# MKB Bank Zrt.

*CONSOLIDATED FINANCIAL STATEMENTS IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS AS ADOPTED BY THE EUROPEAN UNION FOR THE YEAR ENDED DECEMBER 31, 2017*

Deloitte.

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Company Registration Number: 01-09-071057

# INDEPENDENT AUDITOR'S REPORT

To the Shareholders of MKB Bank Zrt.

### *Opinion*

We have audited the consolidated financial statements of MKB Bank Zrt. and its subsidiaries (the „Group") for the year 2017 which comprise the consolidated statement of financial position as at December 31, 2017 – which shows a total assets of HUF 2,044,987 million –, and the related consolidated statement of recognized income, consolidated statement of comprehensive income – which shows a net profit for the year of HUF 19,201 million –, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at December 31, 2017 and of its consolidated financial performance and its consolidated 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 consolidated financial statements were prepared in all material respects in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (hereinafter: "the Accounting Act") relevant to the entities preparing consolidated 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 Consolidated Financial Statements*" section of our report.

We are independent of the Group 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 consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated 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 loan receivables*** | |
| (See Sections 4. i, 11. and 30. of the Notes to the Financial Statements for the details)<br>The net value of loans to customers in an amount of HUF 858,592 million comprise 42% of the total assets (gross book value of HUF 938,351 million), the relevant impairment charge recorded in the current year was HUF 9,775 million. The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of both the application of portfolio based collective impairment models, and determination of individual specific impairment of loans. The most significant assumptions applied in provisioning calculation are the followings:<br>- historical loss data,<br>- valuation of collaterals,<br>- estimated time to realize the collaterals,<br>- probability of default,<br>- estimate that future cash-flows expected to be realized.<br>Based on the significance of the above described circumstances the calculation of impairment of loans was identified as a key audit matter. | The relevant audit procedures performed by us included the followings:<br>- evaluating internal controls relating to monitoring of loans and calculating and recording of impairment,<br>- evaluating of specific loan impairments with random sample based on risk profiles, including the review of consideration and valuation of collaterals and estimations of expected future cash-flows,<br>- evaluating the appropriateness of collective provisioning models, and review of the assumptions and management estimates applied and parameters, including comparison with historic data, and recalculation of impairment charge with the involvement of our experts,<br>- review of subsequent events (sold receivables), and analysis of the possible effect on the year audited,<br>- evaluating of impairment triggers related to the non-impaired portfolio,<br>- evaluating the appropriateness of related disclosures. |

***Other Information: The Consolidated Business Report***

Other information includes the consolidated business report of the Group for 2017. Management is responsible for the preparation of the consolidated business report in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (hereinafter: "the Accounting Act") and other regulations. Our opinion on the consolidated financial statements provided in the section of our independent auditor's report entitled „*Opinion*" does not apply to the consolidated business report.

Our responsibility in connection with our audit of the consolidated financial statements is to read the consolidated business report and, in doing so, consider whether the consolidated business report is materially inconsistent with the consolidated 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 consolidated 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 consolidated business report is consistent with the financial statements.

In our opinion, the consolidated business report of the Group for 2017 corresponds to the consolidated financial statements of the Group for 2017 and the relevant provisions of the Accounting Act in all material respects. As the Group is not subject to additional requirements under any other regulation in connection with the consolidated business report, we have not formulated an opinion on this matter.

In addition to the above, based on the information obtained about the Group and its environment, we must report on whether we became aware of any material misstatements in the consolidated 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 Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with the Accounting Act, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

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

Our objectives during the audit are to obtain reasonable assurance about whether the consolidated 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 consolidated 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 consolidated 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 Group'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 Group'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 consolidated 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 Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion

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 Group'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 consolidated 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 MKB Bank Zrt. by the General Meeting of Shareholders on March 20, 2017 and our uninterrupted engagement has lasted for 5 years.

*Consistence with the Additional Report to the Audit Committee*
We confirm that our audit opinion on the consolidated financial statements expressed herein is consistent with the additional report to the Audit Committee of MKB Bank Zrt., which we issued on April 4, 2018 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 Group. In addition, there are no other non-audit services which were provided by us to the MKB Bank Zrt. and and its controlled undertakings and which have not been disclosed in the consolidated business report.

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

Budapest, April 4, 2018

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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.
# Group

10 011 922 641 911 401
statistic code

***Consolidated***
***Financial***
***Statements***

Prepared in accordance with the
International Financial Reporting Standards
as adopted by the EU

Budapest, 4 April 2018

*31 December 2017*

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Data in HUF million except stated otherwise

