
The Bank performs the oprisk self-assessment unit by unit, in order to recognise and understand the operational risks related to the work processes and to increase the level of risk-awareness of the units.

Key Risk Indicators - KRIs
The key risk indicators are those performance/risk ratios that are suitable for revealing areas and factors critical for operational risk, the change of value of which indicates the change of factors important from the point of view of risk occurrence. By defining and monitoring the values of the suitable indicators the Bank intends to help forecasting, preventing and reducing operational risks.

Scenario analysis
Scenario analysis is an expert estimation based on the analysis of current internal processes in order to estimate the frequency and loss effect of rare but significant oprisk events.

The Bank performs scenario analysis on yearly basis.

Model list
The model list contains all models on department level being used in the Bank and describes their goals. It also contains the frequency of their maintenance and validations as well as the way in which their results are used.

Business Continuity Planning

In order to undisturbedly maintain the Bank's operational processes it is necessary to evaluate the potential threats of the certain processes, their probability of occurrence and the potential damages resulting from the fallout of the processes. This risk analysis and the procedures needed to maintain the functionality of the Bank's organisation is included in the Business Continuity Plan and the Disaster Recovery Plan (BCP-DRP) The BCP-DRP includes measures that have to be taken when the processes that are critical regarding the Bank's operation and (eg. IT) resources that support these processes get damaged or become unmaintainable.

Membership of the Hungarian Interbank Operational Risk Database (HunOR)

The Bank is one of the foundation members of the Hungarian Interbank Operational Risk Database (HunOR) and reports their loss data towards regularly and anonymously.

i, Capital management

The Bank's lead regulator, the National Bank of Hungary sets and monitors capital requirements for the Bank as a whole.

Capital allocation

The Bank measures the pillar 1 and pillar 2 risks and the Bank's Asset and Liability Management Committee (ALCO) monitors the results using a monthly reporting framework.

Basel III

The calculations are Basel III/CRR (575/2013/EU regulation) compliant.

The supervisory objectives of Basel III are to promote safety and soundness in the financial system and maintain at least the current overall level of capital in the system, enhance competitive equality, constitute a more comprehensive approach to addressing risks, and focus on internationally active banks. Basel III is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. The Capital Requirements Regulation (CRR) is directly effective in Hungary.

Basel III provides three approaches of increasing sophistication to the calculation of pillar 1 credit risk capital requirements. The Bank uses the standardised approach, which requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, and groups other counterparties into broad categories and applies standardised risk weightings to these categories.

Basel III also introduces capital requirements for operational. For the capital requirement calculation the Bank currently has adopted the standardized approach to the determination of Bank operational risk capital requirements.

Data in HUF million except stated otherwise

The second pillar of Basel III (Supervisory Review and Evaluation Process - SREP) involves both the Bank and the Supervisory regulators taking a view on whether a Bank should hold additional capital and how much against risks not covered or not entirely covered in pillar 1. In framework of the pillar 2 Internal Capital Adequacy Assessment Process (ICAAP) the Bank introduced policies and processes for measuring capital requirement of risks not captured by pillar 1 and to measure pillar 1 risks with more sophisticated methodology. Under pillar 2 the materiality of the following risks is to be analysed:

- Credit risk
- Market risk
- Liquidity risk
- Risk estate risk and risk derived from other assets
- Participation risk
- Operational risk
- Modell risk
- Business and strategic risk

Pillar 3 of Basel III is related to market discipline and aims to make firms more transparent by requiring them to publish specific, prescribed details of their risks, capital and risk management under the Basel III framework.

The capital requirement is limited by a complex limit system, which contains the limits of the material risk types by institutions and business lines.

5.18

	2018 Basel III IFRS	**2017 Basel III HAS**
Share capital	100 000	100 000
Outstanding share capital	*100 000*	*100 000*
Reserves	56 834	57 463
Intangible assets	(17 014)	(11 490)
AVA - additional valuation adjustments	(422)	(444)
Additional Tier 1	**-**	**-**
Tier 1: Net core capital	**139 398**	**145 529**
Subordinated debt	28 002	21 710
Tier 2: Supplementary capital	**28 002**	**21 710**
Regulatory capital	**167 400**	**167 239**
Risk-weighted assets (RWA)	656 326	669 710
Operational risk (OR)	160 681	155 807
Market risk positions (MR)	9 298	6 549
Total risk weighted assets	**826 305**	**832 066**
Regulatory capital / Total assets	9.01%	8.11%
Tier1 ratio	**16.87%**	**17.49%**
Capital adequacy ratio	**20.26%**	**20.10%**

The table above contains the MKB Bank's separate capital adequacy ratio.

As at 31 December 2018, as an actual figure of the Bank regulatory capital was HUF 167.4 billion based on Basel III IFRS under Supervisory Regulation. The increase of regulatory capital - by HUF 161 million – is derived from the increase of profit, capital reserve and subordinated debt and decrease of deduction of ESOP program, which was compensated by the increase of deduction of intangible assets, decrease of revaluation reserve.

Risk-weighted assets including operational and market risk decreased by 0.7 % from HUF 832.1 billion in 2017 to HUF 826.3 besides approximately 3.7 % weakening of domestic currency. The main part of the decrease derived from decrease of business volumes in work out and CRE segment, increase of collateral and the RWA reduction project.

By application of capital management as a tool, the capital is a first priority decision making factor; therefore the bank monitors the changes of the capital elements continuously.

Planning and limitation of capital requirements

The owner of the MKB with strong capital background contributes to its safety, promotes customer confidence, and helps the Bank to manage the negative effects on its profitability which come from macroeconomic turbulences.

j, Forborn assets

During the normal course of business, the Bank enters into forbearance measures to decrease the potential loan loss and maximize collection opportunities for the borrowers who have problems with their payment ability but not with their willingness and capacity to pay.

Restructured exposures are renegotiated, rescheduled (prolonged) or otherwise revised loans, receivables and credits (including also purchased ones) originated in the framework of an amendment or termination of a previously concluded contract, initiated either by the borrower or the Bank, where

- the contract is amended in order to avoid default because the borrower is unable to fulfill its payment obligations in compliance with the conditions of the original contract due to significant deterioration in its financial position or payment ability, and
- the amendments significantly change the original terms and conditions of the outstanding contract largely in favor of the borrower, as compared to the market terms and conditions generally applicable to contracts of the same type and concluded under the same conditions, or
- a supplementary agreement or a new contract is concluded between the borrower and the Bank that relates to a new loan provided for the repayment of the outstanding debts (principal and/or interest) arising from the original contract that is not terminated, or to any further commitment assumed to avoid any increase in the credit risks and to mitigate the possible loss.

Under its forbearance policies, the Bank grants loan forbearance on a selective basis where the borrower is in default on its debt, or there is a high risk of future default, and there is evidence that the borrower made all reasonable efforts to pay under the original contractual terms, and it is expected that the borrower will be able to meet the revised terms. Both corporate and retail loans are subject to forbearance policies. The Bank generally applies the following types of forbearance measures:

- extension of the tenor/final maturity of the loan,

Data in HUF million except stated otherwise

- renegotiation of original repayment schedule, reschedule installments,
- agreement on installment payment,
- reduction of the collateral coverage parallel reducing exposure,
- refinancing of the loan,
- interest rate cut, or lower conditions,
- interest capitalization.

Such exposures and associated credit risks are managed, monitored and reported distinctly by specific restructuring and debt management units of the Bank on the basis of guidelines and procedure rules set by internal regulations incorporating also both legal and supervisory requirements and recommendations. When the conditions of forbearance cease to exist and the following cure period expires, respective assets are returned to normal treatments both from business and risk management perspectives.

To revert to normal treatment regarding Corporate customers, additional criteria is that the customer performs its amended contractual obligations duly through a specified period (180 days or 360 days) and its risk position shows significant improvement. Forborn assets are recorded separately, and the amended terms and conditions of the contract are also indicated in the accounting records. Recognition, derecognition and subsequent valuation of these assets are carried out according to the general rules of accounting as specified by the relevant IFRSs.

The detailed requirements of risk classification and impairment valuation of forborn exposures are included in the accounting policies, and other internal regulations on the valuation of assets and liabilities, as well as in impairment and provisioning policies. Based on these internal guidelines, forbearance measures are always regarded as impairment triggers and, as a consequence, individual impairment assessment should be performed for such exposures where the general methodologies and principles of assessment are to be applied. On the results of such risk assessments, impairment losses and the reversals of previously charged impairments are accounted for according to the common rules defined IFRS 9.

Compared to the previous financial year there were no changes in forbearance policies and practices applied by the Bank.

5.19

	Balance at 31.12.2018	Balance at 31.12.2017
Corporate Banking		
Forbearence loans and advances based on actual restructured status	15 958	17 471
Allowances for impairment	(14 895)	(12 544)
Carrying amount	1 063	4 927
Retail and Private Banking		
Forbearence loans and advances based on actual restructured status	20 160	36 174
Provision	(10 294)	(16 908)
Carrying amount	9 866	19 266
Total carrying amount	**10 929**	**24 193**

Data in HUF million except stated otherwise

6 Cash reserves

6.1

	2018	2017
Cash and balances with Central Banks	19 240	31 599
Cash reserves	**19 240**	**31 599**

The Bank is required to maintain a minimum reserve with the National Bank of Hungary (NBH) equivalent to 1 % (2017: 1%) of certain deposits. The balance of the minimum reserve, in line with the prescription of NBH, is based on the balance at the end of November of these deposit accounts and amounted to HUF 13,334 million as at 31 December 2018 (2017: HUF 14,572 million). As at 31 December 2018, cash on hand amounted to HUF 15,267 million (2017: HUF 14,823 million).

7 Loans and advances to banks

7.1

	2018
Current and clearing accounts	15 676
Money market placements	47 796
Loans and advances	153
Loans and advances to banks (gross amount)	**63 625**
Allowance for impairment	
Balance at 1 January	(11)
Impairment loss for the year:	
Increases due to origination and acquisition	(21)
Decreases due to derecognition	18
Changes due to change in credit risk (net)	(1)
Allowance for impairment at the end of period	**(15)**
Carrying amount	**63 610**

Data in HUF million except stated otherwise

	2017
Current and clearing accounts	13 200
Money market placements	53 901
Loans and advances	10 912
Less collective allowances for impairment	(8)
Loans and advances to banks	**78 005**
Collective allowances for impairment	
Balance at 1 January	**(7)**
Impairment loss for the year:	
Charge for the year	(4)
Reversal	3
Balance at 31 December	**(8)**
Carrying amount	**77 997**

8 Derivative financial assets

8.1

	2018			2017		
	Cost	Fair value adjustment	Book value	Cost	Fair value adjustment	Book value
Derivative instruments by type						
FX-based derivative instruments	-	2 517	2 517	-	2 555	2 555
Index-based derivative instruments	-	-	-	-	1	1
Interest-based derivative instruments	-	14 761	14 761	-	16 746	16 746
Options	299	337	636	-	455	455
Total derivative instruments	**299**	**17 615**	**17 914**	**-**	**19 757**	**19 757**

Data in HUF million except stated otherwise

9 Securities

9.1

	2018
Investment in securities measured at FVTOCI	
Hungarian Government bonds	281 414
Hungarian corporate sector bonds	17 978
Hungarian equities	-
Foreign equities	882
Less allowance for impairment	(65)
Investment in securities measured at amortised cost	
Hungarian Government bonds	372 499
Hungarian corporate sector bonds	38 841
Less allowance for impairment	(63)
Investment in securities measured at FVTPL	
Government Treasury bills	59 211
Government bonds	1 673
Hungarian corporate sector bonds	535
Hungarian equities	59
Securities	**773 029**

The amount of impairment of the FVTOCI financial assets, which is accounted for between other comprehensive income reserve and profit or loss, does not decrease the carrying amount of the financial asset.

	2017
Available-for-sale	
Hungarian Government bonds	324 880
Hungarian corporate sector bonds	17 811
Hungarian equities	33
Foreign equities	702
Less specific allowances for impairment	(33)
Held-to-maturity	
Hungarian Government bonds	484 676
Hungarian corporate sector bonds	74 643
Less specific allowances for impairment	-
Investment in securities	**902 712**

In 2017, the book value of debt and equity instruments measured at fair value through profit or loss (FVTPL) was HUF 52,562 million.

As at 31 December 2018, HUF 202,562 million (2017: HUF 279,972 million) from the total amount of Investments in securities were pledged as collateral for stock exchange, for NBH related to Funding for Growth Scheme and credit card transactions in the ordinary course of business.

The total revaluation effect excluding deferred taxes in equity comprises HUF 3,815 million loss (2017: HUF 2,466 million gain) and HUF 349 million deferred tax income (2017: HUF 112 million deferred tax expense) is disclosed.

In 2018, HUF 3,718 million gain (2017: HUF 17,148 million gain) was recognized in the profit or loss relating to securities measured at FVTOCI, which is a reclassification from other comprehensive income into profit or loss.

Related to Debt securities measured at amortised cost HUF 10,032 million interest income (Held-to-maturity investments in 2017: HUF 7,302 million) was recognized in the Statement of profit or loss during the year.

10 Loans and advances to customers

The net amount of Loans and advances to customers was HUF 893,144 million, of which HUF 885,247 million was measured at amortised cost and HUF 7,897 million at fair value. The amount of fair value customer loans belonging to the wholesale portfolio was HUF 932 million, while the amount of retail loans was HUF 6,965 million on 31 December 2018.

Data in HUF million except stated otherwise

Loans and advances to customers measured at amortised cost:

10.1

2018	Gross amount	Allowance for impairment Stage 1	Allowance for impairment Stage 2	Allowance for impairment Stage 3	Carrying amount
Core business					
Wholesale					
Refinanced loan	54 212	(245)	(45)	(64)	53 858
Funding for Growth Scheme	70 549	(155)	(1 645)	(546)	68 203
Factoring	12 879	(33)	(99)	(68)	12 679
Overdraft	89 388	(213)	(133)	(1 434)	87 608
Széchenyi Loans	31 638	(164)	(140)	(819)	30 515
Other	440 488	(951)	(4 679)	(28 642)	406 216
Total Wholesale	***699 154***	***(1 761)***	***(6 741)***	***(31 573)***	***659 079***
Retail					
Residental mortgage	220 537	(903)	(333)	(19 391)	199 910
HUF	*218 184*	(898)	(330)	*(18 403)*	198 553
Foreign currency	*2 353*	(5)	(3)	*(988)*	1 357
Credit card	2 306	(21)	(44)	(105)	2 136
Overdraft	1 260	(13)	(43)	(138)	1 066
Personal loan	7 068	(634)	(70)	(219)	6 145
Car finance	-	-	-	-	-
Other	2 040	(32)	(3)	(717)	1 288
Total Retail	***233 211***	***(1 603)***	***(493)***	***(20 570)***	***210 545***
Total Core business	**932 365**	**(3 364)**	**(7 234)**	**(52 143)**	**869 624**
Non-core business					
CRE	***16 757***	***(7)***	***(98)***	***(1 029)***	***15 623***
Total	**949 122**	**(3 371)**	**(7 332)**	**(53 172)**	**885 247**

Data in HUF million except stated otherwise

2017	Gross amount	Specific allowances for impairment	Collective allowances for impairment	Carrying amount
Core business				
Wholesale				
Refinanced loan	52 960	(1 074)	(847)	51 039
Funding for Growth Scheme	59 256	(595)	(896)	57 765
Factoring	19 250	(396)	(186)	18 668
Overdraft	63 298	(1 835)	(516)	60 947
Széchenyi Loans	23 885	(498)	(174)	23 213
Other	412 762	(29 723)	(2 534)	380 505
Total Wholesale	***631 411***	***(34 121)***	***(5 153)***	***592 137***
Retail				
Residental mortgage	189 148	(20 959)	(1 575)	166 614
HUF	*186 679*	*(20 106)*	*(1 546)*	*165 027*
Foreign currency	*2 469*	*(853)*	*(29)*	*1 587*
Credit card	2 595	(179)	(47)	2 369
Overdraft	1 500	(227)	(35)	1 238
Personal loan	1 241	(33)	(44)	1 164
Car finance	21 226	(3 964)	(198)	17 064
Other	53 637	(702)	(252)	52 683
Total Retail	***269 347***	***(26 064)***	***(2 151)***	***241 132***
Total Core business	**900 758**	**(60 185)**	**(7 304)**	**833 269**
Non-core business				
CRE	***37 593***	***(11 805)***	***(465)***	***25 323***
Total	**938 351**	**(71 990)**	**(7 769)**	**858 592**

In 2018, other items included HUF 225,436 million working capital loans, HUF 43,014 million investment loans, HUF 64,877 million syndicated loans, HUF 35,830 million loans relating to purchased loans.

In 2017, other items included HUF 178,610 million working capital loans, HUF 27,000 million investment loans, HUF 27,183 million syndicated loans, HUF 46,141 million loans relating to Funding for Growth Scheme and investment SME bonds in the amount of HUF 17,965 million.

Provision for homogeneous groups of loans is disclosed along specific allowances, collective allowances for impairment contains incurred but not yet reported impairment losses.

CRE (previously SCU) remaining portfolio

The Special Credit Unit (SCU) was established in 2011 in order to separate commercial real estate financed customers requiring special treatment and to provide the specific management of their deals. At the end of 2015, significant part of this portfolio has been separated from MKB's portfolio, management of the remaining portfolio is performed by the Corporate Restructuring and Debt Management Directorate.

Data in HUF million except stated otherwise

According to the EU commitments forming part of the Restructuring Plan approved by the European Commission, the gross volume of the remaining CRE (i.e. Commercial Real Estate previously SCU) portfolio has to be reduced below HUF 60 billion by the end of 2019. MKB fulfilled the commitment by the end of 2017, further steps for dismantling the portfolio is not necessary. Even so the portfolio has been reduced significantly by nearly HUF 10 billion in 2018. Nevertheless any new CRE type of business can be approved until 2020 based on the EU commitments.