# MKB Bank Zrt.
## Consolidated Statement of Financial Position as at 31 December 2017

| | Note | 2017 | 2016 |
|---|---|---|---|
| ***Assets*** | | | |
| Cash reserves | **7** | 31 599 | 97 914 |
| Loans and advances to banks | **8** | 78 017 | 67 039 |
| Financial assets measured at FVTPL | **9** | 72 319 | 75 210 |
| Investments in securities | **10** | 902 712 | 924 137 |
| Loans and advances to customers | **11** | 858 592 | 858 072 |
| Non-current assets held for sale and discontinued operations | **40** | 21 648 | 309 |
| Other assets | **12** | 27 469 | 28 081 |
| Deferred tax assets | **25** | 3 312 | 3 320 |
| Investments in jointly controlled entities and associates | **13** | 2 643 | 1 651 |
| Intangibles, property and equipment | **14** | 46 676 | 45 883 |
| **Total assets** | | **2 044 987** | **2 101 616** |
| ***Liabilities*** | | | |
| Amounts due to other banks | **15** | 239 312 | 376 262 |
| Deposits and current accounts | **16** | 1 539 140 | 1 519 868 |
| Financial liabilities measured at FVTPL | **17** | 43 366 | 29 983 |
| Other liabilities and provisions | **19** | 49 853 | 37 197 |
| Deferred tax liabilities | **25** | 5 | 6 |
| Issued debt securities | **20** | 10 624 | 12 892 |
| Subordinated debt | **21** | 22 307 | - |
| **Total liabilities** | | **1 904 607** | **1 976 208** |
| ***Equity*** | | | |
| Share capital | **22** | 100 000 | 100 000 |
| Treasury Shares | | (5 550) | (5 550) |
| Reserves | **23** | 40 381 | 25 368 |
| **Total equity attributable to equity holders of the Bank** | | **134 831** | **119 818** |
| Non-controlling interests | **24** | 5 549 | 5 590 |
| **Total equity** | | **140 380** | **125 408** |
| **Total liabilities and equity** | | **2 044 987** | **2 101 616** |

Budapest, 4 April 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

# MKB Bank Zrt.
## Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2017

| | Note | 2017 | 2016 |
|---|---|---|---|
| **Statement of profit or loss** | | | |
| Interest income | **26** | 56 245 | 62 476 |
| Interest expense | **27** | 16 665 | 23 804 |
| Net interest income | | 39 580 | 38 672 |
| Net income from commissions and fees | **28** | 28 846 | 28 664 |
| Other operating income / (expense), net | **29** | 10 219 | (6 286) |
| Impairments and provisions for losses | **30** | 9 611 | 15 236 |
| Operating expenses | **31** | 48 685 | 38 283 |
| Share of jointly controlled and associated companies' profit | | 389 | 273 |
| Profit before taxation | | 20 738 | 7 804 |
| Income tax expense / (credit) | **32** | 1 537 | (1 692) |
| PROFIT FOR THE YEAR | | 19 201 | 9 496 |
| ***Other comprehensive income:*** | | | |
| ***Items that may be reclassified subsequently to profit or loss:*** | | | |
| Revaluation on AFS financial assets | **10** | (4 243) | 7 889 |
| Exchange differences on translating foreign operations | | - | 2 |
| Other comprehensive income for the year net of tax | | (4 243) | 7 891 |
| TOTAL COMPREHENSIVE INCOME FOR THE YEAR | | 14 958 | 17 387 |
| **Profit attributable to:** | | | |
| **Shareholders of the bank** | | **19 202** | **9 496** |
| **Non-controlling interests** | | **(1)** | **-** |
| **Total comprehensive income attributable to:** | | | |
| **Shareholders of the bank** | | **14 959** | **17 387** |
| **Non-controlling interests** | | **(1)** | **-** |
| Net income available to ordinary shareholders | | 19 202 | 9 496 |
| Average number of ordinary shares outstanding *(thousands)* | | 85 000 | 137 602 |
| **Earnings per Ordinary Share** *(in HUF)* | **33** | | |
| Basic | | 226 | 69 |
| Diluted | | 219 | 69 |
| **Earnings per Ordinary Share from continuing operation** *(in HUF)* | **33** | | |
| Basic | | 226 | 69 |
| Diluted | | 219 | 69 |

Budapest, 4 April 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Data in HUF million except stated otherwise

# MKB Bank Zrt.
# Consolidated Statement of Changes in Equity for the year ended 31 December 2017

| | Note | Share capital | Treasury shares | Share premium | Share-based payments | Translation of foreign operations | Retained earnings | Revaluation on AFS financial assets | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|
| At 1 January 2016 | | 225 490 | - | 222 886 | - | 2 | (339 101) | (1 292) | - | 107 985 |
| Profit/(loss) for the year | | - | - | - | - | - | 9 496 | - | - | **9 496** |
| Other comprehensive income for the year | | - | - | - | - | 2 | - | 7 889 | - | **7 891** |
| First / (final) consolidation of subsidiaries | | - | - | - | - | (4) | - | - | 5 590 | **5 586** |
| Decrease of share capital | | (125 490) | - | (201 157) | - | - | 326 647 | - | - | **-** |
| Acquisition of treasury Shares (ESOP) | | - | (5 550) | - | - | - | - | - | - | **(5 550)** |
| At 31 December 2016 | | 100 000 | (5 550) | 21 729 | - | - | (2 958) | 6 597 | 5 590 | 125 408 |
| Profit/(loss) for the year | | - | - | - | - | - | 19 202 | - | (1) | **19 201** |
| Other comprehensive income for the year | | - | - | - | - | - | - | (4 243) | - | **(4 243)** |
| Change in non-controlling interests | | - | - | - | - | - | - | - | (40) | **(40)** |
| Share-based payments | | - | - | - | 54 | - | - | - | - | **54** |
| At 31 December 2017 | | 100 000 | (5 550) | 21 729 | 54 | - | 16 244 | 2 354 | 5 549 | 140 380 |