Asset realization strategy

The recovery expectations at the elements of the asset portfolio has been determined based on, the asset realization strategy. In the framework of the asset realization strategy the Bank keeps some assets in long-term in order to maximize recovery from those assets.

Allowances for impairment

10.2

	2018
Allowances for impairment on loans and advances to customers	
Balance at 1 January	86 481
Impairment loss for the year:	
Increases due to origination and acquisition	6 345
Decreases due to derecognition	(13 555)
Changes due to change in credit risk (net)	(9 650)
Changes due to modifications without derecognition (net)	(740)
Decrease in allowance account due to write-offs	(5 663)
Other adjustments	657
Balance at 31 December	**63 875**

Data in HUF million except stated otherwise

	2017
Specific allowances for impairment on loans and advances to customers	
Balance at 1 January	93 009
Impairment loss for the year:	
Charge for the year	24 875
Reversal	(9 994)
Utilisation	(8 487)
Effect of foreign currency movements	(296)
Unwinding of discount	(1 080)
Reclassification	(11)
Reclassification to Non-current assets held for sale	(32 438)
Balance at 31 December	**65 578**
Collective allowances for impairment on loans and advances to customers	
Balance at 1 January	11 319
Impairment loss for the year:	
Charge for the year	5 043
Reversal	(9 169)
Utilisation	(12)
Effect of foreign currency movements	(22)
Unwinding of discount	106
Reclassification	(57)
Balance at 31 December	**7 208**

The aim of the IFRS 9 credit risk scoring system is to assign a PiT (point-in-time) PD to each relevant customer. The IRB rating system for Pillar II. capital requirement calculation was modified according to IFRS 9 requirements. Both of rating systems use the same default definition and model structure, including the quantitative and qualitative sub-models and the explicative variables. The calibration processes are different. In the case of IFRS 9 it depends on the stage of a given customer. In the stage 1, the time horizon is one year, in the stage 2 the lifetime PiT PD's are estimated. The stage 3 contains the defaulted customers, where the PD equals to 1.

In the stage 2, the one year PD is transformed the lifetime PD, based on the Markov chain, and Vintage analysis estimation of transition probabilities and taken into account the macro economical, especially the year-on-year GDP forecasts, in the first three years of the estimation horizon. From the fourth year, the TTC (through-the-cycle) PD has been used.

Data in HUF million except stated otherwise

10.2.1

2018	Gross amount Stage 1	Stage 2	Stage 3	POCI
Retail				
Investment grade	48 394	-	-	-
Standard credit quality	137 133	3 219	-	2 620
Intensive monitoring	3 321	3 662	-	587
Default	134	-	19 972	14 169
Total Retail	***188 982***	***6 881***	***19 972***	***17 376***
Wholesale				
Investment grade	122 594	-	-	-
Standard credit quality	485 876	1 801	-	-
Intensive monitoring	7 399	41 203	120	-
Default	351	-	39 810	-
Total Wholesale	***616 220***	***43 004***	***39 930***	***-***
CRE				
Investment grade	-	-	-	-
Standard credit quality	14 173	1	-	-
Intensive monitoring	-	1 522	-	-
Default	1	-	1 060	-
Total CRE	***14 174***	***1 523***	***1 060***	***-***
Total	**819 376**	**51 408**	**60 962**	**17 376**

2018	Impairment Stage 1	Stage 2	Stage 3	POCI
Retail				
Investment grade	153	-	-	-
Standard credit quality	1 412	255	-	87
Intensive monitoring	38	237	-	16
Default	-	-	12 764	7 704
Total Retail	***1 603***	***492***	***12 764***	***7 807***
Wholesale				
Investment grade	86	-	-	-
Standard credit quality	1 334	210		-
Intensive monitoring	341	6 532	67	-
Default	-	-	31 505	-
Total Wholesale	***1 761***	***6 742***	***31 572***	***-***
CRE				
Investment grade	-	-	-	-
Standard credit quality	7	-	-	-
Intensive monitoring	-	98	-	-
Default	-	-	1 029	-
Total CRE	***7***	***98***	***1 029***	***-***
Total	**3 371**	**7 332**	**45 365**	**7 807**

The deals of customers belonging to the retail portfolio (household and small company) are classified in sets (pools) homogenous from risk consideration. In pools PD, LGD and CCF values are allocated. Internal rating based models calculate the risk parameters which determine the level of impairment.

Data in HUF million except stated otherwise

In case of individually not significant wholesale customers the calculation of impairment and provision have changed to internal rating based method. The required provisioning rates are calculated based on the credit conversion factor, the statistical analysis of default and the loss given default. Individually assessed items where no specific provision has been set aside the impairment and provision have to be calculated based on the above method.

In case of retail and wholesale exposures collectively assessed provision is allocated for the following portfolios on monthly basis:

- on performing loans Incurred Loss (ICL) is calculated, and
- on non-performing loans Specific Loan Loss Provisions (SLLP) is accumulated.

Since the Bank has introduced the performing and non-performing classification in its provision allocation method instead of product based collective assessment in retail and the new internal method in wholesale, the level of incurred loss has grown.

The concentration of Loans and advances to customers by industry at 31 December was as follows:

10.3

2 018	Gross amount	Allowances for impairment	Carrying amount
Sovereign	54 885	(107)	54 778
Private	246 564	(25 888)	220 676
Financial institution	203 880	(185)	203 695
Real estate	36 397	(1 588)	34 809
Other	415 293	(36 107)	379 186
Loans and advances to customers	**957 019**	**(63 875)**	**893 144**

2 017	Gross amount	Specific allowances for impairment	Collective allowances for impairment	Carrying amount
Sovereign	30 490	-	(124)	30 366
Private	245 992	(22 589)	(2 026)	221 377
Financial institution	157 532	(16)	(103)	157 413
Real estate	55 935	(12 621)	(538)	42 776
Other	440 971	(30 352)	(4 408)	406 211
Loans and advances to customers	**930 920**	**(65 578)**	**(7 199)**	**858 143**

The major sectors included in other are logistics, food and beverages, agriculture, oil and gas, construction, manufactoring and engineering sectors.

At 31 December 2018 there were no loans designated as hedged item in a fair value hedge relationship.

Finance lease receivables

The Bank does not enter into finance lease transactions as a lessor.

Data in HUF million except stated otherwise

11 Other assets

11.1

	2018
Prepayments and other debtors (other financial assets)	16 459
Inventory	458
Corporate income tax refundable	-
Impairment	(399)
Other assets	**16 518**

Specific allowances for impairment

Balance at 1 January	(336)
Impairment loss for the year:	
Increases due to origination and acquisition	(63)
Decreases due to derecognition	113
Changes due to change in credit risk (net)	(113)
Balance at 31 December	**(399)**

	2017
Prepayments and other debtors	16 624
Inventory	459
Corporate income tax refundable	159
Specific allowances for impairment	(125)
Other assets	**17 117**

Specific allowances for impairment

Balance at 1 January	(124)
Impairment loss for the year:	
Charge for the year	(61)
Reversal	4
Utilization	56
Balance at 31 December	**(125)**

Data in HUF million except stated otherwise

12 Investments in subsidiaries, jointly controlled entities and associates

12.1

	2018	2017
Cost	42 972	49 898
Investments in subsidiaries, jointly controlled entities and associates	**42 972**	**49 898**

On 30 September 2018 the Bank sold its investment in MKB Befektetési Alapkezelő Zrt., Therefore the investment is subsidiaries decreased by HUF 100 million. On 4 December 2018 the Registry Court has finished the termination process of MKB Jelzálogbank Zrt, hence the investments is subsidiaries decreased by HUF 3,810 million. The Bank impaired its investment in MKB Üzemeltetési Kft. in the amount of HUF 1,795 million because of the net asset value of the subsidiary has significantly decreased. The aim of the Employee Share Ownership Program (ESOP) has partially fulfilled, the required settlements between the Bank and the ESOP were performed, which indicated further decrease in the amount of the investments in subsidiaries.

13 Intangibles, property and equipment

13.1

2018	Intangible assets	Freehold property	Equipment	Total
Cost				
Balance at 1 January	30 798	6 536	2 645	39 979
Additions – including internally developed	9 387	11	1 114	10 512
Disposals	(2 066)	-	(465)	(2 531)
Balance at 31 December	**38 119**	**6 547**	**3 294**	**47 960**
Amortization and depreciation and impairment losses				
Balance at 1 January	19 308	2 865	1 503	23 676
Amortization and depreciation for the year	1 805	300	297	2 402
Disposals	(8)	-	(303)	(311)
Balance at 31 December	**21 105**	**3 165**	**1 497**	**25 767**
Carrying amounts				
At 1 January	11 490	3 671	1 142	16 303
Balance at 31 December	**17 014**	**3 382**	**1 797**	**22 193**

Data in HUF million except stated otherwise

2017	Intangible assets	Freehold property	Equipment	Total
Cost				
Balance at 1 January	25 548	10 486	2 918	38 952
Additions – including internally developed	5 881	14	659	6 554
Disposals	(631)	(3 964)	(932)	(5 527)
Balance at 31 December	**30 798**	**6 536**	**2 645**	**39 979**
Amortization and depreciation and impairment losses				
Balance at 1 January	17 748	4 027	1 923	23 698
Amortization and depreciation for the year	1 514	487	312	2 313
Impairment loss	83	-	-	83
Disposals	(37)	(1 649)	(732)	(2 418)
Balance at 31 December	**19 308**	**2 865**	**1 503**	**23 676**
Carrying amounts				
At 1 January	7 800	6 459	995	15 254
Balance at 31 December	**11 490**	**3 671**	**1 142**	**16 303**

Depreciation and amortization is presented among the Operating expenses.

In 2018 and 2017, no Non-cancellable operating leases are possessed.

In 2018 and 2017, the most significant component of these investments and developments was the costs related to the Core system replacement process at the Bank. MKB Bank has completed successfully its entire digital transformation, including a full replacement of its core banking system, between 29 June and 5 July 2018 in accordance with plans. The services relating to the new digital core system were implemented gradually in daily operational functioning of the credit institution. In addition, the Bank disclosed several other items here concerning capitalisations of functional developments of other IT systems.

14 Amounts due to other banks

14.1

	2018	2017
Due on demand	4 787	3 651
Money market deposits	31 157	7 842
Borrowings	178 209	225 388
Amounts due to other banks	**214 153**	**236 881**

The largest balance of the amount due to other banks is HUF 77,024 million, which is the re-financing loans relating to Funding for Growth Scheme at National Bank of Hungary.

Data in HUF million except stated otherwise

15 Deposits and current accounts

15.1

	2018	2017
From corporate clients	1 059 776	1 255 899
From retail clients	321 062	296 596
Deposits and current accounts	**1 380 838**	**1 552 495**

As at 31 December 2018, deposit and current accounts measured at fair value from the total amount was HUF 0 million (2017: HUF 1,658 million).

Finance leases as a lessee

As part of its business activities, the Bank enters into finance lease transactions as a lessee. At 31 December 2018 and 2017, the reconciliation of the Bank's future minimum lease payments at the end of the reporting period and their present value by relevant remaining maturity periods was the following:

15.2

2018	up to 1 year	1 year to 5 years	over 5 years	Total
Future minimum lease payments	1 138	4 636	12 911	18 685
Unpaid finance expense	(936)	(3 573)	(5 349)	(9 858)
Present value of minimum lease payments	**202**	**1 063**	**7 562**	**8 827**
Finance leases as a lessee	**202**	**1 063**	**7 562**	**8 827**

2017	up to 1 year	1 year to 5 years	over 5 years	Total
Future minimum lease payments	856	5 277	12 641	18 774
Unpaid finance expense	(931)	(4 460)	(5 321)	(10 712)
Present value of minimum lease payments	**(75)**	**817**	**7 320**	**8 062**
Finance leases as a lessee	**(75)**	**817**	**7 320**	**8 062**

In 2018, no contingent rents were recognized in finance income (2017: HUF NIL). The net carrying amount of the leased office (IT) equipment amounted to HUF 383 million at the end of 2018. The net carrying amount of the lands and buildings used by the reporting entity was HUF 2,382 million at the end of 2018 (2017: HUF 2,591 million). In case of building the contractual maturity is 25 years, with no residual value.

Data in HUF million except stated otherwise

16 Derivative financial liabilities

16.1

	2018 Cost	2018 Fair value adjustment	2018 Book value	2017 Cost	2017 Fair value adjustment	2017 Book value
Derivative instruments by type						
FX-based derivative instruments	-	2 986	2 986	-	4 265	4 265
Index-based derivative instruments	-	1	1	-	-	-
Interest-based derivative instruments	-	28 063	28 063	-	38 846	38 846
Credit default swaps	-	132	132	-	-	-
Options	223	203	426	179	76	255
Derivative financial liabilities	**223**	**31 385**	**31 608**	**179**	**43 187**	**43 366**

The derivative financial instruments disclosed in the table are measured at fair value through profit or loss.

17 Derivative liabilities held for risk management

The Bank used interest rate swaps designated as fair value hedges to hedge its exposure to changes in the fair value of certain loans and advances. Interest rate swaps were matched to specific loans.

As at the end of period the Bank had no positive or negative fair value derivatives designated in a qualifying hedge relationship.

Other derivatives held for risk management

The Bank uses other derivatives, not designated in a qualifying hedge relationship, to manage its exposure to foreign currency, interest rate, equity market and credit risks. The instruments used include interest rate swaps, cross-currency interest rate swaps, forward contracts, and options.

18 Other liabilities and provision

18.1

	2018	2017
Accruals and other creditors	33 564	37 514
Other taxes payable	2 553	2 040
Provisions	2 591	4 027
Other liabilities and provisions	**38 708**	**43 581**

Data in HUF million except stated otherwise

Provision for contingencies and commitments

18.2

	2018	2017
Balance at 1 January	2 912	4 338
Provisions made during the year	1 154	2 364
Provisions used during the year	(595)	-
Provisions reversed during the year	(1 530)	(2 593)
Unwinding of discount	3	-
Other movements	1	(82)
Balance at 31 December	**1 945**	**4 027**

Provisions recognized for different type of products are disclosed in Note 32.

Operating lease as a lessee

The Bank leases some of its branches through one of its subsidiaries in the form of operating lease. At 31 December 2018 and 2017, the total amount of future minimum lease payments under non-cancellable operating leases by relevant remaining period was the following:

18.3

2018	up to 1 year	1 year to 5 years	over 5 years	Total
Minimum lease payments	694	2 016	867	3 577
Non-cancellable operating leases	**694**	**2 016**	**867**	**3 577**

2017	up to 1 year	1 year to 5 years	over 5 years	Total
Minimum lease payments	975	2 815	1 743	5 533
Non-cancellable operating leases	**975**	**2 815**	**1 743**	**5 533**

In 2018, lease were recognised as an expense in the period amounted to HUF 4,015 million (2017: HUF 3,870 million). Furthermore no contingent rents (2017: HUF 0 million) and no sublease payments were recognised.

The leasing contracts remaining maturity ranges from 1 year to 10 years. Most of the leasing agreements are EUR based. Bank branches, warehouses and archives are operated in the leased property.

The contingent rents are yearly increased by inflation rates of Eurostat. Most of the leasing contracts were extend as a right of option.

19 Issued debt securities

During the reporting period MKB issued bonds for support its business activity. The table below shows the new issuance, repayment and other changes during the year:

19.1

Interest	Balance at 1 January	Issued debt securities	Repurchased debt securities	Repaid debt securities	Revaluation result	Balance at 31 December
31 December 2018						
Zero coupon	496	533	-	(300)	4	733
Fixed rate	1 276	-	300	(1 711)	135	-
Structured	9 314	-	117	(4 735)	199	4 895
Accrued interest	33	-	-	-	-	68
Total	**11 119**	**533**	**417**	**(6 746)**	**338**	**5 696**
31 December 2017						
Zero coupon	-	500	-	-	(4)	496
Fixed rate	1 646	-	82	(240)	(212)	1 276
Structured	11 209	-	(30)	(1 705)	(160)	9 314
Accrued interest	37	-	-	-	-	33
Total	**12 892**	**500**	**52**	**(1 945)**	**(376)**	**11 119**

The Bank uses fair value option revaluation through profit or loss for structured bonds, as they are related to assets, which share the same risk that give rise to opposite changes in fair value. On 31 December 2018, the carrying amount of FVTPL own issued bonds amounted to HUF 5,696 million (2017: HUF 9,827 million).

20 Subordinated debt

20.1

2018	Interest	Date of issue	Amount in original currency	Original currency	Carrying amount in million HUF
Subordinated debt	Fixed rate	26.05.2017	70 000 000	EUR	23 061
Subordinated debt	Fixed rate	19.03.2018	15 000 000	EUR	4 941
Total			**85 000 000**	**EUR**	**28 002**

2017	Interest	Date of issue	Amount in original currency	Original currency	Carrying amount in million HUF
Subordinated debt	Fixed rate	26.05.2017	70 000 000	EUR	22 307
Total			**70 000 000**	**EUR**	**22 307**

Subordinated debts are direct, unconditional and unsecured obligations of the Bank, and are subordinated to the claims of the Bank's depositors and other creditors.

On 26 May 2017, MKB Bank Zrt. made a decision to issue subordinated bond in the amount of EUR 70 million with fixed rate interest. The final maturity is 14 June 2024. The bonds were sold to private stakeholders.

The amount of the subordinated debt increased by EUR 15 million to EUR 85 million related to new commitment in March 2018.

21 Share capital

The Bank's authorised, issued, called up and fully paid share capital comprises 100,000,000 (2017: 100,000,000) ordinary shares of HUF 1,000 (2017: HUF 1,000) each. All issued shares rank pari passu in the event of a winding up.

22 Reserves

Share premium

Share premium comprises of premiums on share capital issuances.

Retained Earnings

Retained earnings comprise the accumulated profit after taxes earned in the course of the operating life of an entity of the Bank less any dividend payment.

General reserve

According to the Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (Banking Act), banks shall set aside as general reserve 10% of Profit after taxation. Dividends can be paid only after recognition of general reserve. This reserve can be utilized only for losses derived from ordinary activity. Credit institution can reclassify part or total of its retained earnings into general reserve. Supervisory authority can allow the entity not to set aside the amount calculated as above stated.