Budapest, 4 April 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Data in HUF million except stated otherwise

# MKB Bank Zrt.
## Consolidated Statement of Cash Flows for the year ended 31 December 2017

| | Note | 2017 | 2016 |
|---|---|---|---|
| *Cash flows from operating activities* | | | |
| Profit before taxation | | **20 738** | **7 804** |
| *Adjustments for:* | | | |
| Depreciation, amortisation and impairment | **14** | 4 546 | 5 407 |
| Impairment on other assets | **12** | 58 | (44) |
| Provisions for off-BS items and settlement for customers | **19** | (915) | 1 420 |
| Impairment on financial assets (loans and advaces) | **8, 11** | 8 802 | 8 346 |
| Deferred tax movement | **32** | 7 | (1 647) |
| Net Interest income | | (43 930) | (44 197) |
| Dividends on available for sale securities | | (17) | (12) |
| Revaluation of issued securities | | (376) | (1 402) |
| Revaluation and other result of AFS securities | | (46 913) | 10 668 |
| Foreign Exchange movement | **8, 11, 14, 19, Change in Equity** | (335) | (306) |
| *Cash flows from operating activities* | | (58 335) | (13 963) |
| Change in loans and advances to banks (gross amounts) | **8** | (10 978) | (15 256) |
| Change in loans and advances to customers (gross amounts) | **11** | (8 936) | (63 156) |
| Change in non-current assets held for sale and discontinued operations | **40** | (21 339) | 32 327 |
| Change in trading assets | **9** | 2 891 | 18 358 |
| Change in other assets (gross amounts) | **12** | 554 | (7 180) |
| Change in amounts due to banks (short term) | **15** | (153 969) | 63 383 |
| Change in current and deposit accounts | **16** | 19 271 | 140 700 |
| Change in other liabilities and provisions (without provision charge of the year) | **19** | 13 490 | 733 |
| Change in trading liabilities | **17, 18, Change in Equity** | 13 383 | 9 232 |
| Interest received | | 48 362 | 58 637 |
| Interest paid | | (4 432) | (14 440) |
| Dividends received | | 17 | 12 |
| Income tax | | (1 537) | 1 692 |
| | | (103 223) | 225 042 |
| **Net cash (used in)/generated by operating activities** | | **(161 558)** | **211 079** |
| *Cash flow from investing activities* | | | |
| Investment in group companies | **23, Change in Equity** | (992) | (82) |
| Disposals of group companies | **40** | (54) | - |
| Purchase of property and equipment | **14** | (2 726) | (2 195) |
| Disposals of property and equipment | **14** | 3 174 | 1 539 |
| Purchase of intangible assets | **14** | (6 403) | (3 623) |
| Disposals of intangible assets | **14** | 617 | 1 |
| Purchase of AFS securities | **10** | (1 393 806) | (849 883) |
| Disposals of AFS securities | **10** | 1 654 456 | 838 160 |
| Change in HTM securities (without impairment) | **10** | (196 557) | (55 453) |
| **Net cash (used in)/ generated by investing activities** | | **57 709** | **(71 536)** |
| *Cash flow from financing activities* | | | |
| Change in issued securities | **20** | (1 892) | (71 331) |
| Change in subordinated liabilities | **21** | 22 307 | - |
| Change in amounts due to banks (Borrowings) | **15** | 17 019 | (11 771) |
| **Net cash generated by / (used in) financing activites** | | **37 434** | **(83 102)** |
| Net decrease / (increase) of cash and cash equivalents | | (66 415) | 56 441 |
| **Cash reserves at 1 January** | **7** | **97 914** | **41 494** |
| FX change on cash reserve | | 100 | (21) |
| **Cash reserves at December 31** | **7** | **31 599** | **97 914** |

Budapest, 4 April 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

# Notes to the Financial Statements

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## 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 consolidated financial statements of the Bank as at and for the year ended 31 December 2017 comprise the Bank and its subsidiaries (together referred to as the "MKB Group" or "Group"). The Group conducts its financial services businesses through domestic banking and non-banking subsidiaries.[1]

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[2] 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.

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

[1] For further information on consolidated subsidiaries please see Note 5
[2] BRRD

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.

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 consolidated financial statements of the Group 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. These financial statements were authorised for issue by the Board of Directors on 4 April 2018.

## 3 Basis of measurement

The consolidated 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
- available-for-sale financial assets are measured at fair value through other comprehensive income
- other financial instruments are measured at amortised cost

The consolidated 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 35.

# 4 Summary of significant accounting policies

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

**a, Financial statement presentation**

These consolidated financial statements include the accounts of MKB and its subsidiaries, jointly controlled entities and associates ("the Group"). The income, expenses, assets and liabilities of the subsidiaries are included in the respective line items in the consolidated financial statements, after eliminating inter-company balances and transactions.

**b, Consolidation**

***Subsidiaries***

Subsidiaries are entities controlled by the Group. Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. In assessing control, substantive voting rights are also taken into account. Newly acquired subsidiaries are consolidated from the date that the Group gains control. The acquisition accounting method is used to account for the acquisition of subsidiaries by MKB. The cost of an acquisition is measured at the fair value of the consideration given at the date of exchange, the acquisition – related costs are recognized in profit or loss.