The Bank discloses general reserve as part of retained earnings. In 2018, MKB recognized general reserve of HUF 6,624 million (2017: HUF 4,097 million).

Revaluation reserves

Revaluation reserve of financial assets measured at FVTOCI includes the cumulative net change in the fair value.

The Bank did not apply any reclassification adjustments relating to components of other comprehensive income. For financial instruments measured at fair value through other comprehensive income, the Bank has recognized an impairment loss in accordance with IFRS 9, which is shown in the Revaluation reserve.

Data in HUF million except stated otherwise

23 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

23.1

	2018 Assets	2018 Liabilities	2018 Net	2017 Assets	2017 Liabilities	2017 Net
Intangibles, property and equipment	203	45	158	-	27	(27)
Investments in subs., jointly contr. entities and associates	1 274	33	1 241	891	27	864
Available-for-sale securities	122	6	116	122	118	4
Loans and advances to customers	690	-	690	690	-	690
Amounts due to customers	479	-	479	479	-	479
Issued debt securities	-	36	(36)	-	36	(36)
Provisions	169	-	169	-	-	-
Derivatives	-	-	-	150	-	150
Other items	73	27	46	264	-	264
Tax loss carry-forwards	2 168	-	2 168	857	-	857
Offsetting	(147)	(147)	-	(208)	(208)	-
Non-current assets held for sale	40	-	40	40	-	40
Effect on implementation of IFRS 9	700	-	700	-	-	-
Net tax assets / (liabilities)	**5 771**	**-**	**5 771**	**3 285**	**-**	**3 285**

24 Interest income

24.1

	2018	2017
Cash reserves	547	400
Loans and advances to banks	60	42
Loans and advances to customers	25 051	26 451
Derivatives	8 059	6 844
Investments in securities	19 141	18 412
Interest income	**52 858**	**52 149**

Included within various captions under interest income for the year ended 31 December 2018 is a total of HUF 2,329 million (2017: HUF 974 million) accrued on impaired financial assets.

25 Interest expense

25.1

	2018	2017
Amounts due to other banks	723	523
Deposits from customers	2 436	3 436
Issued debt securities	8	232
Subordinated liabilities	1 166	595
Other fees and commisions similar to interest expenses	402	-
Derivatives	11 843	11 934
Interest expense	**16 578**	**16 720**

In 2018 and 2017 the Bank did not realise neither interest income nor expense from derivatives held in a qualifying fair value hedging relationship.

Data in HUF million except stated otherwise

26 Net income from commissions and fees

26.1

	2018	2017
Commission and fee income	**35 178**	**36 886**
Payment and account services	21 699	19 972
Credit related fees	1 784	1 568
Card services	2 539	2 678
Brokerage fees and other securities business	5 207	9 071
Other commission and fee income	3 949	3 597
Commission and fee expense	**9 348**	**8 956**
Payment and account services	2 694	2 586
Credit related fees	1 081	863
Card services	1 789	1 555
Brokerage fees and other securities business	1 456	1 379
Other commission and fee expense	2 328	2 573
Net income from commissions and fees	**25 830**	**27 930**

At the end of the reporting period brokerage fees do not include fees from trust management and other securities services (2017: HUF 0 million).

27 Other operating income / (expense), net

27.1

	2018	2017
Net gain/(loss) on trading securities	3 965	2 215
Net gain/(loss) on the sale of securities	(2 095)	17 077
Net gain/(loss) on non-trading securities measured at FVTPL	(738)	-
Net gain/(loss) on trading derivative transactions	22 714	8 200
Fair Value results from FVTPL revaluation (FVO)	14	(124)
Expenses relating to bank levies	(2 073)	(1 979)
Transaction duty	(12 432)	(11 463)
Other taxes	(3 139)	(3 155)
Other operating income/(expense), net	(821)	(515)
Other operating income / (expense), net	**5 395**	**10 256**

The result from fair value revaluation of structured bonds designated at fair value through profit or loss was HUF 14 million gain (2017: 152 million gain), and in 2017 it amounted to HUF 145 million gain regarding long term deposits designated at fair value.

Data in HUF million except stated otherwise

Banking tax is shown under other expenses as it does not meet the criteria of current income tax.

Financial institutions operating on 1 January 2018 shall be liable to pay this tax in the whole amount also in 2018 according to the Act. The financial plans are calculated with remaining, but decreasing rate of banking tax. In the following years, instead of the 2009 annual accounts, as a rolling tax base, the total asset data from the previous second year shall be taken into account.

In 2018, the credit institutions providing also investment and supplementary services were levied an additional banking tax concerning these services.

In the case of positive profit before taxes, calculated without the special tax of financial organizations (banking tax), credit institutions are obliged to pay a special tax on these profits at a rate of 30 %, and this special tax is to be deducted from the banking tax up to its amount. This special tax is disclosed as, and together with, banking tax.

28 Net impairments / (reversal) and provisions for losses

28.1

	Note	2018	2017
Net impairment loss / (reversal)			
Loans and advances to banks	**7**	4	2
Loans and advances to customers	**10**	(240)	9 825
Securities	**9**	(195)	229
Other assets	**11**	(34)	123
Realised loss on sale of loans		(175)	692
Provision on			
Guarantees and contingencies	**32**	(866)	(921)
Impairments / (reversal) and provisions for losses		**(1 506)**	**9 950**

Data in HUF million except stated otherwise

29 Operating expenses

29.1

	2018	2017
General and administration expenses	4 106	4 776
Legal and advisory services	2 693	3 792
Wages and salaries	16 739	14 872
Compulsory social security obligations	4 712	4 369
Occupancy costs	8 231	8 208
Marketing and public relations	1 054	1 028
Communication and data processing	6 759	6 082
Operating expenses	**44 294**	**43 127**

In 2018, the Bank's average statistical employee number was 1,858 (2017: 1,801).

30 Income tax

Income tax expense recognized in the Statement of Comprehensive Income

30.1

	2018	2017
Current tax expense	*1 467*	*1 473*
Hungarian corporation tax charge – on current year profit	1 467	1 473
Deferred tax expense/(income)	*(2 024)*	*(89)*
Income tax (income) / expense	**(557)**	**1 384**

Both in the reporting period and in 2017 9% current income tax rate was applied on taxable profit in Hungary. Due to this 9% current income tax rate and 9% deferred tax rate applied based on the available future plans.

Reconciliation of effective tax rate

30.2

	2018		2017	
	%	HUF million	%	HUF million
Profit before income tax		24 717		20 538
Income tax using the domestic corporation tax rate	9,00%	2 224	9,00%	1 848
Effect of tax rates in foreign jurisdictions	0,11%	26	0,16%	32
Non-deductible expenses	0,57%	141	0,23%	48
Tax exempt income	-3,10%	(765)	-2,65%	(544)
Re-assessment of unrecognised tax losses/interest carryforwards	-5,79%	(1 430)	0,00%	-
Re-assessment of unrecognised tax credit	-2,83%	(700)	0,00%	-
Other tax effects	-0,21%	(53)	0,00%	-
Income tax (income) / expense	**-2,25%**	**(557)**	**6,74%**	**1 384**

MKB Bank Zrt. used a prudent approach concerning tax losses. Workout companies were not allowed to recognize any deferred tax assets above the limit of deferred tax liability in their books and the relating tax income and other companies used their available plan figures for calculation the upper limit. In 2011 legal base of tax loss changed and due to this fact, tax losses can be used at maximum the 50% of the tax base in the future. Based on this calculation, deferred tax asset on balance sheet items and on tax loss carry forwards totalled at HUF 5,918 million (2017: HUF 3,493 million) before offsetting (see Table 30.4).

On 31 December 2018, the Bank had unused tax losses amounting to HUF 337,980 million (2017: HUF 339,307 million) with the following maturity:

30.3

	2018	2017
Maturity between 1 and 5 years	58 102	59 429
Mature between 5 and 10 years	279 878	279 878
Tax loss carryforwards	**337 980**	**339 307**

The Bank has HUF 313,891 million (2017: HUF 329,785 million) tax losses carried forward, on which no deferred tax asset was recognised.

In 2015, the rules of utilization of tax losses carried forward have changed in Hungary: tax losses arising in 2015 and in following years, can be utilized solely in the next five years after the tax year in which it was generated. Tax losses incurred before 2015 can be utilized until 2030.

In 2018, the Bank booked HUF 349 million deferred tax asset (2017: HUF 112 million deferred tax liability) directly against equity relating to AFS securities' revaluation.

Data in HUF million except stated otherwise

The following table presents the main factors of change in deferred tax:

30.4

2018 P/L-effective and neutral effects on deferred tax assets (DTA) and deferred tax liabilities (DTL)	Opening balance DTA/DTL	P/L-effective movement of DTA/DTL	P/L-neutral movement of DTA/DTL	Closing balance DTA/DTL
Deferred Tax Assets - due to taxable temporary differences				
Assets				
Loans and advances to bank, Loans and advances to customers	690	-	-	690
Financial assets measured at FVTPL	122	-	-	122
Securities	892	-	382	1 274
Intangible Assets	210	(7)	-	203
Non-current assets held for sale	40	-	-	40
Other Assets	54	19	-	73
				-
Liabilities				-
Amounts due to other banks, Deposits and current accounts	479	-	-	479
Provisions	150	19	-	169
Deferred Tax Assets - due to tax losses (total)	857	1 311	-	2 168
Deferred Tax Assets - Tax Credits	-	700	-	700
Subtotal DTA before netting	**3 494**	**2 042**	**382**	**5 918**
Deferred Tax Liabilities - due to taxable temporary differences				
Assets				
Securities	(112)	-	80	(32)
Property, plant and equipment and investment property	(27)	(18)	-	(45)
Liabilities				
Issued debt securities	(36)	-	-	(36)
Derivative financial liabilites	(6)	-	-	(6)
Other liabilities	(27)	-	-	(27)
Subtotal DTL before netting	**(208)**	**(18)**	**80**	**(146)**
Netting of short-term DTA	(7)	-	-	(7)
Netting of short-term /DTL	6	-	-	6
Subtotal DTA after netting of balance sheet positions	**3 487**	**2 042**	**382**	**5 911**
Netting of p/l-effective DTA with p/l-effective DTL (per earning reserves)	-	-	(80)	(80)
Subtotal DTL after netting of balance sheet positions	**(202)**	**(18)**	**80**	**(140)**
Netting of p/l-effective DTL with p/l-effective DTA (per earning res	(202)	(18)	80	(140)
Subtotal DTA after netting completely with DTL	**3 285**	**2 024**	**462**	**5 771**
Subtotal DTL after netting completely with DTA	**-**	**-**	**-**	**-**

2017 P/L-effective and neutral effects on deferred tax assets (DTA) and deferred tax liabilities (DTL)	Opening balance DTA/DTL	P/L-effective movement of DTA/DTL	P/L-neutral movement of DTA/DTL	Closing balance DTA/DTL
Deferred Tax Assets - due to taxable temporary differences				
Assets				
Loans and advances to bank, Loans and advances to customers	658	33	(1)	690
Financial assets measured at FVTPL	162	(40)	-	122
Securities	-	892	-	892
Intangible Assets	181	29	-	210
Non-current assets or disposal groups as held for Sale and assets from discontinued operations	-	40	-	40
Other Assets	50	3	-	53
Liabilities				
Amounts due to other banks, Deposits and current accounts	468	11	-	479
Provisions	-	150	-	150
Other liabilities	1	(1)	-	-
Deferred Tax Assets - due to tax losses (total)	2 298	(1 441)	-	857
Subtotal DTA before netting	**3 818**	**(324)**	**(1)**	**3 493**
Deferred Tax Liabilities - due to taxable temporary differences				
Assets				
Securities	(201)	189	(100)	(112)
Property, plant and equipment and investment property	(15)	(12)	-	(27)
Liabilities				
Issued debt securities	(8)	(28)	-	(36)
Derivative financial liabilites	(50)	44	-	(6)
Provisions	(244)	244	-	-
Other liabilities	-	(27)	-	(27)
Subtotal DTL before netting	**(518)**	**410**	**(100)**	**(208)**
Netting of short-term DTA	(50)	44	-	(6)
Netting of short-term /DTL	50	(44)	-	6
Subtotal DTA after netting of balance sheet positions	**3 768**	**(280)**	**(1)**	**3 487**
Netting of p/l-effective DTA with p/l-effective DTL (per earning reserves)	-	-	-	-
Subtotal DTL after netting of balance sheet positions	**(468)**	**366**	**(100)**	**(202)**
Netting of p/l-effective DTL with p/l-effective DTA (per earning res	1 727	(348)	-	1 379
Subtotal DTA after netting completely with DTL	**3 300**	**86**	**(101)**	**3 285**
Subtotal DTL after netting completely with DTA	**-**	**(18)**	**18**	**-**

31 Earnings per share

The calculation of basic earnings per share on 31 December 2018 based on the net income attributable to ordinary shareholders of HUF 25,274 million (2017: HUF 19,154 million) and a weighted average number of ordinary shares outstanding of 100,000 thousands (2017: 100,000 thousands).

Basic value

31 December 2018

$$\text{Earnings per Ordinary Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding (thousands)}} = \frac{\text{HUF 25,274 million}}{\text{100,000 thousands}} = \text{HUF 253}$$

31 December 2017

$$\text{Earnings per Ordinary Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding (thousands)}} = \frac{\text{HUF 19,154 million}}{\text{100,000 thousands}} = \text{HUF 192}$$

The calculation of fully diluted earnings per share was based on the profit attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding after any adjustment for the effects of all dilutive potential ordinary shares. At the end of 2018 and 2017, there were no dilution factor that might cause an adjustment in the weighted average number of ordinary shares, therefore basic and diluted EPS were equivalent.

Diluted value

31 December 2018

$$\text{Diluted Earnings per Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding taking into account the dilution factors (thousands)}} = \frac{\text{HUF 25,274 million}}{\text{100,000 thousands}} = \text{HUF 253}$$

31 December 2017

$$\text{Diluted Earnings per Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding taking into account the dilution factors (thousands)}} = \frac{\text{HUF 19,154 million}}{\text{100,000 thousands}} = \text{HUF 192}$$

Data in HUF million except stated otherwise

32 Contingencies and commitments

32.1

2018	Gross amount	Provision Stage 1	Provision Stage 2	Provision Stage 3	IAS 37	Net amount
Contingencies						
Guarantees and similar obligations	148 275	(109)	(285)	(70)	-	147 811
Obligations from letters of credit and other short	14 164	(10)	-	-	-	14 154
Other contingent liablities (including litigation)	21 751	-	-	(220)	(1 241)	20 290
Total contingencies	**184 190**	**(119)**	**(285)**	**(290)**	**(1 241)**	**182 255**
Commitments						
Undrawn commitments to extend credit	251 299	(361)	(149)	(140)	-	250 649
Total commitments	**251 299**	**(361)**	**(149)**	**(140)**	**-**	**250 649**

2017	Gross amount	Provision	Net amount
Contingencies			
Guarantees and similar obligations	146 053	(1 676)	144 377
Obligations from letters of credit and other short	13 881	(22)	13 859
Other contingent liablities (including litigation)	96 444	(1 296)	95 148
Total contingencies	**256 378**	**(2 994)**	**253 384**
Commitments			
Undrawn commitments to extend credit	314 292	(1 033)	313 259
Total commitments	**314 292**	**(1 033)**	**313 259**

33 Use of estimates and judgements

Management discusses with the Bank Supervisory Board the development, selection and disclosure of the Bank's critical accounting policies and estimates, and the application of these policies and estimates.

These disclosures supplement the commentary on financial risk management (see Note 5).

Key sources of estimation uncertainty

Allowances for credit losses

Assets accounted for at amortised cost are evaluated for impairment on a basis described in accounting policy (see Note 3).

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances but the individual impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on the estimates of future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective allowances.

Uncertain or unanticipated future events could result in material adjustments to provisions or additional provisions. The accounting values determined are not fair values or market prices that might be determined if the underlying assets are sold to a third party.

Determining fair values

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. See also “Valuation of financial instruments” below.

Critical accounting judgements in applying the Bank’s accounting policies

Critical accounting judgements made in applying the Bank’s accounting policies include:

Valuation of financial instruments

The Bank’s accounting policy on fair value measurements is discussed under Note 4.

The Bank measures fair values using the following hierarchy of methods:

- Level 1: Quoted market price in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument’s valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations.

Counterparty risk (CVA) and own credit risk (DVA) is also taken into account by calculation of fair value of derivative transactions except of the followings:

1. Netting of NPVs to counterparty level is allowed only in case of International Swaps and Derivatives Association (ISDA) agreement is available.
2. If the partners have Credit Support Annex (CSA) for the derivative then both CVA and DVA are 0.
3. If the contract covered by collateral then CVA=0.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the end of the reporting period that would have been determined by market participants acting at arm’s length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which usually are developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Example of instruments involving significant unobservable inputs includes certain over the counter structured derivatives and certain loans and securities for which there is no active market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determination of fair value. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

Data in HUF million except stated otherwise

The table below analyses financial instruments carried at fair value, by valuation method:

33.1

	Note	Quoted market prices in active markets	Valuation techniques - observable inputs	Valuation techniques - significant unobservable inputs	Total
31 December 2018					
Derivative financial assets	**8**	-	17 914	-	17 914
Securities	**9**	184 947	176 805	-	361 752
Loans and advances to customers	**10**	-	-	7 898	7 898
Derivative financial liabilities	**16**	-	31 608	-	31 608
Issued debt securities	**20**	-	5 696	-	5 696
Total		**184 947**	**232 023**	**7 898**	**424 868**
31 December 2017					
Financial assets measured at FVTPL	**8, 9**	242	72 077	-	72 319
Investments in securities	**9**	112 615	230 778	-	343 393
Deposit and current accounts	**15**	-	1 658	-	1 658
Financial liabilities measured at FVTPL	**16**	-	43 366	-	43 366
Issued debt securities	**19**	-	9 827	-	9 827
Total		**112 857**	**357 706**	**-**	**470 563**

The determination of fair value level and the transfers between levels are in line with accounting policy (see Note 4). There were no transfers between fair value levels in the financial year ended on 31 December 2018.