The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair value of the Group's share of identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of identifiable assets, liabilities and contingent liabilities acquired, the difference is recognised immediately in the statement of comprehensive income.

***Fund management***

The Group manages and administers assets held in investment funds on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's funds management activities is set out in Note 38.

### *Transactions eliminated on consolidation*

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

## c, Investments in jointly controlled entities and associated companies

### *Jointly controlled entities*

Where the Group is a party to a contractual arrangement whereby, the parties that have joint control of the arrangement have rights to the net assets of the arrangement, the Group classifies its interest in the venture as a joint venture. Jointly controlled entities are included in the consolidated financial statements using equity method of accounting, from the date that joint control effectively commences until the date that joint control effectively ceases. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the Group's share of net assets.

### *Associates*

MKB classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint ventures, as associates. For the purpose of determining this classification, control is considered to be the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Associates are accounted for under the equity method of accounting except when the investment is acquired and held exclusively with a view to its disposal in the near future, in which case it is accounted for under the cost method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in MKB's share of net assets. For consolidation purpose MKB uses financial statements of an associate within a three months limit if the reporting period of the entity is different as at the end of year.

Profits on transactions between MKB and its associates and joint ventures are eliminated to the extent of MKB's interest in the respective associates or joint ventures. Losses are also eliminated to the extent of MKB's interest in the associates or joint ventures unless the transaction provides evidence of an impairment of the asset transferred.

## d, Intangible assets

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

### *Goodwill*

Goodwill arises on business combinations, including the acquisition of subsidiaries, and on the acquisition of interests in joint ventures and associates, when the cost of acquisition exceeds the fair value of the Group's share of identifiable assets, liabilities and contingent liabilities acquired. If the Group's interest in the fair value of identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost of acquisition, the excess is recognised immediately in the statement of comprehensive income.

Goodwill is not amortised but annually tested for impairment.

For the purpose of impairment testing, goodwill is allocated to one or more of the Group's cash-generating units, that are expected to benefit from the synergies of the business combination, irrespective whether other assets or liabilities are assigned to them. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the present value of the expected future cash flows from a cash-generating unit with the carrying amount of its net assets, including attributable goodwill. Goodwill is stated at cost less accumulated impairment losses. Impairment losses recognized for goodwill are charged to the statement of comprehensive income and are not reversed in a subsequent period.

Goodwill on acquisitions of interests in joint ventures and associates is included in ‘Investments in jointly controlled entities and associates’.

At the date of disposal of a business, attributable goodwill is included in the Group’s share of net assets in the calculation of the gain or loss on disposal.

### *Other intangible assets*

Intangible assets that have a finite useful life are measured initially at cost and subsequently carried at cost 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 Group 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.

## e, 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.

Equipment, fixtures and fittings (including equipment on operating leases where MKB Group 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 the „Operating expenses" line in the 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.

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

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 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 loss.

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

## f, Cash reserves

Cash reserves include notes and coins on hand, unrestricted balances held with central banks 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 Group in the management of its short-term commitments.

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

## g, 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 the transaction cost that is directly attributable to the acquisition or issue of financial assets or financial liabilities. In the normal course of business, the fair value of a financial instrument at 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 valuation technique with variables, which include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading gain or loss on inception of the financial instrument. When unavailable market data has 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 Group enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value 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 ceases 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, prepayment rates and default rates. Where a portfolio of financial instruments has quoted prices in an active market, the fair value of these 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; from then on it becomes 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 Group's liabilities.

## h, Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Group which are not classified as Fair Value Through Profit or Loss. Loans and advances are recognised when cash is advanced to borrowers (settlement date). They are derecognised when borrowers repay their obligations, the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less impairment losses. 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.

## i, Impairment of loans and advances

At the end of each reporting period the Group assesses whether there is objective evidence that loans and advances are impaired. Loans and advances are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that loans and advances are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.
Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the statement of comprehensive income. The carrying amount of impaired loans at the end of the reporting period is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

### *Individually assessed loans and advances*

For all loans that are considered individually significant, the Group assesses on a case-by-case basis at the end of each reporting period whether there is any objective evidence that a loan is impaired. Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired assets continues to be recognised through the unwinding of the discount.

### *Collectively assessed loans and advances*

Impairment is assessed on a collective basis for homogeneous groups of loans that are not considered individually significant.

Loans, which are not assessed on an individual basis, or where the individual assessment has resulted in no specific provision, are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. However, losses in these groups of loans are recorded on an individual basis when loans are written off, at which point they are removed from the group.

In assessing collective impairment the Group uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked.

### *Write-off of loans and advances*

A loan (and the related impairment allowance account) is normally written off, either partially or in full, when there is no realistic prospect of further recovery of the principal amount and, for a collateralised loan, when the proceeds from realising the security have been received.

### *Reversals of impairment*

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The reversal is recognised in the statement of comprehensive income.

### *Assets acquired in exchange for loans*

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as other assets or as assets held for sale if it meets the requirements of IFRS 5 and reported in 'Other assets' or 'Non-current assets held for sale and discontinued operations'. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the statement of comprehensive income, in 'Other operating income'. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write down, is also recognised in 'Other operating income', together with any realised gains or losses on disposal.