There is no active quotation of Discount government bonds when they reach within 3-month maturity. For discount government bonds within the maturity of 3 months, MKB Banks is using yield-curve valuation technique. The inputs of the yield-curve are the relevant active market prices, consequently it is considered as Level 2 valuation.

As part of its trading activities the Bank enters into OTC structured derivatives, primarily options indexed to equity prices, foreign exchange rates and interest rates, with customers and other banks. Some of these instruments are valued using models with significant unobservable inputs, principally expected long-term volatilities and expected correlations between different asset prices or foreign currency exchange rates. These inputs are estimated based on extrapolation from observable shorter-term volatilities, recent transaction prices, quotes from other market participants and historical data.

In determining fair values, the Bank does not use averages of reasonably possible alternative inputs as averages may not represent a price at which a transaction would take place between market participants on the measurement date. When alternative assumptions are available within a wide range, judgements exercised in selecting the most appropriate point in the range include evaluation of the quality of the sources of inputs (for example, the experience and expertise of the brokers providing different quotes within a range, giving greater weight to a quote from the original broker of the instrument who has the most detailed information about the instrument) and the availability of corroborating evidence in respect of some inputs within the range.

Data in HUF million except stated otherwise

Nature and extent of exposure to risks arising from financial instruments:

33.2

	Note	Interest	Foreign exchange rate	Other
31 December 2018				
Derivative financial assets	**8**	3 111	13 179	43
Securities	**9**	357 230	3 156	225
Loans and advances to customers	**10**	7 898	318	-
Deposit and current accounts	**15**	-	-	-
Derivative financial liabilities	**16**	28 063	2 986	560
Issued debt securities	**19**	5 696	-	5 696
Total		**401 998**	**19 639**	**6 524**
31 December 2017				
Financial assets measured at FVTPL	**8, 9**	69 480	3 450	71
Investments in securities	**9**	342 692	58 190	702
Deposit and current accounts	**15**	1 658	-	1 658
Financial liabilities measured at FVTPL	**16**	39 003	4 517	4
Issued debt securities	**19**	9 827	3 050	9 827
Total		**462 660**	**69 207**	**12 262**

The table above presents the major risks and the amounts of fair value of financial instruments. Each financial instrument is reported at fair value and categorized based on all the risk factors which they are exposed to. Most type of financial instruments are exposed to more than one risk, therefore fair values of those instruments are included in all relevant columns, resulting that the sum of total exposures by line may not be equal to the relevant lines in the SFP.

34 Accounting classifications and fair values

The estimated fair values disclosed below are designated to approximate values at which these instruments could be exchanged in an arm's length transaction. However, many of the financial instruments have no active market and therefore, fair values are based on estimates using net present value and other valuation techniques (see Note 4 f, and Note 33), which are significantly affected by the assumptions used on the amount and timing of the estimated future cash flows and discount rates. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured.

Data in HUF million except stated otherwise

The table below sets out the carrying amounts and fair values of the Bank's financial assets and financial liabilities:

34.1

2018	Note	Fair value through profit or loss	Amortised cost	Fair value through other comprehensive income	Total carrying amount	Fair value
Financial assets						
Cash reserves	**6**	-	19 240	-	19 240	19 240
Loans and advances to banks	**7**	-	63 610	-	63 610	62 534
Derivative financial assets	**8**	17 914	-	-	17 914	17 914
Securities	**9**	61 478	411 277	300 274	773 029	769 384
Loans and advances to customers	**10**	7 898	885 246	-	893 144	886 574
Total		**87 290**	**1 379 373**	**300 274**	**1 766 937**	**1 755 646**
Financial liabilities						
Amounts due to other banks	**14**	-	214 153	-	214 153	214 153
Deposits and current accounts	**15**	-	1 380 838		1 380 838	1 380 838
Derivate financial liabilities	**16**	31 608	-	-	31 608	31 608
Issued debt securities	**19**	5 696	-	-	5 696	5 696
Subordinated debt	**20**	-	28 002	-	28 002	28 002
Total		**37 304**	**1 622 993**	**-**	**1 660 297**	**1 660 297**

2017	Note	Fair value through profit or loss	Loans and receivables	Available for sale	Held to maturity	Other amortised cost	Total carrying amount	Fair value
Financial assets								
Cash reserves	**6**	-	-	-	-	31 599	31 599	31 599
Loans and advances to banks	**7**	-	78 005	-	-	-	78 005	78 014
Measured at amortised cost		-	*78 005*	-	-	-	*78 005*	*78 014*
Financial assets measured at FVTPL	**8, 9**	72 319	-	-	-	-	72 319	72 319
Investments in securities	**9**	-	-	343 393	559 319	-	902 712	907 715
Loans and advances to customers	**10**	-	858 143	-	-	-	858 143	826 873
Measured at amortised cost		-	*858 143*	-	-	-	*858 143*	*826 873*
Total		**72 319**	**936 148**	**343 393**	**559 319**	**31 599**	**1 942 778**	**1 916 520**
Financial liabilities								
Amounts due to other banks	**14**	-	-	-	-	236 880	236 880	243 184
Deposits and current accounts	**15**	1 658	-	-	-	1 550 837	1 552 495	1 554 176
Measured at fair value		*1 658*	-	-	-	-	*1 658*	*1 658*
Measured at amortised cost		-	-	-	-	*1 550 837*	*1 550 837*	*1 552 518*
Financial liabilities measured at FVTPL	**16**	43 366	-	-	-	-	43 366	43 366
Issued debt securities	**19**	9 827	-	-	-	1 292	11 119	11 139
Measured at fair value		*9 827*	-	-	-	-	*9 827*	*9 332*
Measured at amortised cost		-	-	-	-	*1 292*	*1 292*	*1 807*
Subordinated debt	**20**	-	-	-	-	22 307	22 307	29 297
Total		**54 851**	**-**	**-**	**-**	**1 811 316**	**1 866 167**	**1 881 162**

The methods and the assumptions applied in determining fair values of financial instruments when a valuation technique is used were as follows:

Cash reserves

Due to the short term nature, the carrying amount of Cash reserves is a reasonable approximation of their fair value.

Financial assets measured at FVTPL

Fair values of Financial assets measured at FVTPL and derivative assets and liabilities held for risk management that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques.

Investments in securities

The fair values of instruments grouped into Investments in securities are based on quoted market prices, when available. If quoted market prices are not available, fair value is estimated using quoted market prices of similar securities. For further information, please refer to Note 8.

Loans and advances to banks and to customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by coupon rates. In general, contractual cash flows are discounted using a rate which is sum of the available interest rate which would have been offered if the customer applied for loan at the end of the reporting period plus the counterparty marge. The used interest rates are available in published Terms and Conditions as of 31 December 2018 and the counterparty marge is available in the Bank's systems. The rediscounted cash flows are decreased using by the same impairment percentage as it was used for impairment purpose, and it is considered as fair value of the loan portfolio.

Non-performing loans which are assessed for impairment individually are discounted with discount factors which are calculated as in case of performing loans, but that estimated cash flows of these loans are used for calculation, which was also used for impairment purpose.

In the case of work-out loans where the bank expects cash flows only from sale of collaterals and therefore they are impaired to the net present value of this amount, the fair value is equal with the carrying amount.

The fair value of Loans and advances to banks and to customers on demand is not different from the amounts receivable at the end of the reporting period.

Amounts due to other banks and Current and deposit accounts

For the purposes of estimating fair value, Amounts due to other banks and Current and deposit accounts are grouped by residual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities plus MKB own credit risk. For determining own credit risk (DVA – Debit Value Adjustment) the bank uses the own PD and LGD used also for risk purposes which is also in line with the DVA calculation method for negative fair value derivatives. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the end of the reporting period.

Issued debt securities and Subordinated debt

Fair values are determined using quoted market prices at the end of the reporting period where available, or by reference to quoted market prices for similar instruments plus own credit risk.

Data in HUF million except stated otherwise

35 Related parties

The Bank's related parties include the parent companies, joint ventures, associates, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members. Government-related entities are exempt from the general disclosure based on IAS 24.25. Key Management Personnel are the members of the governing boards of the Bank like Supervisory Board and the members of the Board of Directors.

Transactions with related parties

Related parties have transacted with the Bank during the period as follows:

35.1

	Parent company and its group		Consolidated subsidiaries		Non-consolidated subsidiaries		Associates		Key Management Personnel		Other related parties	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Assets												
Loans and advances to customers	12 796	-	141 167	131 090	976	1 380	332	265	134	348	-	-
Derivative financial assets	-	-	-	-	-	-	-	-	-	-	109	-
Equity instruments	-	-	41 832	-	715	-	611	-	-	-	244	-
Other asset	-	-	904	355	-	-	-	-	-	-	138	-
Liabilities												
Current and deposit accounts	25 807	50	16 372	20 984	276	509	207	200	258	219	4 658	-
Derivative finacial liabilities	-	-	-	-	-	-	-	-	-	-	229	-
Other liabilities	-	-	507	7	-	-	-	-	-	-	70	-
Income statement												
Interest income	-	-	739	590	21	991	6	7	10	8	-	-
Interest expense	-	-	(56)	(85)	(1)	(2)	-	-	-	-	-	-
Net income from commissions and fees	-	-	141	-	8	-	6	-	2	-	7	-
Other net income / (expense)	-	1	(56)	55	(4)	12	46	2	(659)	(767)	(4)	-
Contingencies and commitments	12 202	-	10 187	14 996	1 089	980	97	106	711	-	290	-
Provision	2 637	-	36 651	-	2 113	10	4	5	-	-	-	-

The amount outstanding from Key Management Personnel represents mortgages and secured loans granted and these loans are secured over property of the respective borrowers.

The above transactions with other than Key Management Personnel were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Other related parties include the interests of the Key Management Personnel.

Impairment losses and provisions against balances outstanding with related parties were recognized during ordinary course of impairment assessment. Incurred loss has been recognized on balance sheet items and off balance sheet items with related parties which were individually or collectively assessed and the test resulted NIL impairment at the end of the period.

Data in HUF million except stated otherwise

Key management personnel compensation for the period comprised:

35.2

	2018	2017
Short-term employee benefits	658	767
Total	**658**	**767**

36 Segment information

The following segment information has been prepared in accordance with IFRS 8, "Operating Segments," which defines requirements for the disclosure of financial information of an entity's operating segments. It follows the "management approach", which requires presentation of the segments on the basis of the internal reports about components of the entity which are regularly reviewed by the chief operating decision-maker in order to allocate resources to a segment and to assess its performance. Management reporting for the Bank is based on IFRS.

Business segments

The business segments identified by the Bank represent the organizational structure as reflected in its internal management reporting systems. The Bank is organized into four business lines, each with its own distinct market and products. Each business line has its own set of objectives and targets broken down by operating units, which are consistent with the Bank's overall strategic direction.

As of 30 June 2018, the Bank's business segments and their main products were:

Corporate Banking

The Bank provides trade finance, a wide array of credit, account and deposit products, forfeiting and factoring, letters of credit, guarantees, international payments, project and structured finance, investment and financial advisory services to large entities through branches and electronic delivery channels.

Institutional Banking

MKB Bank serves financial institutions, financial service companies and other entities with financial services, as well as international and domestic payments, the Treasury department deals with investments in securities, hedging transactions and correspondent banking, The Bank participates in bank-to-bank finance.

Retail and Private Banking

The Bank provides a wide range of deposit and savings instrument, credit and debit cards, portfolio management, and a limited number of loan products to high net worth individuals and entrepreneurs through 54 full-service branches and sub-branches (2017: 69 branches), ATMs, telephone and electronic channels.

Data in HUF million except stated otherwise

Other

Residual items which cannot be directly allocated to business segments (mainly general administration expenses) are included in the Other category.

36.1

2018	Note	Corporate Banking	Institutional Banking	Retail and Private Banking	Other	Total
Assets						
Cash reserves	**6**	-	19 240	-	-	19 240
Loans and advances to banks	**7**	-	63 610	-	-	63 610
Derivative financial assets	**8**	-	17 914	-	-	17 914
Securities	**9**	70 501	702 528	-	-	773 029
Loans and advances to customers	**10**	684 350	-	208 794	-	893 144
Non-current assets held for sale and dicontinued operations	**37**	3 359	-	879	-	4 238
Other assets	**11**	-	-	-	16 518	16 518
Deferred tax assets	**23**	-	-	-	5 771	5 771
Investments in jointly controlled entities and associates	**12**	42 972	-	-	-	42 972
Intangibles, property and equipment	**13**	-	-	-	22 193	22 193
		801 182	**803 292**	**209 673**	**44 482**	**1 858 629**
Liabilities						
Amounts due to other banks	**14**	-	214 153	-	-	214 153
Deposits and current accounts	**15**	1 059 776	-	321 062	-	1 380 838
Derivate financial liabilities	**16**	-	31 608	-	-	31 608
Other liabilities and provisions	**18**	855	-	-	37 853	38 708
Issued debt securities	**19**	156	1 042	4 498	-	5 696
Subordinated debt	**20**	-	28 002	-	-	28 002
Shareholders' equity	**21, 22**	-	-	-	159 624	159 624
		1 060 787	**274 805**	**325 560**	**197 477**	**1 858 629**
Income statement						
Gross revenue - external customers		37 158	39 553	18 794	-	95 505
Gross revenue - inter-segment		(1 269)	3 896	(2 627)	-	-
Interest and commission expenditure		(1 490)	(23 279)	(1 158)	-	(25 927)
Impairment and provisions for losses	**28**	4 368	(156)	(3 256)	550	1 506
Operating costs		(19 208)	(5 125)	(19 961)	-	(44 294)
Expenses related to bank levies		-	-	-	(2 073)	(2 073)
Profit / (Loss) before taxation		**19 559**	**14 889**	**(8 208)**	**(1 523)**	**24 717**
Segment result		**19 559**	**14 889**	**(8 208)**	**(1 523)**	**24 717**
Other information						
Capital expenditure		-	-	-	10 513	10 513
Depreciation and amortisation	**13**	1 844	-	558	-	2 402

Data in HUF million except stated otherwise

2017	Note	Corporate Banking	Institutional Banking	Retail and Private Banking	Other	Total
Assets						
Cash reserves	6	-	31 599	-	-	31 599
Loans and advances to banks	7	-	78 005	-	-	78 005
Financial assets measured at FVTPL	8, 9	-	72 319	-	-	72 319
Investments in securities	9	82 328	820 384	-	-	902 712
Loans and advances to customers	10	639 868	-	218 275	-	858 143
Non-current assets held for sale and dicontinued operations	37	-	-	21 648	-	21 648
Other assets	11	-	-	-	17 116	17 116
Deferred tax assets	23	-	-	-	3 285	3 285
Investments in jointly controlled entities and associates	12	49 897	-	-	-	49 897
Intangibles, property and equipment	13	-	-	-	16 303	16 303
		772 093	**1 002 307**	**239 923**	**36 704**	**2 051 027**
Liabilities						
Amounts due to other banks	14	-	236 880	-	-	236 880
Deposit and current accounts	15	1 255 899	-	296 596	-	1 552 495
Financial liabilities measured at FVTPL	16	-	43 366	-	-	43 366
Other liabilities and provisions	18	3 021	-	96	40 464	43 581
Issued debt securities	19	301	914	9 904	-	11 119
Subordinated debt	20	-	22 307	-	-	22 307
Shareholders' equity	21, 22	-	-	-	141 279	141 279
		1 259 221	**303 467**	**306 596**	**181 743**	**2 051 027**
Income statement						
Gross revenue - external customers		32 573	50 432	18 037	-	101 042
Gross revenue - inter-segment		(70)	265	(195)	-	-
Interest and commission expenditure		(1 093)	(23 797)	(787)	-	(25 677)
Impairment and provisions for losses	28	(949)	(4)	(8 700)	(68)	(9 721)
Operating costs	29	(19 097)	(5 153)	(18 877)	-	(43 127)
Expenses related to bank levies		-	-	-	(1 979)	(1 979)
Profit / (Loss) before taxation		**11 364**	**21 743**	**(10 522)**	**(2 047)**	**20 538**
Segment result		**11 364**	**21 743**	**(10 522)**	**(2 047)**	**20 538**
Other information						
Capital expenditure		-	-	-	9 129	9 129
Depreciation and amortisation	13	3 495	-	825	-	4 320

Measurement of segment profit or loss

Segment reporting under IFRS 8 requires a presentation of the segment results based on management reporting methods with reconciliation between the results of the business segments and the separate financial statements. The information provided about each segment is based on the internal reports about segment profit or loss, assets and other information which are regularly reviewed by the chief operating decision maker.

Calculation of intersegment revenue

Intersegment revenues and expenses are calculated on market interest method. In the case of refinanced loans, as well as those linked to a deposit, are evaluated against the connected transaction. Revenues and expenses on refinanced loans and loans linked to deposit are calculated with reference to the interest of the underlying transaction.

Since the Bank’s business activities are diverse in nature and its operations are integrated, certain estimates and judgments have been made to apportion revenue and expense items among the business segments.

Data in HUF million except stated otherwise

37 Non-current assets held for sale and discontinued operations

At the end of the previous year the net amount of non-current assets held for sale and discontinued operations was HUF 21,648 million.

On 31 December 2017, a large loan-portfolio in gross value of HUF 54,153 million and the relating specific allowances of HUF 32,505 million, which resulted in net amount of HUF 21,648 million was reclassified to non-current assets held for sale. The Agreement of receivables assignment was signed in the fourth quarter of 2017. According to the contract transferring of the loan-portfolio must be performed in two parts next year: in February and in the last quarter of 2018. The buyer paid up 10% of the total price in 2017. The next two instalments are due on the day of transfers. The transfer of the first package assigned to buyer contained 84 % of the total loan-portfolio. The second part will be transferred in the last quarter of 2018. The buyer paid the first instalment and the second being due on the date of delivery.

The result of the sale of the loan portfolio in 2018 is a profit of HUF 1,984 million.

On 31 December 2018, a large loan-portfolio in gross value of HUF 13,274 million and the relating loss allowances of HUF 9,036 million, which resulted in net amount of HUF 4,238 million was reclassified to non-current assets held for sale. The Bank willing to sign the agreement of receivables assignment in the second or in the third quarter of 2019.

Non-current assets held for sale and assets and liabilities discontinued operation include the followings:

37.1

	2018	2017
Assets		
Loans and advances to customers	4 238	21 648
Non-current assets held for sale and discontinued operations	**4 238**	**21 648**

38 Government grants

The National Bank of Hungary (NBH) launched its three-pillar Funding for Growth Scheme (FGS) on 1 June 2013, primarily to stimulate lending to small and medium-sized enterprises. Under Pillar I and II of the FGS the NBH provided refinancing loans to credit institutions participating in the Scheme, at 0 per cent interest rate and with a maximum maturity of 10 years, which were lent further by the credit institutions to the SMEs with a capped interest margin.

Under Pillar I of the Scheme investment and current asset loans, EU subsidy financing, and loan refinancing denominated in Hungarian Forint could be carried out. Pillar II of the Scheme aimed to reduce the ratio of SME’s foreign currency loans, allowing conversion of foreign currency loans to forint loans.

On 11 September 2013 the Monetary Council decided to continue the Scheme, and launched the second phase, which was available until 31 December 2016.

On 16 March 2015, the National Bank of Hungary launched FGS Plus Program, in order to improve access credit facility of small and medium-sized enterprises not participating in FGS so far.

On 6 October 2015, the Monetary Council decided to launch the third phase of FGS – aiming at the gradual ending of the program. The third phase consists of two Pillars, in Pillar II a market priced EUR/HUF swap transaction (CIRS) is linked to the refinancing denominated in Hungarian Forint, which allows credit institutions lending in foreign currency – without any currency risk – to SMEs having natural foreign currency hedge.

MKB Bank participated in all phases of the Scheme, and lent HUF 251,586 million loan to SME’s since the beginning of the program, with an interest rate of 2.5% and EUR 56 million in course of the third phase.

The loans lent as part of FGS are measured at amortised cost at MKB Bank, however at initial recognition the difference between the carrying amount and the fair value of the loans and parallel of the NBH funds was deferred to Other assets (HUF 12,953 million) and to Other liabilities (HUF 10,853 million), which is amortised to Profit and loss during the term of the loans. This difference was driven by the gap between the market interest rate and the subsidized rate.

The fair value of the loans amounted to HUF 68,114 million as of 31 December 2018 (2017: HUF 74,931 million).

MKB Bank joined Market Loan Program - called PHP - on 19 January 2016 that is aimed at stimulating the banks’ transition towards lending on market terms, and to continue to encourage banks to grant loans to SMEs. At the same time, the National Bank of Hungary also started to phase out the NHP III program.

MKB Bank undertook a HUF 25 billion growth in the net volume of SME lending in 2016 concerning Market-based Lending Scheme (PHP), which increased by HUF 5 billion in 2017 in the framework of the second phase of PHP. Therefore MKB concluded HIRS transactions with NBH in a total amount of HUF 120 billion.

Data in HUF million except stated otherwise

39 Events after the end of the reporting period

The following change occurred in the direct shareholder structure of MKB Bank Zrt. in the first quarter of 2019. By way of sale and purchase Promid Finance Zrt. purchased a part of the share package owned by MKB Bank ESOP Organisation, a total of 2,564,411 dematerialised ordinary series “A” in face value HUF 1000 per share. Following the transfer of the shares Promid Finance Zrt. holds 2.564411% share, while the present share of the ESOP Organisation of 5.379403% decreased to 2.814992%. The fact of purchase was recorded in the share register on 27 February 2019.

The effective shareholder structure of MKB Bank Zrt. is the following:

Name of the shareholders	Number of shares (pieces)	Total face value of shares (HUF)	Ownership share (%)
1. METIS Magántőkealap	35 000 001	35 000 001 000	35.000001%
2. Blue Robin Investments S.C.A.	32 900 000	32 900 000 000	32.900000%
3. RKOFIN Befektetési és Vagyonkezelő Kft.	13 620 597	13 620 597 000	13.620597%
4. EIRENE Private Magántőkealap	9 999 999	9 999 999 000	9.999999%
5. Pantherinae Pénzügyi Zrt.	3 100 000	3 100 000 000	3.100000%
6. MKB Bank MRP Szervezet	2 814 992	2 814 992 000	2.814992%
7. Promid Finance Zrt.	2 564 411	2 564 411 000	2.564411%
Total	**100 000 000**	**100 000 000 000**	**100.00%**

At the General Meeting of MKB Bank Zrt. held on 17 January 2019 the following decisions were made:

1. Decision regarding the preparation for Series ‘A’ ordinary shares issued by the Company to be listed on the Budapest Stock Exchange, and changing the form of operation with transformation into a public limited company with effect depending on stock market listing. The General Meeting requested the Board of Directors to take measures necessary for the preparation of listing Series ‘A’ ordinary shares on the Budapest Stock Exchange.
2. In relation to the decision indicated in paragraph 1 the General Meeting approved the re-transformation of preference shares into ordinary shares with effect subject to stock market listing and change of form.
3. With regard to the decisions referred to in paragraphs 1 and 2, the General Meeting adopted a decision for the modification of the Articles of Association to take effect subject to stock market listing and change of form. According to the Articles of Association with indefinite effect the Company shall be a public limited company with share capital exclusively consisting of ordinary shares and the provisions of the Articles of Association complying with stock market requirements.

The following changes were performed in the constitution of the managing and supervisory boards in the course of the first quarter of 2019. From among the members of the Supervisory Board dr Barcza Mihály, the chairman of the Supervisory Board, Szemerey Tamás, member of the Supervisory Board, dr Lovászi-Tóth-Ádám, member of the Supervisory Board, from among the members of the Board of Directors Jaksa János, chairman of the Board of Directors and Drabik Zsolt, external member of the Board of Directors resigned from their positions.

At its meeting held on 17 January 2019 the General Meeting elected dr Balog Ádám, chief executive as the chairman of the Board of Directors - with the relevant permit of the National Bank of Hungary in effect. As of the date of the permit, 31 January 2019, dr Balog Ádám has been performing his duties as the chairman and chief executive of MKB Bank Zrt.

Pursuant to the right incorporated in the preference share, with the relevant permits of the National Bank of Hungary in effect, the shareholders owning preference shares delegated dr Hornung Ágnes as chairperson of the Supervisory Board and dr Ipacs László and Oszlányi Törtel András as members of the Supervisory Board. The membership of dr Hornung Ágnes in the Supervisory Board took effect on 28 February 2018, while the membership of dr Barcza Mihály ceased at the same time. The membership of dr Ipacs László and Oszlányi Törtel András in the Supervisory Board took effect on 25 February 2019, while the membership of Szemerey Tamás and dr Lovászi-Tóth Ádám ceased at the same time. As of 12 March 2019 the General Meeting elected Oszlányi Törtel András and dr Ipacs László as members of the Audit Committee for the duration of their Supervisory Board membership.

Another significant change in the top management is that as of 14 January 2019 Ginzer Ildikó took control of the deputy chief executive position of MKB Bank Corporate and Treasury and Bakonyi András took control of the deputy chief executive position of MKB Bank Risk Management.

As of 8 January 2019 the employment of Bánfi Zoltán, deputy chief executive for Investment Bank and EU Development was terminated, his position has not been filled in.

The employment relationship of Márk Hetényi as deputy chief executive and, by virtue of the rules of law, his internal Board of Directors membership was terminated as of March 31, 2019 with mutual consent. Márk Hetényi will pursue his work as external Board of Directors member as soon as the respective supervisory permission is granted and the membership is accepted by him by way of declaration.

Csaba Gabor Fenyvesi will continue his work from April 1, 2019 as Chief Financial and Operations Officer of MKB Bank Zrt. and after receiving the respective permission of the National Bank of Hungary as Deputy Chief Executive Officer.

The Court of Registration approved the rationalization process of the Euroleasing Group via merger in accordance with the planned timing of 31 December 2018, based on which the merger of MKB-Euroleasing Autóhitel Zrt. and MKB-Euroleasig Zrt. into MKB-Euroleasing Autólízing Zrt. took place, hence the three companies continuing operation under the name MKB Euroleasing Autólízing Zrt. from 1 January 2019. Euroleasing Kft., I.C.E. Kft. and Reteail Prod Zrt. continue to operate as fully owned subsidiaries of MKB Euroleasing Autólízing Zrt., constituting fully owned subsidiaries of MKB-Euroleasig Zrt prior to the merger process.

On 16 January 2019 the Court of Registration registered the changes approved at the General Meeting of Solus Capital Venture Capital Fund Management Ltd. held on 27 December 2018 (extension of powers of Board of Directors, new provisions concerning Investment Committee).

Based on its decision of 30 November 2018, the Court of Registration removed Medister Kft. from the register with effect from 31 January 2019 due to transformation of company, i.e. merger into MKB Ingatlan Kft.

On 19 February 2019 the Court of Registration registered the following changes in relation to MKB Inkubátor Kft.:

- Registered seat of the company changed to 1138 Budapest, Kassák Lajos u. 18. instead of 1132 Budapest, Nyugati tér 5., with executive director Márk Hetényi replacing Zoltán Bánfi.

On 11 March 2019 the Board of Directors of MKB Venture Capital Fund Management Ltd. approved the following:

- New Fund to be set up within MKB Venture Capital Fund Management Ltd.,
- Management Rules of BÉTA Private Equity Fund to be set up within MKB Venture Capital Fund Management Ltd.,
- Report on the Q4 2018 financial management of MKB Venture Capital Fund Management Ltd.

On 28 March 2019 MKB Bank Zrt. issued subordinated bonds in the total nominal value of EUR 31 million with fixed interest rate at 4.5% p.a. (MKB Subordinated Bond 2026/A), maturity date on 15 April 2026.

BUSINESS REPORT
to the separate 2018 financial statements of
MKB Bank Zrt. (Prepared under IFRS)

In 2018, the scope of activities of MKB Bank Zrt. comprised the following sectors:

- **banking services**
- **finance and operating leases**
- **financial and investment services**
- **other loans**

MKB Bank's profit after taxation for 2018 under IFRS amounted to HUF 25,274 million gain.

Shareholders' equity was HUF 159,624 million at 2018 year-end.

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Annex

Governing bodies of MKB Bank Zrt. as at 31 December 2018

Supervisory Board:	Board of Directors:	Executive Committee :
Chairman	Chairman	Chairman
dr Mihály Barcza	János Jaksa	dr Ádám Balog
Members	Members	Members
Albert Godena	dr Ádám Balog	András Bakonyi
Rita Feodor	dr András Csapó	Zoltán Bánfi
dr Ádám Lovászi-Tóth	Zsolt Drabik	dr András Csapó
Ferenc Müller	Márk Hetényi	Csaba Gábor Fenyvesi
János Nyemcsok	Imre Kardos	Ildikó Ginzer
Tamás Szemerey	Balázs Nyitrai	Márk Hetényi
		János Nyemcsok

MANAGEMENT'S DISCUSSION & ANALYSIS

(International Financial Reporting Standards, IFRS)

The following section of the Annual Report provides a discussion and analysis of the Group's financial condition and results of operations so as to help the reader to assess any changes in the financial condition and profits for the year 2018. The forthcoming analyses are based on figures reported in MKB Bank's consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU ("IFRS") as at, and for the financial year ended 31 December 2018 and audited by Deloitte Könyvvizsgáló és Tanácsadó Kft. chartered accountants. On this basis, the discussion focuses on the performance of the Group as an entity. The consolidated financial statements prepared in accordance with IFRS are presented separately.

OPEARTING ENVIRONMENT

International macroeconomic environment

Economic growth rates of developed countries – particularly those of the eurozone, and the USA – have, in recent years, reached and even exceeded the level that may be considered as sustainable in the long term; owing to the advanced stage of the business cycle a slow-down in the main economic centres may be regarded as a natural phenomenon. Moreover, certain trade policy developments may render growth perspectives even gloomier. Growth in the eurozone gradually decelerated in 2018, but the lower GDP figure of the last quarter was partly a result of certain one-off factors whose disappearance may be followed by a modest bounce-back in economic growth in 2019.

Inflationary processes in developed markets were driven by international oil price trends. Consequently, the rate of inflation in the eurozone reached and even exceeded the Central Bank's target of 2% in the second half of 2018, but the inflation indicators reflecting the basic trend referred to a modest price pressure.

Despite the advanced stage of the business cycle the ECB did not start to tighten monetary policy in 2018, owing, primarily, to the heterogeneity of the eurozone. The market participants' expectations concerning the ECB's first interest rate increase have gradually shifted to the first half of 2020, due to the disclosure of data on weaker economic performance. Nonetheless, policy rates may remain at their current levels at least until the summer of 2019, according to ECB's communication.

Hungarian macroeconomic environment

2018 was a year of dynamic economic growth in Hungary – the second half of the year brought about some outstanding growth rates. Hungary's economy grew by as much as 5% year-on-year in Q4 2018, bringing the country's GDP growth rate near a 14-year high. Hungary's economy expanded by 4.8% in 2018, 0.7 percentage point higher than in 2017.

The domestic economic cycle entered its mature phase in that the easy-to-absorb labour supply has run out and the utilisation of the capacities of the machinery and equipment in place cannot be increased materially either. Consequently, economic growth in the short and medium term will be determined by the improvement of productivity.

Annual average inflation was 2.8% in 2018, showing an increase in the inflationary pressure in comparison with the average of 2.4% recorded in 2017. The increase of wages is expected to continue in 2019 as a result of the tight labour market and the two-year wage agreement concluded at end-2018, and the wage increase is bound to affect prices too, which may be counteracted by the lowering of employer contribution rates from mid-2019. Inflationary expectations, which play an important role in pricing decisions, continue to be anchored at low levels. Accordingly, domestic inflation should end up near the 3% target of the central bank.

In September 2018 the National Bank of Hungary (MNB) set about transforming its monetary policy instruments, indicating that it has geared up for gradually and prudently normalising the monetary policy. In addition to the three-month commercial bank deposit facility the tools applied in order to cut long term rates (IRS and the mortgage bond purchase programme aimed at achieving monetary policy goals) were also phased out by the end of 2018, therefore the role of the policy instrument was taken over by the mandatory reserve.

Although internal processes are indicative of a likelihood of the application of stricter domestic monetary policy conditions, there will be no external pressure on the MNB until the ECB starts raising its rates. In accordance with global and regional trends domestic short term interbank rates may gradually rise in 2019, while the domestic policy rate is expected to be increased only after 2019.

The growth of employment and wages is likely to slow down somewhat in 2019, which may entail a decrease in the rate of increase of consumption as well. As a result of this and of the projected deceleration of the expansion of investments the dynamic of domestic economic growth is expected to be less vigorous in 2019.

Overview of the banking sector[2]

The domestic banking system is benefiting from the prevailing general economic stability and has clearly embarked on a growth path. This is reflected by a trend of sustainable expansion in corporate and retail lending. At the same time, the sector is also characterised by a massive liquidity surplus. Another favourable trend is a significant decrease in the proportion of non-performing loans, a trend that has been enabled by a boosting macroeconomic environment, portfolio cleansing processes taking place in the sector, the significantly higher quality of new lending transactions and the expanding credit portfolios.

Despite the fact the operations of credit institutions continued to be highly profitable in 2018, with outstanding ratios by international comparison, their profitability has fallen short of what they achieved in 2017 according to nonconsolidated data. The banking sector’s outstanding 2017 performance was caused by one-off items – primarily the significant volume of reversed impairment costs – which are not sustainable in the long term, therefore a certain bounce-back is natural. While credit institutions’ gross operating income – driven by gains on financial transactions – increased, as a result of the combined effects of cost increases (primarily as a consequence of the growth in IT costs entailed by conformity to regulatory requirements as well as the increase in the cost of human resources in line with the dynamic of wages in the labour market) and the decrease in the reversal of impairments and provisions as a consequence of the financial institutions’ running out of reversible portfolios the sector’s total profit after taxes have fallen short of the amount recorded in 2017. The processes taking place in the banking sector in the prevailing environment of fierce competition, such as digitalisation, operational efficiency improvement, economies of scale and enhanced process efficiency, are equally aimed at maintaining and even improving the sector’s profitability.

[2] Source: MNB

MKB expects demand for loans and willingness to borrow to remain high in 2019; these are expected to be driven on the retail side by growing consumer confidence, continued improvement in growth expectations and a rise of real wages, while in the corporate segment the trend should be supported by capacity increasing investments in response to the sector's running out of available resources.

Similarly to 2018 the participants of the sector will be facing a variety of challenges in 2019 again, as a result of the growing intensity of pricing competition and the preparations for a cycle of growing interest rates. In addition to the public dues levied on the sector and besides the requirements of the PSD2 and MiFID2 directives, the implementation of the Instant Payment System requires the banking system to make massive investments.

PERFORMANCE OF MKB BANK IN 2018

MKB Bank Zrt's (standalone) IFRS total assets amounted to HUF 1,858.6 billion at the end of 2018, down 9.4% year-on-year. The portfolio of customer loans increased by 4.1% to HUF 893.1 billion, while customer deposits dropped by 11.1% to HUF 1,380.8 billion. MKB Bank's profitability improved considerably in 2018: its profit after taxes grew to HUF 25.3 billion from HUF 19.2 billion in 2017.

The Bank's financial and business fundamentals, including capitalisation, liquidity, funding structure, balance sheet structure and the performance of its business lines, are stable.

PERFORMANCE OF THE INDIVIDUAL BUSINESS LINES[3]

Retail segment

The developments of strategic priorities in 2018 were aimed at increasing the number of customers, lending and the business line's market share. In addition to organic growth MKB laid particular emphasis on its corporate relationships, its strategic cooperation with its subsidiaries and maximising the benefits from synergies in relation to MKB Pension Fund, MKB-Pannónia Health and Mutual Fund and MKB-Euroleasing.