## j, Financial assets measured at FVTPL and Negative fair values of derivative financial instruments

Treasury bills, debt securities and 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 Group enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). They are measured initially at fair value, with transaction costs taken to the statement of comprehensive income. Subsequently, their fair values are re-measured, and all gains and losses from changes therein are 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. Dividends earned on trading equity instruments are disclosed separately among interest income when received. Interest payable on financial liabilities acquired for trading purposes is reported as other operating expense.

Financial instruments, other than those held for trading, are classified as fair value through profit or loss, if they meet the following criterion: the Group may designate financial instruments at fair value when the designation eliminates or significantly reduces valuation, or recognition of inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or from recognising gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by the Group are:

### *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 recognised in the Statement of comprehensive income.

### *Structured Bonds*

MKB issues structured bonds for its retail and institutional clients since 2008. In these bonds there are embedded derivatives (options) that have to be separated under IAS 39.11 unless the hybrid instruments are measured at fair value. The Group 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 as at fair value through 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 Group 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). They are measured initially at fair value, with transaction costs taken directly to the statement of comprehensive income. Subsequently, the fair values are re-measured, and gains and losses from changes therein are recognised in "Interest income".

## k, Investments in securities

Investments in securities are classified as available-for-sale, if there was a decision made previously about possible disposal as a result of changes in market conditions or the securities have not been classified into the other categories. Financial investments are recognised on trade date, when the Group enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either those securities are sold or borrowers repay their obligations.

Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently re-measured at fair value, and changes therein are recognised in equity in the 'Revaluation reserve' (Note 23) until the securities are either sold or impaired. When available-for sale 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".

At the end of each reporting period an assessment is made on whether there is objective evidence of impairment in the value of a financial asset or group of assets. This usually arises when circumstances are such that an adverse effect on future cash flows from the asset or group of assets can be reliably estimated. If an available-for-sale security is impaired, the cumulative loss (measured as the difference between the asset's acquisition cost (net of any principal repayments and amortisation) and its current fair value, less any impairment loss on that asset previously recognised in the statement of comprehensive income) is removed from equity and included in the statement of comprehensive income.

When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in provisions attributable to time value are reflected as a component of interest income.

Debt instruments, that the Group intends and is able to hold to maturity are classified as held-to-maturity investments and are measured at amortised cost. At the end of each reporting period an assessment is made on whether there is objective evidence of impairment in the value of a financial asset or group of assets. If there is objective evidence of impairment in case of held-to-maturity investments, the carrying amount of investments is decreased against profit or loss.

### l, Derivatives

Derivatives are recognised initially, and are subsequently re-measured, 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 when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated as at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the statement of comprehensive income.

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.

The method of recognising fair value gains and losses does not depend on whether derivatives are held for trading or are designated as hedging instruments. All gains and losses from changes in the fair value of derivatives held for trading or designated as hedging instrument in hedging relationships are recognised in the statement of comprehensive income as the Group uses only fair value hedges to hedge its risks.

### m, Hedge accounting

As part of its asset/liability management activities, the Group may use interest rate swaps and cross currency interest rate swaps, to hedge against existing foreign currency and interest rate exposures. A hedging relationship qualifies for special hedge accounting if, and only if, all of the following conditions are met:

- at the inception of the hedge there is formal documentation of the hedging relationship that includes - among others - the identification of the hedging instrument , the specific hedged item and the nature of risk being hedged.
- a high level of hedge effectiveness is expected at the inception and the hedge is actually effective throughout the hedge period,
- hedge effectiveness can be reliably measured.

The Group also requires a documented assessment on an ongoing basis in line with IAS 39, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values of the hedged items. Interest on designated qualifying hedges is included in “Interest income” or “Interest expense”.

### *Fair value hedge*

A fair value hedge represents a contract that hedges a recognised asset or liability, or an identified portion of such an asset or liability, against exposure to changes in the fair value that is attributable to a particular risk and that will affect the reported net income. The gain or loss from re-measuring the hedging instrument at fair value and the loss or gain on the hedged item attributable to the hedged risk are recognised immediately in net profit or loss for the period.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the statement of comprehensive income based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case, it is released to the statement of comprehensive income immediately.

### *Hedge effectiveness testing*

To qualify for hedge accounting, the Group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value must offset each other in the range of 80 per cent to 125 per cent.

## n, Derecognition of financial assets and liabilities

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Group enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include, for example repurchase transactions.

## o, Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

## p, 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 Group 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 Group 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 the lessor, the Group 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 Group is the lessee, leased assets are not recognised in 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 expense, net", respectively.

## q, Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities, issued and subordinated liabilities are the Group's sources of debt funding.

When the Group 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 Group'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 rate method, except for the items which at initial recognition are designated by the Group to the fair value through profit or loss category.

The Group carries some deposits, debt securities and subordinated liabilities at fair value, with fair value changes recognised immediately in profit or loss as described in the accounting policy (Note 4 k).

## r, Provisions

A provision is recognised if, as a result of a past event, the Group 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. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Contingent liabilities, which include certain guarantees, are possible obligations that arise from past events of which 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 Group, 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 unless the probability of settlement is remote.

## s, 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.

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 tax rates that are expected to be applied to the temporary differences when they reverse, based on 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 re-measurement 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.

### t, 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 rate method. The effective interest rate 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 Group 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 Group 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 income is recognised on available-for-sale securities using the effective interest rate method, calculated over the asset's expected life. Dividends are recognised in the statement of comprehensive income when the right to receive payment has been established.