Developments took place on a continuous basis to improve the efficiency of internal and external processes, intensive product developments resulted in an expanding product range and administrative processes were rendered quicker and more convenient by digital services, including continued development of the mobile banking application and the digitisation of the branch office network. It was in parallel with the replacement of its account management system that MKB Bank introduced the digital signature option at its branch offices, a major step towards paperless processes. Particular emphasis was laid on providing sales staff members with continued training, thereby strengthening the consultative advisory services provided at the branch units. The combination of these developments guarantees improved customer experience for customers doing business at branch offices as well as in the digital space.

In 2018, MKB carried out major upgrades and renovations on its physical network. Three branch offices were completely refurbished. In our Váci Street Headquarters we have established a competence centre for small enterprises and modernized our branches in Budapest and in a rural mall.

[3] Source: MNB, KAVOSZ, Eximbank, MFB, MKB's own calculation

To drive changes in customers' habits, enhance cost effectiveness and ensure sustainable profitability our network's operations were improved considerably. In addition to the already wide range online business options, bound to expand further in the future, MKB Bank provides face to face customer service in 51 branch offices across Hungary.

Our Key Partner Programme – in which preferential terms and conditions are offered for employees of our partners – has been renewed and the number of cooperation arrangements has increased. In the context of the Key Account Programme MKB sets up shop at contracted employees' premises to provide their employees with financial advice at their own workplace.

2018 saw the establishment of our Direct Sales Force Network, providing for nationwide presence. By proactively approaching customers as MKB's own agents at the events of the Key Partner Programme and other external activities the salespersons belonging to the network made a major contribution to the business line's customer acquisition and loan disbursement results.

In addition to the Direct Sales Force Network and the Key Partner Programme the Bank relies on external sales channels as well in selling its products. All of these provided effective support enabling MKB to become a dominant player in the domestic market as regards the sale of mortgage loans and small corporate products. In 2018 the Bank continued to strengthen and enhance its relationships with loan intermediaries and even made efforts to improve its partners' customer experience by developments in its external sales channels. To boost intermediary satisfaction and the efficiency of day-to-day cooperation in December 2018 we opened our Mortgage Loan Partner Centre in Budapest. The primary aim of opening the Centre was to ensure both professional service provision and partner-oriented operations. The lessons drawn from the operation of the Mortgage Loan Partner Centre will be useful input to the establishment of additional centres in the future.

MKB Plaza, the Bank's retail loyalty programme has, since 2018, been providing its services for customers through an upgraded website and mobile application. MKB Plaza is now available for the customers of MKB Euroleasing as well; thus the entire clientele of the MKB Group has access to 150 types of discounts and preferential terms and conditions offered by nearly 100 service providers. The success of the loyalty programme is proven by the fact that the number of registered customers more than doubled in the span of just one year, to over 70,000.

MKB achieved impressive results in loan disbursement: during the last three years[4] the amount of retail housing loans disbursed by the Bank increased by 206%, while the overall growth of this particular market segment was only 134%. There was an even more dynamic increase in the segment of personal loans: the total amount disbursed by MKB increased by 472%, in contrast to the 248% overall expansion of the segment during the same period.

The portfolio of retail assets managed by the Bank[5] at the end of the year exceeds HUF 780 billion. The structure of savings changed slightly: the proportion of government securities and deposits increased somewhat, while that of investment funds and bonds diminished.

[4] In January to December 2018, relative to January to December 2015.
[5] Deposits + bonds + investment funds + government securities

MKB SZÉP Card

MKB SZÉP Card product continued its impressive performance in 2018. It became a popular and versatile means of payment that can be used conveniently on a daily basis. As a result of certain regulatory changes only the SZÉP Card remains in the favourable tax category, therefore this already popular form of fringe benefit is likely to become even more popular in the future.

The number of card holders increased by some 10% in 2018, to over 240,000 by the end of the year. The HUF 15.6 billion employer contribution transferred to MKB SZÉP Card owners in 2018 was 2.5% up year-on-year, while the ratio of their use had increased by 5.9%, in an amount of HUF 15 billion.

In the wake of regulatory changes both the procedure whereby SZÉP Cards are applied for and the process whereby the benefit is transferred by employers changed considerably from 2 January 2019. Accordingly, MKB Bank Zrt. has taken over the services of issuing and keeping records of SZÉP Cards and has concluded account contracts with about 200,000 customers.

MKB SZÉP Card holders can now make payments to about 22,500 contracted service providers with their cards.

Digital products and channels

Digitalisation transforms the banking industry, as well. Banks and customers have no other choice but understand, adopt and apply this new way of thinking. Digital products and channels render day-to-day banking processes easier, they bring down the prices of services and drive competition among banks.

In 2018 MKB Bank fully implemented its digital transformation project, turning the Bank, by the end of a three-year period, into a digital player of its sector, one that is now a dominant player even at a European level. By replacing the core system the Bank established the digital architecture of the future, making it possible to continue the development of its services and improve its customers' positive experiences during the coming decade. The services linked to MKB's new digital core system are gradually integrated in the financial institution's day-to-day operations.

MKB introduced its mobile application, started its online bank account opening option and introduced the contactless payment method, and it also renewed its portal in parallel with the digital transformation. Through the Digital Branch Office service the customer can be provided with personalised information concerning mortgage loan or investment products simply and conveniently, online.

The introduction of the biometric signature function in our branch office network is a major step towards paperless banking.

The Bank sees great potential in robotisation as well, therefore it has introduced a variety of robotised functions in its day-to-day activities.

MKB regards the enabling of what is called open banking not only because this is necessary for legal compliance but also because of the major potentials lying in this system. New solutions enabled by the new technology make it possible to provide customers with increasingly personalised services in the future. After thorough preparations in 2018 MKB Bank was among the first institutions at the beginning of 2019 – in accordance with the relevant EU directive[6] – to open its APIs (Application Programming Interface), enabling new secure fintech developments aimed at making it even more easy for customers to do business with the Bank. At the same time, MKB is working on additional digital developments for both its retail and its corporate customers, which will be compatible with the new PSD2 requirements as well. MKB Fintechlab, supporting product and service development with new, innovative partners, is a key partner in these efforts.

Corporate and institutional customers

MKB's permanent strategic objective is to maintain a strong corporate business line, based on our traditional strengths. The corporate business line is focused on local knowledge, professional service provision, advice-based sales and the provision of innovative solutions.

What MKB sells to its customers is not simply a variety of products but complex business solutions and advice, setting up complex credit facilities and satisfying special banking needs when necessary. MKB can provide effective and efficient solutions to all participants of the corporate segment, regardless of customer size.

To continue the development of the customer life-cycle based approach the Bank devoted major resources in 2018 to further optimising the product development processes and models, as well as to developing digitised solutions.

Despite major limitations and restrictions entailed by the EU commitments, maintaining portfolios continue to be crucial for MKB Bank in the large corporate business line, thereby keeping up the strong market positions and the diversified loan portfolios and avoiding the build-up of material risk, industry or customer concentrations.

Small and medium-sized (SME) customers continued to be a key segment for the Bank in 2018. The advisory model was further developed, new financing programmes were introduced for such customers and product penetration was further increased. The introduction of the NHP[7] Fix programme was also of outstanding importance: to make it possible for the programme to be available from the first days of 2019 we embraced major developments last year. Meeting the new additional requirements of the guarantee institutions was paramount: the Bank is continuously fine tuning its SME financing possibilities to make sure that the options enabled by the programmes are available primarily for those SMEs that are most in need of them.

In the framework of the Széchenyi Programme the Bank managed to further expand its lending portfolio in 2018, by 9.1% to HUF 41.7 billion, with which it maintained its significant – 18.6% – market share. As one of the elements of opening towards the agricultural sector – by continuously optimising and enhancing the available options – MKB participated in the financing of the Agricultural Rural Development Programme. We have been traditionally closely cooperating with Eximbank to maximise the number of customers provided with funding: in 2018 the Bank achieved a 15.1% market share of the disbursements refinanced by Eximbank, in terms of the number of transactions.

MKB has been supporting businesses in their efforts at improving their competitiveness and the effective utilisation of funds by providing useful information and face-to-face advice through the network of MFB Points which have been in operation since July 2017: in 2018 funds of a total of HUF 4.6 billion were reserved through MKB's MFB Point network.

[6] PSD2 (the revised Payment Services Directive)
[7] Funding for Growth Scheme of the central bank

The provision of services for small enterprises was also supported by the Bank by developing an own agent network of nationwide coverage.

Investment services

The MKB Group provides a wide range of investment banking type services, including Treasury services (trading on commission, custody services and sales), fund management, capital market and transaction consultancy, Private Banking, tender drafting and project management consultancy as well as venture capital fund management, a service launched in 2018.

In addition to its funds offering a wide variety of investment opportunities, MKB Pannónia Investment Fund Manager offered the products of five foreign and three domestic partners for the various customer segments. In addition to the investment funds sold by the company, the range of its investment products was widened by the offering of structured bonds and certificates as well.

MKB Bank is a primary and contracted dealer of institutional and retail government securities. The Government Debt Management Agency rewarded the Bank's activities as a distributor in 2018 by awarding it the 3rd position in the "Primary Dealer of the Year" competition.

Similarly to previous years, in 2018 MKB Bank, as a member of the Budapest Stock Exchange, recorded the second largest turnover in the forward forex section on the Exchange.

At the end of the previous year MKB became a Nominated Advisor (NOMAD) on XTend, the BSE's newly formed SME market. Its regular analysis and price listing activity was launched in regard to the Alteo and the Masterplast stocks. Moreover, MKB has been providing regular analysis coverage for the BIF stocks as well since July 2018.

MKB's Capital Market and Transaction Consulting division carried out the first successful capital raising transaction (Megakrán) on Xtend. The new type of capital raising transaction, a success for SMEs, which was something of a novelty, was a major step forward in the development of the entire Hungarian capital market.

In 2018 MKB Private Banking expanded the portfolio of assets under its management at a rate nearly twice as the average growth rate in the market, securing a market leader position in its own segment. The division is managing assets worth a total of HUF 545 billion. At the same time, the average volume of the portfolios managed by the division is also outstanding, over HUF 300 million, the highest average per-customer amount of assets managed by service providers associated with banks. Another Private Banking consultation unit was set up in the town of Nyíregyháza, and at the same time the professional workshop supported in close cooperation with MKB Pannónia Fund Manager is also highly popular. As a result of the increased effectiveness of the work organisation and the service providing model which is always focused on customers' interests, the customer satisfaction indicator improved considerably in comparison to 2017. Pioneering in innovation, a decision making system, which is quitter unparalleled in the domestic market – the robot advisor – will ensure continued improvement in the standards of professional service provision in the Private Banking business.

The Premium investment service involves the provision of personalised investment advice based on sample portfolios, together with a broad product range and individual products, as well as consultancy with our highly trained professionals. The total customer portfolio under management in the context of the Premium investment service launched in 2016 increased to HUF 107 billion by end-2018, while the average per-customer portfolio exceeds HUF 30 million. MKB aims to continue to improve the quality of the priority service – based on customers' needs surveyed –, and to launch a vigorous acquisition campaign. To this end, the Bank is reconsidering the value proposition, the service level and the service provision model for the segment.

The experts of the Analysis Centre have been supporting the activities of the MKB Group and its customers for nearly 4 years now. The expert team's macroeconomic, stock market as well as money and capital market analyses make a crucially valuable contribution to the successfulness of the investment services of the MKB Group.

Service quality and customer satisfaction

MKB Bank focuses its operations on enhancing customer experience as one of its key strategic objectives. The Bank maintains continuous dialogue with its customers, monitoring their satisfaction. It was to this end that the Bank set up at the end of 2017 the on-line panel called MKB Dialog, in order to ensure that customer's opinions are integrated in the Bank's day-to-day operations, whether regarding the introduction of new products or even new on-line solutions.

Customer satisfaction is one of the most important determinants of MKB's operations.

SUBSIDIARIES/STRATEGIC ARRANGEMENTS AND PARTNERS

The range of MKB's own banking products and services is supplemented by those provided by its subsidiaries and partners. The key objectives include maintaining or enhancing the market positions of the subsidiaries engaged in business activities, increasing cooperation among the members of the Group and strengthening the auxiliary financial services.

SUBSIDIARIES[8]

MKB-Euroleasing Group

As one of the top three leasing companies in Hungary MKB-Euroleasing is a highly active and dominant market participant in car financing, in financing large commercial vehicles and in financing agricultural and general purpose machines.

The company managed to continue building its diversified portfolio in 2018, an effort lunched in 2016.

The primary goal of last year was to further strengthen the long-term profitability of MKB-Euroleasing Group, in addition to the planned increase in volume, the focus has shifted towards more profitable transactions. The strategy was more successfully implemented than had been expected originally, as the volume of new financing transactions increased by a mere 2 percent year-on-year – with a slightly decreasing average transaction size – but the profit generating capability of the newly contracted portfolio was 10% higher than that of the transactions concluded in 2017.

MKB-Euroleasing's strategic goal is to retain the already secured market share, provide for a stable market presence and continued acquisition of customers in segments of higher profitability.

[8] Source: Hungarian Leasing Association, BAMOSZ

In the car financing and the agricultural machine financing segments MKB-Euroleasing is one of the two largest market participants.

MKB Consulting

As a member of the MKB Group, MKB Consulting became a major player in the tender and consulting market by the end of the third year after its establishment.

The effectiveness of the Company's activities in the tender business is indicated by the fact that its key corporate customers were granted a total of HUF 12.5 billion in the way of financial assistance through tenders in research, development and innovation, while as many as 460 customers in its small business portfolio received financial assistance in a total amount of HUF 2.7 billion.

In its advisory business line MKB Consulting performs activities in fund raising for a variety of institutions, including towns with county right, the Budapest Stock Exchange (BÉT), equity fund managers and even MKB Group itself.

It was with the help of its advisory experience that MKB Consulting participated – in the context of the Modern Towns Programme – in working out the urban development ideas and concepts of towns with county right as well as in elaborating their financing models.

In 2018 MKB Consulting provided financial advisory services, in connection with capital programmes, for venture capital funds and other market participants, by working out business plans for funds focusing on certain priority target areas, together with the associated investment strategies, as well as by providing expert assistance to the launching of funds, *inter alia.*

MKB Consulting also took part, as a strategic partner of BÉT, in the latter's training and stock exchange preparatory projects.

MKB Inkubátor Kft - MKB Fintechlab

We believe that large companies and start-ups complement each other, therefore MKB was the first domestic financial institution to engage the world of star-ups, technology and innovation. MKB Fintechlab – also as the Bank's innovation laboratory and start-up incubator – has by now become a dominant participant of fintech innovation in both the domestic and the international arena. MKB Fintechlab has become capable of doing business with start-ups operating in the world's fintech capitals as well.

MKB Fintechlab is supporting the implementation of the MKB Group's strategy in three key areas: it is building up a community around the MKB Group of entities pioneering in innovation, its incubation programme fosters start-ups and it searches for and builds up valuable partnerships for the MKB Group.

MKB Fintechlab consolidated and strengthened its international positions in 2018 and today it is operating as the leading fintech knowledge centre of the Central and Eastern European region. Start-ups from 6 countries participated in the 2018 spring incubation programme; as many as 110 start-ups from 15 countries have registered for the 2019 programme.

In November 2018 Fintechlab and Oracle together organised the first fintech hackathon in Hungary and the Central and Eastern European region. A total of 15 new innovative business solutions were created in the open banking competition and the participants successfully tested MKB Bank's new digital system.

Three innovative partnerships, created by MKB Fintechlab, were integrated in MKB Bank's day-to-day operations last year, of which mention should be made in particular of the robot-advisor developed by Blueopes for MKB Private Banking.

MKB-Pannónia Investment Fund Manager

2018 was a busy year in all segments of the Company's operations: focus was laid in the first half of the year on the streamlining of internal processes, while in the second half emphasis was laid on tightly controlled management of market processes. Last year characterized by marked volatility and – in certain markets – plummeting prices. The year's performance was dominated by decreasing prices in developed stock markets in the fourth quarter, poor performance of the developing stock markets in the second half and a temporary faltering of the Hungarian government security market in the first half of the year.

Despite the deteriorating external environment the Fund Manager made major efforts to keep up its product development processes, launching four special funds in 2018, to be followed by additional ones in 2019.

The total value of the assets taken care of by the Fund Manager is nearly HUF 600 billion, therefore, with its 7.4% market share the Company continues to rank among the Top 5 participants of the domestic fund and asset management market.

Solus Capital Venture Capital Fund Manager

In recent years MKB has, started working on creating the organisational requisites for capital investment activities. It has established the company called MKB Venture Capital Fund Manager and acquired a shareholding in Solus Capital Venture Capital Fund Manager, putting in place the framework required for efficient capital raising activities.

It was in August 2018 that Solus launched Solus I Venture Capital Fund, aiming to facilitate investments contributing to both regional development and the technological modernisation of the SME sector. The Capital Fund makes investments in small and medium-sized enterprises outside the Central Hungary Region that are capable of rapid growth through intelligent technology innovation. The capital fund established with nearly HUF 13 billion in registered capital, with funding – in the context of the S3 Venture Capital Programme – by MFB and other private investors, carried out 3 successful venture capital investment transactions in 2018.

STRATEGIC COOPERATION ARRANGEMENTS AND PARTNERS[9]

MKB Pension Fund

MKB Pension Fund operates with one of the most favourable conditions applied by the leading domestic funds; its robust technical/professional track record, stable and prudent operation and skilled asset manager team, as well as its long term investment results guarantee for the savings of its members. The Voluntary segment of MKB Pension Fund, with a history of 24 years, had nearly 83,000 members and managed more than HUF 132 billion worth of assets at the end of 2018. With its stable 10% market share it is the 5th largest participant of the domestic market. Its Private segment had a total of 3,789 members and managed HUF 18.9 billion in assets at the end of 2018.

[9] Source: Association of Mutual Funds

The individual contributions of its members increased by 2% in 2018, while employers paid 4% more than in the previous year. This is a clear indication of the members' conscious and steady commitment to pension savings. By choosing the fund facility customers access significant benefits. Enabled by low costs, tax-free yields and tax benefits provided by the state they can accumulate substantial amounts even without any financial expertise to supplement their pensions, contributing to the maintenance of the standards of living they secured themselves during their economically active years. The Fund lays particular attention to maximising the satisfaction of customer requirements, therefore it is constantly seeking for and applying new and innovative solutions, as a result of which it further enhanced the functions offered by the Personal storage space and Electronic business through continued developments in 2018. The features of these services enable users to simply and quickly view the data stored in the system, monitor the increase of their savings, the annual account history and the current portfolios. The Employer portal offers efficient administrative solutions by enabling electronic administrative procedures.

MKB-Pannónia Health and Mutual Fund

MKB-Pannónia Health and Mutual Fund has been one of the largest, best-performing funds for 21 years. The Fund closed another highly successful year in 2018 as well: its assets grew by 30% to HUF 15.6 billion, therefore with its 27% market share it is the largest participant of the health funds' market. The Fund's membership also increased by a dynamic 13%, to a total of 210,000 by the end of the year, making it the third largest health and mutual fund in Hungary. The substantial growth was partly a result of the merger of Dimenzió Voluntary Health and Mutual Fund into MKB-Pannónia Health and Mutual Fund with effect from 1 January 2018. The merger enabled the utilisation of additional synergetic effects and expanded the Fund's service portfolio, making it possible to further raise its standards of customer experience.

The popularity of the fund is clearly indicated by a hitherto unprecedented 30% increase in individual contributions, along with a 19% increase in employer contributions year-on-year.

The Fund has a total of 15,500 contracted partners across Hungary, of which nearly 9,000 also accept payment with MKB Health Fund cards.

The Fund continues to aim at providing a social service package with a healthcare element, supported by state tax refunding as well.

FINANCIAL PERFORMANCE

Statement of Financial Position

Total assets of the Bank decreased by 9.38%, compared to the end of 2017, and amounted to HUF 1,858,629 million as at 31 December 2018.

Cash reserves decreased by HUF 12,359 million compared to the end of 2017: cash on hand grew by HUF 443 million, while the balance of the account held at National Bank of Hungary declined by HUF 12,802 million.

Loans and advances to banks decreased by 18.45%, i.e. HUF 14,395 million compared to the end of 2017, mainly because of the lower volume of money market balances with other commercial banks and deposit accounts with decreased balance at NBH.

Derivative financial assets measured at fair value showed a decrease, driven by HUF 2,014 million lower balances of interest-related instruments and derivative transactions with other risks also decreased by HUF 29 million, while currency-related instruments were HUF 200 million higher.

Investments in securities decreased by 19.08%, i.e. HUF 182,245 million compared to prior year end. The decline was mainly caused by the lower balances of interest-bearing treasury bills, Hungarian government bonds, and the volume of bonds issued by other corporate entities also showed a decrease as compared to 2017 year-end. At 2018 year-end the elements of the portfolio were: 53.20% Financial assets at amortised cost, 38.84% Financial assets at fair value through other comprehensive income and 7.96% Financial assets held for trading.

In 2018, the balance of Loans and advances to customers increased by 4.08% compared to the end of 2017, and amounted to HUF 893,144 million as at 31 December 2018.

The amount of Non-current assets held for sale and discontinued operations decreased by HUF 17,410 million compared to 2017 year-end, since the transfer of assets in net amount of HUF 21,648 million previously reclassified to assets recognised held for sale on 31 December 2017, was performed in 2018. The Bank intends to sell further loans to dismantle the non-performing portfolio in 2019.

Other asset balances showed a decline of HUF 439 million from 31 December 2017 to 31 December 2018 primarily due to lower amount of accrued other income in 2018.

Investments in subsidiaries, jointly controlled entities and associates decreased by HUF 6,926 million comparing 2018 year-end to 2017, mainly driven by higher profit of MKB-Pannónia Alapkezelő Zrt. On 30 September 2018, MKB Bank Zrt. sold his ownership interest of MKB Befektetési Alapkezelő Zrt, as result the value of subsidiary shares reduced by HUF 100 million. On 4 December 2018, the Court of Registration registered the liquidation of MKB Jelzálogbank, that resulting in further decrease in the subsidiary shares by HUF 3,810 million. Partially achieved the MKB Munkavállalói Részvényprogramjának (MRP)'s purpose, the required settlements between the Bank and the MRP came true, which caused another reduction in the subsidiary shares.

During the reporting period Amounts due to other banks reflected a decrease of 9.59%, i.e. HUF 22,728 million. The decline resulted mainly from lower amount of liabilities in connection with the refinancing loan facilities, which was partly offset by higher amount of loans from credit institutions.

Deposits and current accounts owed to customers declined by 11.06%, i.e. HUF 171,657 million in comparison with the volume as at 2017 year-end, induced mainly by HUF 109,013 million drop in balances of current and short-term deposit accounts and bank deposits decreased in the amount of HUF 16,620 million.

Among liabilities, Derivative financial liabilities decreased by 27.11%, i.e. by HUF 11,758 million, primarily due to fair value change of interest- and currency-related derivative transactions.

Other liabilities and provisions declined by HUF 4,873 million or 11.18%, from 2017 year-end, mainly caused by lower amount of provisions made and the decrease in passive accrued items.

In accordance with the regulation the share capital of Euro - Immat Üzemeltetési Kft., one of MKB Bank's subsidiaries, was reduced by HUF 3 billion from HUF 4,758 million to HUF 1,758 million resulted in the required shareholder's equity / share capital ratio. The Court of Registration registered the capital reduction on 5 March 2018.

On 9 March 2018, MKB Bank Zrt. issued subordinated debt in the amount of EUR 15 million bearing interest at a fixed rate. The bonds were sold to private stakeholders. The final maturity is 14 June 2024.

Statement of Profit or Loss and Other Comprehensive Income

In 2018, Net interest income showed a HUF 851 million growth compared to the previous year mainly caused by higher interest income relating to securities classified as held for trading.

Net income from commissions and fees decreased by 7.52%, i.e. HUF 2,100 million in 2018 compared to the previous year, due to the change of pricing policies and product conditions.

The net balance of Other operating income and expense showed a decrease of HUF 4,860 million, and amounted to HUF 5,395 million net income as at 31 December 2018. The decline primarily was a result of lower net gain realised on sale of liquidity, which was partly offset by the increase in net trading result accounted for on hedging transactions in the same period of 2018.

Impairments and provisions dropped by HUF 11,456 million compared to prior year end, and amounted to HUF 1,506 million net release of provisions in 2018. The main driver of the significantly lower provision was the improved quality of customer loans as a part of the portfolio has been separated.

Operating expenses grew by HUF 1,167 million, mainly due to higher personnel related expenses which was partly offset by the decrease in administrative expenses.

Data in HUF million except stated otherwise

Expenses for Legal and advisory services contain the following other audit service fees for 2018:

2018	Amount in HUF
Review of IFRS 9 opening balance sheet Review in line with the 2410 ISRE standard of the opening financial data of the Bank as of January 1, 2018 in line with IFRS 9 submitted to the National Bank of Hungary	5 500 000 + VAT
Engagement related to performing status of mortgage loans ** Assurance engagement relating to performing status of mortgage loans offered as coverage	3 329 000 + VAT
Engagement related to dividend payment Assurance engagement in connection with the compliance with the dividend ban commitment made by the Bank towards the European Union	1 000 000 + VAT
Other audit service fees*	**9 829 000 + VAT**

* Fix fee per each service

** Several services are completed during the year. Total amount represents fees accounted for all completed audit services during 2018.

Fees for audit services contain the following 2018:

2018	Amount in HUF
Audit fee of the Bank	73 500 000 + VAT
Total audit fee	**73 500 000 + VAT**

Based on above factors, MKB Bank’s profit after taxation for 2018 amounted to HUF 25,274 million.

For the end of 2018, total other comprehensive income decreased by HUF 9,012 million compared to the previous year and resulted in HUF 13,255 million loss due to lower revaluation on financial assets measured at FVTOCI.

CAPITAL MANAGEMENT

The Capital situation of MKB Group was sufficient at the end of 2018. As a result of the 2018YE profit (an therefore core capital accumulation) and a subordinated debt the available core capital increased significantly. The owner of the MKB Bank is committed to maintain the bank's capital adequacy and implement all the necessary measures.

Domestic and international guidelines require the Bank to maintain certain minimum capital-to-asset ratios. These risk-based ratios are determined by allocating assets and specified off-balance sheet instruments into different weighted categories, with higher levels of capital being required for categories perceived as representing greater risk. Regulatory capital is divided into Tier 1 Capital and Tier 2 Capital. In addition to retained earnings, the Bank may raise regulatory capital by issuing several types of financial instruments to the public. These financial instruments are then classified as either Tier 1 or Tier 2, depending on the types of conditions or covenants they place upon the issuer.

As at 31 December 2018, as an actual figure of the Bank regulatory capital was HUF 167.4 billion based on Basel III IFRS under Supervisory Regulation. The increase of regulatory capital - by HUF 161 million – is derived from the increase of profit, capital reserve and subordinated debt and decrease of deduction of ESOP program, which was compensated by the increase of deduction of intangible assets, decrease of revaluation reserve.

Risk-weighted assets including operational and market risk decreased by 0.7 % from HUF 832.1 billion in 2017 to HUF 826.3 besides approximately 3.7 % weakening of domestic currency. The main part of the decrease derived from decrease of business volumes in work out and CRE segment, increase of collateral and the RWA reduction project.

By application of capital management as a tool, the appropriate capital safety is a first priority decision making factor, therefore the Bank monitors the changes of the capital elements continuously.

Legal limits defined by the
Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (Banking Act),
Regulation (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT on prudential requirements for credit institutions and investment firms and amending Regulation (CRR):

- CRR 395-400.§, Banking Act 302.§ large loan limit -> no excess
- Banking Act 100.§ investment limit -> no excess
- Banking Act 101-102.§ total investment limit -> no excess

NON-FINANCIAL STATEMENT (short version)[10]

Brief description of the business model of the company

MKB joined the Hungarian banking sector in 1950. Initially it took part in international payments and was responsible for providing banking services in support of foreign trade. After the banking reform in 1987, the Bank continued to function as a universal commercial bank, with a traditionally strong market share in corporate and private banking.

MKB pursues its activities in Hungary. At the moment it is the fourth largest commercial bank in the country. The knowledge and expert base as well as the embedded system of relations built over the fifty years of operation, made MKB a major operator in the Hungarian corporate trade financing, cash and liquidity management and investment market. As a financial partner understanding businesses, it supports the operation of companies and offers financing suited to their needs and opportunities.

MKB puts great emphasis on supporting businesses with its almost seventy years of corporate finance experience, innovative solutions, expert competence and development ideas. MKB gradually builds strategic partnerships with the major actors of the Hungarian economy. MKB intends to make an active contribution to the achievement of the objectives of its retail and corporate customers with its financing and, indirectly, to also contribute to an increase in the performance of the Hungarian economy.

MKB strongly concentrates on the quality of its customer relations. Professional services to customers is the most important value for the Bank, where the focus is on customer relations and experience, as well as value preservation and generation. That is why the Bank regularly conducts customer satisfaction surveys in each customer segment. According to the customer satisfaction survey conducted in 2017, the Bank is making good progress in achieving its objectives in the field of customer relations.

MKB is a major and large corporate bank, with strong organisational knowledge in that segment, hence corporate customer relations are in the focus of attention and the Bank is actively building on existing business relationships. Besides preserving its market share in the large corporate segment, growth in the retail segment is also one of MKB's objectives.

The fair banking values are extremely important in the daily operation and future image of the Bank, therefore it strives towards a sustainable business model, manageable level of risk provisions and profitable operation. Profitability is intended to be achieved through the strengthening of profitable business lines and the improvement of operating profitability.

Social and employment as well as human rights policy and its results, the applied due diligence processes

Community engagement:

It is important for MKB Bank to use all its available economic power to contribute to the development of the community and it is also committed to building co-operation that encourages extensive community engagement. The co-operation activities involve efforts to develop the financial culture, various educational programmes, targeted sponsoring and other

[10] The full Non-Financial Statement is available on the Bank's website.

support activities. All these activities are value-driven and have always been and will also be implemented in future to suit the local needs.

The community engagement programmes of MKB Bank:

Through its donation and sponsoring activities, MKB intends to offer true assistance in the support of programmes and matters serving the interests of the whole society, including financial culture and mindset development, value creation and preservation and the creation of opportunities, which are the most important aspects.

Health preservation activities:

MKB has introduced a complex health preservation programme under the title of '#20 Minutes Health – health is the best investment', which goes well beyond the activities of other Hungarian banks conducted in this field to date. The extremely effective programme included a TV campaign in 2018 and it has and still achieves a great deal of success in the social media. Its main goal is to strengthen a health focused social way of thinking.

Social responsibility:

Within the framework of the social corporate responsibilit5y programme, MKB supports with financial and tangible donations the operation of organisations and institutions the activities of which are in line with the principles of the Bank. MKB donated a large amount of furniture to Heim Pál National Institute of Paediatric Care and intends to do its best to continue supporting the operation of the hospital in the future too. In addition, to improve the conditions of life of children suffering from cancer and their family members, MKB donated a minibus to Together for Children Living with Cancer Foundation.

Educational activities:

MKB Bank runs versatile educational programmes and is involved in various educational co-operation.

In co-operation with the National Association of Agricultural Equipment and Machine Distributors (MEGFOSZ), the Bank set an objective of promoting agricultural engineering, responding to changes in modern agricultural production.

The MKB Agro Partner Centre, established in 2017 as part of the corporate business line of MKB Bank, supports the foundation and operation of agro businesses as a financial partner understanding agriculture.

In the 'Be an Agricultural Engineer' programme, 5,000 students were presented the various opportunities and more than 1,000 students of 19 Hungarian specialist schools listened to presentations on 27 career orientation days.

In the first semester of the 2018/2019 academic year MKB offered professional consultation to a team of students of Budapest Corvinus University (BCE) who could rely on their knowledge in business economics, acquiring useful practical experience in the Bank.

Financial culture and awareness developing activities:

The employees of MKB Bank took part voluntarily in the 'Money Week' events, founded by the Banking Association and Financial Compass Foundation to increase the financial knowledge of primary and secondary school students.

Data in HUF million except stated otherwise

Activities aimed at equal opportunities:

MKB Bank has had a relationship with the International Child Rescue Service (NGYSZ) which supports children facing difficulties in life. Owing to the 21 years of co-operation of the parties, in each academic year one hundred children and young people with outstanding abilities yet in socially disadvantaged positions can benefit from the extraordinary opportunities provided under the MKB Scholarship Scheme.

Besides the scholarship schemes, which constitute one pillar of the corporate social responsibility activities of MKB Bank, the MKB Christmas Children's Gala held in December each year is another major event in the co-operation between the Bank and NGYSZ.

MKB Bank has developed its equal access strategy in line with the requirements of the legislation and the supervisory authority (MNB) with the objective of integrating the requirements of the strategy into the Bank's daily operation and making them an integrated part of the attitude of executive officers and all members of staff.

Within the scope of corporate social responsibility, state support is available through MKB Bank for disabled persons to be used for making their homes accessible.

As a traditional and major operator of the Hungarian financial sector, MKB Bank is also committed to provide support and makes significant donations. The MKB Benefactor Programme was introduced in 2018 for collecting donations.

Employment:

MKB completed a risk assessment in employment and identified the risks relevant in terms of its operation which are also taken into account in its HR activities.

An Orientation Day is organised for new colleagues, recruited for MKB Bank. The purpose of that day is to integrate the new colleagues and to deliver the basic training required for employment as well as present the global organisation to them.

The HR strategy concentrates on improving the employee experience by promoting flexible work, using the available digital devices and developing a co-operation-based corporate strategy.

Breakdown of the staff employed by MKB Bank by jobs (FTE):

Area	Subordinate	Head of department	Director	Deputy CEO + executive director	Total
CEO Directorate of Investment Banking and EU Development	12	-	2	1	15
Deputy CEO for Digitisation, Retail and Strategy	841	13	15	4	873
Deputy CEO for EU Commitments	15	3	-	1	19
Deputy CEO for Legal, Corporate and Group Governance	39	-	2	2	43
Chief Risk Officer	164	2	5	1	172
Deputy CEO for Corporate Banking and Treasury	210	11	28	3	252
Chief Executive's Office	366	8	11	6	391
Total	**1 647**	**37**	**63**	**18**	**1 765**

Data in HUF million except stated otherwise

Breakdown of the staff employed by MKB Bank by average age, duration of service and area (years):

Area	0-2 years	10 + years	2-5 years	5-10 years	Average
CEO Directorate of Investment Banking and EU Development	40	40	42	44	41
Deputy CEO for Digitisation, Retail and Strategy	39	46	37	39	41
Deputy CEO for EU Commitments	34	45	42	31	41
Deputy CEO for Legal, Corporate and Group Governance	37	45	44	40	41
Chief Risk Officer	34	45	37	38	40
Deputy CEO for Corporate Banking and Treasury	36	44	35	38	40
Chief Executive's Office	38	47	37	39	42
Average	**38**	**46**	**37**	**39**	**41**

Breakdown of the staff employed by MKB Bank by duration of service and area (FTE):

Area	0-2 years	10 + years	2-5 years	5-10 years	Total
CEO Directorate of Investment Banking and EU Development	4	4	6	1	15
Deputy CEO for Digitisation, Retail and Strategy	292	310	154	118	874
Deputy CEO for EU Commitments	2	7	8	2	19
Deputy CEO for Legal, Corporate and Group Governance	18	11	10	5	44
Chief Risk Officer	21	67	45	39	172
Deputy CEO for Corporate Banking and Treasury	61	111	43	37	252
Chief Executive's Office	128	176	47	38	389
Total	**526**	**686**	**313**	**240**	**1 765**

Breakdown of the staff employed by MKB Bank by gender (number of employees):

Area	Staff			Directors		
	Male	Female	Total	Male	Female	Total
CEO Directorate of Investment Banking and EU Development	8	7	15	2	1	3
Deputy CEO for Digitisation, Retail and Strategy	311	563	874	15	4	19
Deputy CEO for EU Commitments	10	9	19	1	-	1
Deputy CEO for Legal, Corporate and Group Governance	18	25	43	2	2	4
Chief Risk Officer	55	117	172	4	2	6
Deputy CEO for Corporate Banking and Treasury	104	148	252	29	2	31
Chief Executive's Office	135	255	390	14	3	17
Total	**641**	**1 124**	**1 765**	**67**	**14**	**81**

MKB Bank offers an extra-wage benefit package to its employees, consisting of a number of components. The employee benefit package includes financial benefits and a number of other components aimed at improving the working environment, maintaining a healthy lifestyle, motivated performance at work and strengthens the feeling of being part of a team. The benefits provided by the Bank are described in detail in the Cafeteria Policy.