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.

### u, Fees and commission

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).

### v, 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.

### w, Dividends

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

## x, 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 Group 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 Group 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 39.

## y, Foreign currencies

Items included in the financial statements of each of the Group’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 Group 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 rate 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.

## z, Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss that 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 recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. Guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

### aa, 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.

### ab, Treasury shares

The cost of the Group's equity instruments that it has reacquired ("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 entity or by other members of the consolidated Group. Consideration paid or received is recognised directly in equity.

### ac, Earnings per share

The Group 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 33.

### ad, Standards and Interpretations effective in the current period

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

- **Amendments to IAS 7 „Statement of Cash Flows"** - Disclosure Initiative (endorsed on 6 November 2017, effective for annual periods beginning on or after 1 January 2017).

- **Amendments to IAS 12 "Income Taxes"** - Recognition of Deferred Tax Assets for Unrealised Losses (endorsed on 6 November 2017, effective for annual periods beginning on or after 1 January 2017).

### ae, 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 9 "Financial Instruments"** – adopted by the EU on 22 November 2016 (effective for annual periods beginning on or after 1 January 2018, with earlier application permitted), On 24 July 2014 the International Accounting Standards Board issued IFRS 9 Financial instruments, as a replacement of IAS 39 Financial instruments: Recognition and Measurement. The Standard includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. The version of IFRS 9 issued in 2014 supersedes all previous versions. IFRS 9 does not replace the requirements for portfolio fair value hedge accounting for interest rate risk (often referred to as the 'macro hedge accounting' requirements) since this phase of the project was separated from the IFRS 9 project due to the longer term nature of the macro hedging project.

After the adoption by the EU the Group has started a project for the preparation of implementing IFRS 9 standard. The impact on the group financial statement is set out in Note 43.

- **IFRS 15 "Revenue from Contracts with Customers"** (effective for annual periods beginning on or after 1 January 2018, with earlier application permitted) and **Clarifications to IFRS 15 "Revenue from Contracts with Customers"** (endorsed on 31 October 2017, effective for annual periods beginning on or after 1 January 2018),

  IFRS 15 sets out the requirements for recognizing revenue that applies to all contracts with customers (except for contracts that are within the scope of the Standards on leases, insurance contracts and financial instruments). IFRS 15 replaces the previous revenue Standards: IAS 18 Revenue and IAS 11 Construction Contracts, and the related Interpretations on revenue recognition.

  The adoption of the above presented new Standard would have no significant impact on the financial statements.

- **IFRS 16 "Leases"** (effective for annual periods beginning on or after 1 January 2019)

  The International Accounting Standards Board (IASB) issued IFRS 16 Leases in January 2016. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). In October 2015, the IASB decided to require an entity to apply the new Leases Standard for annual periods beginning on or after 1 January 2019 and to permit early application if the entity also applies IFRS 15 Revenue from Contracts with Customers at or before the date of early application. The aim of the standard is to ensure that assets and liabilities arising under leases are recognised in the statement of financial position.

  IFRS 16 replaces the previous leases Standard, IAS 17 Leases, and related Interpretations (IFRIC 4).

  The adoption of the above presented new Standard would have no significant impact on the financial statements.

- **IFRS 4 (Amendment) "Insurance Contracts"** Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (effective for annual periods beginning on or after 1 January 2018)

  On 12 September 2016 the International Accounting Standards Board issued amendments to International Financial Reporting Standard (IFRS) 4 Insurance Contracts. The amendments provide two options for entities that issue insurance contracts within the scope of IFRS 4:

- an option that permits entities to reclassify, from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets (the "overlay approach");
- an optional temporary exemption from applying IFRS 9 for entities of which predominant activity is issuing contracts within the scope of IFRS 4 (the "deferral approach").

The application of both approaches is optional and an entity is permitted to stop applying them before the new insurance contracts standard is applied.

The adoption of the above presented Amendment would have no impact on the financial statements.

### af, 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 from the following standards, amendments to the existing standards and interpretations, which were not endorsed for use in EU as at 4 April 2018 (the effective dates stated below is for IFRS in full):

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

- **IFRIC 23 "Uncertainty over Income Tax Treatments"** (effective for annual periods beginning on or after 1 January 2019),

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

- **Annual improvements to IFRS Standards 2014-2016 Cycle**, issued on 8 December 2016 (the amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after 1 January 2018, and on or after 1 January 2017)

- **IAS 40 (Amendment) "Investment Property"** Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018)

  The IASB amended the standard to reinforce the principle for transfers into, or out of, investment property in IAS 40 to specify that such a transfer should only be made when there has been a change in use of the property.

- **IFRIC 22 "Foreign Currency Transactions and Advance Considerations"** (effective for annual periods beginning on or after 1 January 2018, earlier application is permitted)

  On 8 December 2016 the International Accounting Standards Board issued IFRIC 22 Foreign Currency Transactions and Advance Considerations. IFRIC 22 clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency.

- **Amendments to IFRS 9 "Financial Instruments"** - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IAS 28 "Investment in Associates and Joint Ventures" -** Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019).

The Group anticipates that the adoption of these standards, amendments to the existing standards and interpretations will have no material impact on the financial statements of the Group in the period of initial application, except for IFRS 9 “Financial instruments”.

At the same time, hedge accounting regarding the portfolio of financial assets and liabilities, whose principles have not been adopted by the EU, is still unregulated. According to the Group`s estimates, application of hedge accounting for the portfolio of financial assets or liabilities pursuant to IAS 39: “Financial Instruments: Recognition and Measurement”, would not significantly impact the financial statements, if applied as at the end of the reporting period.

# 5 Group of consolidation

The Bank has performed an analysis in order to examine, whether as an investor it controls its investees, and to what extent the control exists. This control determines the disclosure of the investees as a subsidiary, joint arrangement (joint operation or joint venture) or as an associate in the consolidated financial statements of the Group.

The conclusions were prepared in accordance with the International Financial Reporting Standards and the Accounting policies (4.a Financial statement presentation, 4.b Consolidation, 4.c Investments in jointly controlled entities and associated companies).

As the first step of the analysis, the relevant activities of the investees were considered. Subsequently the Bank analyzed to what extent the Group is exposed to variable returns from its involvement with the investees, as well as whether through its voting rights, delegated officers or other contractual rights the Group is able to affect those returns, namely it has power over the investees.

Investees that are not material to the Group, were exempted from the group of consolidation. Subsidiaries were excluded as well, in case two of the following conditions are jointly met:

- the net revenues are less than HUF 500 million,
- the share capital is less than HUF 500 million, and
- the amount of total assets is less than EUR 10 million.

Jointly controlled entities and associated companies (using equity method of accounting) can be exempted from the consolidation, if two of the following conditions are jointly met:

- the Group’s share in net assets is less than HUF 500 million, and
- the Group’s share in the current year change of shareholders’ equity is less than HUF 200 million, because those investees are not considered material,
- the Group’s amount of total assets is less than EUR 10 million, and
- the Group’s exposure is less than HUF 500 million.

In case one of the subsidiaries of the exempted subsidiaries is to be consolidated based on the above thresholds, then the previously exempted subsidiary must be consolidated as well.

Furthermore the Bank can exempt the subsidiary, jointly controlled entity and associated company from the group of consolidation, if:

- the headquarter is situated in a country, where the legal system does not allow the submission of the necessary data and information,
- the consolidation would lead to misleading results (particularly, in case the duration of the control or the participation is foreseen to be less than one year),
- MKB’s ability to control the investee is restricted legally or contractually,

Data in HUF million except stated otherwise

- without these entities, the consolidated financial statements of the Group provide a true and fair view about the financial position and performance of the Bank and other subsidiaries. In case there are more subsidiaries complying with this requisite, they must be examined together, whether the exemption of these entities distort the true and fair value of the parent company and other subsidiaries, namely the sum of the total assets and contingent liabilities individually and collectively are less than 2 % of total assets of the parent company.
- Financial service companies and auxiliaries with total assets less than EUR 10 million, and are below the thresholds related to net revenues and share capital, are not considered material.
- In case the entities do not reach the minimum of the defined conditions individually, but they exceed those collectively, they cannot be considered negligible, the Bank does not exempt them from the group of consolidation.

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

5.1

**2017**

| 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 | Workout activities |
| 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 Employee Share Ownership Program |
| MKB Bank Teljesítményjavadalmazási MRP szervezete | 0,00% | 0,00% | Hungary | Special purpose entity for Employee Share Ownership 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 |

**2016**

| 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 | Workout activities |
| 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. | 99,00% | 99,00% | Hungary | Mortgage loan refinancing |
| MKB Bank MRP Szervezet | 37,50% | 0,00% | Hungary | Special purpose entity for Employee Share Ownership 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 |

**The conclusions related to the entities examined, broken down by activities**

**a) Vehicle financing:**

**Euroleasing Group**

**MKB-Euroleasing Zrt.**

Based on the contract signed on 12 June 2015 by MKB Bank Zrt. and the former co-owners of Euroleasing Group, the Bank obtained 100% direct ownership and voting rights in the company, in which the participation was 50% previously. In 2015, four new members of the Supervisory Board and also four new members of the Board of Directors were appointed by the Bank. Since 2017, the members of the Supervisory Board and the Chairman of the Board of Directors have been delegated by the Bank. Refinancing is solely provided by MKB.

**MKB-Euroleasing Autóhitel Zrt.**

In accordance with the above mentioned transaction of Euroleasing Group, the Bank has 74% direct ownership in MKB-Euroleasing Autóhitel Zrt. (hereinafter: Autóhitel), and furthermore 26% indirect ownership through MKB-Euroleasing Zrt., therefore it owns 100% of the voting rights. The Bank influences directly the important decisions related to relevant activities through managing bodies and regular professional collaboration and it takes part in the preparations of important regulations (accounting and risk policies). In 2015, the Bank nominated new members to the Board of Directors and to the Supervisory Board. The Chairman of the Board of Directors and all members of the Supervisory Board have been delegated by MKB, since 2017. The Bank is exposed significantly to the variable returns from Autóhitel, as the financing of the company is solely ensured by the Bank, so its operation is directly depending on it. From September 2015, as MKB possesses all these rights, it can alone influence the relevant activities and affect the total returns.

Based on these facts and also according to IFRS 10 MKB concluded that there exists control over Autóhitel, so it is consolidated as a subsidiary in the Group financial statements.