Talent management at MKB Bank:

A complex calibration process across the company and standard performance evaluation system were introduced for the first time in 2018. In the same year a company-wide talent management programme covering also the subsidiaries was developed and introduced.

Employee training also plays an important role. The Bank provides regular further training to its employees, in addition to the mandatory training required by law. The introduction of new banking products also requires many hours of training. In 2018 employees also took part in training dedicated to the Digital Switchover.

The MKB Academy programme constitutes the framework of the Bank's training strategy. The system has 5 pillars. Besides the mandatory training (Mandatory Pillar), attention is also paid to the professional development of the colleagues, which is assisted with training courses dedicated to various topics (Professional Pillar). Skill development training activities are also available on a number of topics (Soft Skill Pillar). Employees can choose from different training courses to learn how to use the banking tools more effectively (System Pillar). A wide range of skill development training activities are also offered as part of the management training (Management Pillar).

Balance of work and private life at MKB Bank:

The introduction of flexible working hours at MKB Bank is one of the cornerstones of the HR strategy as it is an important component of improving the employee experience.

As part of the HR strategy, MKB intends to increase the share of atypical employment. The objectives also include offering work from home for a large number of employees and therefore the tools and devices are also developed constantly. Working from home reduces stress at work, improves the balance of work and private life and thus increases employee satisfaction, work morale, productivity and loyalty.

MKB Bank and health:

Health development and health preservation are important objectives for MKB Bank, as emphasised in various sports and health campaigns, such as the #20 Minutes Health campaign. Employees are given various opportunities to do sports and there is a lot of concentration on healthy lifestyle. The objective is to provide a healthy work environment for the staff. The Year of Health programme series was announced in 2018, also underlining the importance of health preservation.

Employees benefit from preferential health insurance, which includes diagnostic services and extended consultation hours at the Bank's occupational physician on every day of the week. In 2018 screening tests were also organised for the employees.

Regular office massage is arranged for the staff, in which 178 employees took part in 2018. Hobby and recreation rooms were set up in Váci street and Kassák Lajos street buildings. Fruit bowls are provided to employees at a number of locations. The canteens of the Bank serve fitness food and other items, suitable for special nutrition.

MKB Bank and sports:

The Bank provides a wide range of sports opportunities to its staff. Approximately 110 m^2 fitness rooms have been established at Váci street head office and in Kassák Lajos street office building to be used after work. An increasing number of employees enjoy the facilities of the fitness rooms. MKB supports sports in other ways too. MKB SE is a sports club where colleagues can do joint sports activities.

Secure work environment:

In order to fulfil its legislative obligations, MKB Bank has prepared a risk assessment of the head office and other business sites of the Bank, including all branches. As it is an office work environment, there is only a low risk of accidents. Consequently, there are very few work accidents and their number is decreasing.

Health and safety and fire safety training is mandatory for each employee every year. A separate training material has been developed for the employees of the branch on how to respond if the branch is attacked. The personal, material and organisational conditions of safe work were defined in the Health and Safety Regulations of the Bank in compliance with the law.

A Health and Safety Representative also works at the Bank on behalf of the Works Council. The HS Representative is entitled to make sure that the requirements of healthy and safe work are fulfilled at the Bank.

Corporate governance:

In order to ensure transparent and effective operation and compliance with the law, the activities of the Board of Directors and Supervisory Board of MKB Bank are assisted by a number of sub-committees.

The Board of Directors is the Bank's managing body, consisting of external and internal members. Its responsibilities include the control of all tasks related to the organisational structure and activities of the Bank, development of the business policy, the financial budget and risk strategy and the supervision of the implementation thereof and approval of banking regulations in compliance with the legal requirements.

Major committees assisting the banking operation and activities of the Board of Directors in terms of the non-financial report: Management Committee, Strategy, Innovation and Development Committee, Committee of Ethics.

Human rights protection:

Relying on the standards also expressed in the Code of Conduct, the Bank takes into account the interests of its employees based on fair assessment, recognises their right to the integrity of their private life but, in exchange, the Bank expects its employees to responsibly protect their health.

It is especially important for the Bank to see that its employees can equally focus on their families and work as well as professional career. To support that, the Bank offers a healthy work environment without any discrimination. The Bank does not prepare a risk assessment of the enforcement of human rights but its members of staff operate in compliance with the internal banking regulations that outline the equal access strategy and procedural rules.

The equal access procedural rules of MKB Bank were developed on the basis of Section 283 of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, the Decree of the Minister of National Economy 22/2016 (29 June) on the rules of equal opportunities for persons with disabilities in access to financial services provided by credit institutions and the MNB Recommendation 4/2017 (13 March) on the treatment of disabled customers. The regulation contains the rules of implementation and details defined in MKB Bank's equal access strategy and constitute an inseparable part thereof.

The Bank's equal access was developed in the spirit of the Bank's social responsibility as the Bank pays special attention to the special needs of disabled customers and to special treatments promoting their equal access to services. The fundamental objective is to integrate the strategic requirements into the Bank's daily operation and to make them an integrated part of the attitude of executive officers and all other employees. The purpose of this regulation is to enable the disabled customers of the Bank to have access, whenever possible, to services of the same quality as those offered to ordinary customers but adapted to their special needs.

The Bank applies a fair treatment based on respect and esteem while keeping contact with its stakeholders. It rejects all forms of discrimination based on sex, age, ethnic origin, religious or political belief, belonging to any interest group, sexual orientation, different native languages and any other direct or indirect discrimination-based excluding conduct.

MKB Bank also operates a notification system (anonimbox@mkb.hu email address), where anyone can report any violation of law, or internal regulation or other rule of conduct experienced by them, even anonymously.

A Works Council (WC) also operates at MKB Bank Zrt. in compliance with the currently effective Labour Code. The Works Council is the main interest representation forum, representing the interests of the employees. The employees may be involved in the discussion of issues and taking decisions affecting them and can learn about any change therein through the Works Council. The Ethics and Conciliation Committee of the Works Council has the power to resolve conflicts between employees and conflicts between managers and employees.

MKB Bank does not employ children and is not engaged in forced labour either.

Data protection:

Data protection represents the latest generation of human rights and MKB Bank also pays attention to that field accordingly. In addition to compliance with the GDPR requirements, MKB Bank also warned about the risks of cyber fraud in relation to the European Cyber Security Month, which is an international campaign organised by the European Union Agency for Network and Information Security (ENISA) in October each year.

The purpose of this campaign is to increase cyber security awareness and to widely present the threats existing in cyber space. In 2018 the main topic was the development of the basic cyber hygiene skills of users. In full compliance also with the MNB recommendations, MKB Bank informed its customers on what to do in relation to cyber fraud and data phishing and raised attention about the importance of prevention and alertness regularly on its own platforms as well as in various publications issued on a number of occasions during the year.

The members of staff of MKB Bank have a great deal of experience in how to prevent data phishing, or identify the actual cases as well as implement measures to mitigate losses. The MKB Contact Centre contacts the potentially affected customers and checks whether or not they are aware of the respective transaction or whether they initiated it. MKB Bank also takes all security and legal measures required on such occasions in addition to informing its customers.

Regulations on the related policies, the applied due diligence and risk management procedures:

Regulation on the Recruitment and Selection Process.
Cafeteria Policy.
Incentive system.
Regulation on the Internal Training System of MKB Bank Zrt.
Regulation on Work at Home.
Employee recognition programme.
Regulation on Sponsorship and Management of Support Requests.
Health and Safety Regulation.
Regulation on the Procedural Rules of Promoting Equal Access at MKB Bank Zrt.

Environmental policy and its results, applied due diligence processes

MKB Bank is strongly dedicated to social responsibility, and therefore not only assistance to organisations and institutions worthy of support, but also environmental protection are important to it. In that context, the Bank has introduced a number of targeted measures, including the optimisation of energy consumption of office buildings and increasing the environmental awareness of employees. One of the objectives of the Digital Switchover strategy was to reduce the use of paper in branches by using new IT devices. In its environmental risk assessment the Bank took into account the annual energy consumption and annual carbon dioxide emission.

Data in HUF million except stated otherwise

Measures aimed at optimising energy consumption:

The majority of MKB Bank's energy consumption relates to the utility consumption of buildings and fuel consumption of its vehicle fleet. The consumption of buildings is partly of communal and partly of technology origin. Energy consumption is constantly monitored and supervised in each building. The national centre of this network is at Kassák street office building.

The lighting system is gradually modernised in all MKB buildings in order to reduce electricity consumption. Presence detectors were installed in the majority of public areas to prevent lamps being left switched on. Natural sources of lighting are preferred in all office buildings and attempts are made not to use any artificial lighting in the rooms if there is sufficient sunlight during the day.

The energy consumption optimising measures also included the upgrade of the cooling of the head office and the replacement of the wet cooling towers of the liquid cooling equipment by pure air cooling-based appliances. Thus the efficiency of energy consumption almost trebled and the water and sewer consumption of the buildings has decreased significantly too.

Annual consumption	2018	2017
Electricity (kWh)	13 443 085	13 725 688
Natural gas (gnm3)	989 021	1 166 431
Heat (MJ)	2 427 965	2 822 289
Water (m3)	27 486	30 132

The positive impact of the measure can also be observed in the annual energy consumption indicators of the buildings of MKB Bank.

The last comprehensive energy efficiency audit at MKB Bank was conducted by the Menton Energy Group in compliance with the 27/2012 EU Directive, Act LVII of 2015 and Government Decree 122/2015 (26 May). In addition, on the basis of the Decree of the Hungarian Energy and Public Utility Regulatory Authority (MEKH) 2/2017. (16 February), monthly energy desk officer reports are also prepared with energy consumption analyses.

Selective waste collection and management:

MKB Bank focuses on sustainable development. One of its basic pillars is selective waste collection, which is promoted with bins provided on office corridors and kitchens for collecting PET bottles and caps as well as electronic waste (cartridges, toners, etc.). Following adequate treatment, the selectively collected waste may be recycled, thus reducing the impact on the environment.

MKB Bank takes all reasonable efforts to have green operation, in the context of which electric waste management is another key issue. The digitisation strategy described above has also a positive impact on MKB's paper consumption.

Waste management is governed by a number of laws and regulations, and MKB Bank satisfies all legislative requirements. Waste management reports are prepared annually, containing the classification and quantities of waste generated and collected. In 2018, MKB Bank generated 106,950 kg paper and cardboard waste, 810 kg paper packaging waste and 2,890 kg scrapped electric and electronic waste.

Environmental measures relating to the vehicle fleet of MKB Bank:

MKB Bank has its own vehicle fleet and runs most of its cars on petrol and only fewer cars on diesel. The scheduled replacement of the fleet began in 2017, as a result of which the vehicles at present are not older than 5-6 years. MKB also uses taxi services for its employees. They entered into a contract with a new service provider in 2018. The partner selection was also influenced by the fact that this taxi company runs the largest number of electric cars on the Budapest market.

Anti-corruption and anti-bribery policy and its results, applied due diligence procedures

In compliance with its statutory obligations, MKB Bank laid down its anti-fraud and anti-corruption measures in various regulations.

Anti-money laundering and anti-terrorist financing measures:

MKB Bank developed its group anti-money laundering and anti-terrorist financing policy because it uses the available tools to actively participate in the prevention, combating and detection of money laundering, terrorist financing and economic crime both in Hungary and internationally. In order to effectively perform those tasks, the Bank applies the following main principles:

1. The Bank Group consistently meets and complies with all relevant international and Hungarian embargo rules, requirements and regulations concerning the fight against money laundering and the relevant national and international legislation.
2. The Bank Group does not and will not finance illegal arms transactions, drug trafficking, child work, slave trade, prostitution or corruption.
3. The Bank Group does not and will not finance persons or undertakings managed or controlled by persons qualifying as unreliable, having been sentenced for any related criminal act.
4. The Bank Group duly observes the FATF recommendations and pursues its activities in compliance with them.

The AML procedures apply to all employees of the Bank and fully comply with the FATF 40+9 recommendation, the Directive of the European Parliament and of the Commission 2015/849 and the Regulation of the European Council 2015/847. MKB Bank Zrt takes all reasonable efforts to prevent using the services offered by the Bank for money laundering or terrorist financing. MKB Bank Zrt has a Compliance organisation in which separate departments work on preventing money laundering and terrorist financing. The Bank fully co-operates with the official agencies in the identification of all suspicious cases, with special regard to potential money laundering and terrorist financing. The declarations required under the international regulations are available on the Bank’s website.

In order to reduce the risk of money laundering and terrorist financing, MKB Bank Zrt. must be aware of the activities of its customers, the nature of business relationships, business partners, financial habits, the Hungarian and business practice, the economic background of debits and credits in the account, the expected sales (amount, currency), hence it maintains a regular and active relationship with its customers. In accordance with the legal requirements, the Bank’s staff perform the due diligence of customers. Natural persons and representatives of legal entities must also provide a declaration on the PEP status of the beneficial owner, which is then verified by the Bank’s staff in public sources.

MKB Bank Zrt prepared its internal risk assessment in compliance with the provisions of Act LIII of 2017 on the prevention and combating of money laundering and terrorist financing, taking into account the Hungarian and international economic conditions and habits and the known risk factors. The Bank is also obliged to apply adequate risk classification on the basis of the nature and volume of the business relationship or a transaction order or the conditions related to the customer, product, service or the applied instrument.

MKB Bank identified its major risks in its risk assessment policy and reserves the right to refuse any customer relationship, transaction or transaction order if it is not in accordance with its risk appetite. The Bank monitors unusual activities and has identified cash transactions as a high risk, in particular in the case of extremely large or highly intensive cash turnover, thus verifying it continuously controls such turnover.

MKB Bank does not maintain a business relationship with customers who carry reputational risks, only customers who use their products for legitimate purposes and whose identity can be determined and verified without any doubt. The Bank does not provide services to natural persons or legal entities who/which are subject to any sanction or are included in any restricted list, such as the restricted list of the United Nations Security Council (UN), the EU Consolidated Financial Sanctions list (EU), the Restricted List handled by the Foreign Assets Control Office (OFAC) of the United States, which also includes the Specially Designated Nationals and Blocked Persons (SDN). In addition, the Bank also identified industries, products and countries that represent a high risk.

MKB Bank tries to prevent and detect fraud not only in its customer relations. In the supply contracts partners must commit to compliance with the effective laws and regulations. The Bank’s Compliance Unit also conducts due diligence on the partners before each new contract or a supply contract that has not been reviewed for a year. In 2018, due diligence was conducted on 441 suppliers. The Bank does not enter into any contract with a supplier who does not satisfy the minimum requirements stated by law.

The Bank also expresses the requirement of prudent operation in its Code of Conduct. Compliance with the effective law and the internal regulations of the Bank is a basic requirement for each employee and all partners with a business or other contract with the Bank are also expected to comply with the Code of Conduct.

Rules on gifts:

In order to ensure transparent operation and prevent corruption, the Bank applies strict rules on conflict of interest and gifts to business partners. The Regulations on the Conflict of Interest of Employees and Gifts set out the rules of accepting and providing gifts for employees, the terms and conditions of holding executive officer positions, the restrictions on influential roles in the business organisation and on obtaining an influential share and majority influence as well as the rules of authorisation.

Regulations related to the respective policy and applied due diligence procedures:

On the assessment of reliability of the employees of MKB Bank.
MKB Bank Zrt Group Policy on the Prevention of Money Laundering and Terrorist Financing.
On the conflict of interest of employees and on gifts.
MKB Bank Zrt. group regulation on the prevention and combating of money laundering and terrorist financing and on the implementation of financial and asset restrictions ordered by the European Union and the UN Security Council.
Regulation on the Fraud Reporting System of MKB Bank Zrt.

Key non-financial performance indicators:

- Energy consumption: (included in the Environmental Policy and its results, applied due diligence processes chapter)
- Breakdown of employees by age and gender: (included in the Social and employment as well as human rights policy and its results, the applied due diligence processes chapter)

Budapest, 10 April 2019

dr Ádám Balog
Chairman and Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

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STATEMENT

on the non-consolidated annual financial statements of 2018
and on the Report of the Management
Pursuant to Ministry of Finance Decree no. 24/2008. (VIII.15.)

MKB Bank Zrt (hereinafter: Bank) declares concerning its non-consolidated annual financial statements – accepted by the Annual General Meeting of the Bank on 26 April 2019 and audited by an independent auditor - the following statement:

The Bank declares that the non-consolidated annual financial statements have been compiled in accordance with the applicable accounting rules. The non consolidated annual financial statements compiled based on the best knowledge of the Bank's competent experts and decision making managers present a realistic and reliable picture on the assets, liabilities, financial position, as well as profits and losses of the Bank as an issuer of securities.

The Bank declares furthermore that The Report of the Management (Management's discussion & analysis) provides a reliable picture of the position, situation, development and performance of the Bank as an issuer of securities and describes the key risks and uncertainty factors.

Budapest, 26 April 2019

MKB Bank Zrt.

dr Ádám Balog	Csaba Gábor Fenyvesi
Chairman and Chief Executive Officer	Chief Financial Officer