**MKB-Euroleasing Autólízing Zrt.**

MKB has no direct participation in MKB-Euroleasing Autólízing Zrt. (hereinafter: Autólízing); it has only indirect ownership of 70% through MKB-Euroleasing Autóhitel Zrt., and 30% through MKB-Euroleasing Zrt. The Bank is significantly exposed to the variable returns of the company. Since 2015, the MKB Bank Zrt. has nominated members to the Supervisory Board and to the Board of Directors. From 2017, all members of the Supervisory Board and the Chairman of the Board of Directors are appointed by the Bank. Consequently the Bank is able to influence the important decisions related to the relevant activities. Autólízing is financed solely by MKB, so its operation directly depends on the Bank. As a result of having 100% indirect ownership in Autólízing, the Bank is able to affect its total returns, therefore it controls its investee and consolidates Autólízing as a subsidiary.

**Retail Prod Zrt.**

In 2015, Retail Prod Zrt. became part of the Group of consolidation as a subsidiary of MKB-Euroleasing Zrt. which has 100% ownership and voting rights in Retail Prod Zrt. The main activity of the company is car and consumer financing. Since 2015, the MKB Bank Zrt. has nominated new members to the Board of Directors and to the Supervisory Board. From 2017, MKB Bank Zrt. delegates all members of the Supervisory Board and the Chairman of the Board of Directors, therefore through these bodies and by common regulations and risk management the Bank is able to directly influence the important decisions related to the relevant activities. As a result of the acquisition of Retail Prod Zrt., HUF 604 million gain was recognized and disclosed in Other operating income/(expense), net in the financial statements for 2015 without any changes since then. In order to cover the risks and potential contingent liabilities identified in the portfolio of the acquiree the Group recognized provision for liabilities. At the end of the reporting period the balance of the provision amounted to HUF 412 million.

**b) Workout activity related to lending**

Exter-Adósságkezelő Kft.
Extercom Kft.

MKB owns 100% of the above two entities, resulting that the Bank is fully exposed to the companies' variable returns. Due to the 100% of ownership and voting rights, the Bank is entitled to delegate chief officers, and so could controls the relevant activities. Financing is provided fully by MKB. Consequently the above entities are disclosed as subsidiaries in the financial statements of the Group.

**c) Managing**

**Handling of Property, plant and equipment and Intangible assets, providing services**

MKB Üzemeltetési Kft.
Euro - Immat Üzemeltetési Kft.

**Management of investment funds**

MKB Befektetési Alapkezelő Zrt.
MKB-Pannónia Alapkezelő Zrt. (minority interest)

On 19 October 2017, MKB Bank Zrt. acquired 49% minority interest in Pannónia CIG Alapkezelő Zrt. by raising capital. Due to the transaction share capital rose to HUF 306 120 000. MKB is not able to affect the variable returns and control the relevant activities; therefore it was consolidated with equity method. The company was renamed MKB-Pannónia Alapkezelő Zrt. and its headquarters and location also changed. Az MKB Alapkezelő Zrt. transferred the managed assets to MKB-Pannónia Alapkezelő Zrt. on 1 December 2017.

**Issuance of SZÉP card, support of health and pension funds:**

MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft.

The Bank owns generality of these entities' 100% of the shares and has 100% of the voting rights. Accordingly MKB is entitled to appoint chief executives, and so could controls the relevant activities. The deposits related to SZÉP cards are handled by the Bank. Consequently these entities are disclosed as subsidiaries in the financial statements of the Group.

**d) Specialized credit institutions**

**MKB Jelzálogbank Zrt.**

In order to comply with the laws and take advantages of the business opportunities originating from new regulations, MKB Bank Zrt. decided to establish a new mortgage bank. MKB Jelzálogbank Zrt. (hereinafter: Jelzálogbank) was registered during 2016 with HUF 4 billion total equity, of which the main shareholder was MKB Bank Zrt. with 99 % participation, while Gránit Bank Zrt. held 1% of the shares. In October 2017, MKB Bank acquired 100% ownership and voting rights in the company by acquisition of 1% of the shares. The main role of this specialized credit institution is to refinance mortgage loans granted by commercial banks through financing by issuing mortgage bonds. The operating permission of Jelzálogbank was expected to be obtained during 2017, however in January 2018, the Bank decided to terminate the project relating to the establishment and repeal this proceedings, meanwhile

MKB Bank Zrt. reserves the opportunity to establish own mortgage bank later on. Jelzálogbank is disclosed as a subsidiary in the Group financial statements in 2017.

### e) Employee Share Ownership Program

On 14 July 2016 MKB Bank established the Employee Share Ownership Program (ESOP). This organization was established in order to fulfill the objectives of the Bank's remuneration policy of the Bank which is its only relevant activity of the organization. The Bank is exposed to the variable returns of the organization, as after the completion of the program the Bank is entitled to the surplus assets remained and has to reimburse any loss accumulated. Based on these facts, MKB Bank controls the Employee Share Ownership Program and discloses it as a special purpose entity in the Group financial statements.

On 14 November 2017 MKB Bank established and registered another MRP organization ("MRP organization") to fulfill the objectives of remuneration policy on allowance of top management outside the organization in accordance with regulation 33/2011/MNB. The remuneration package is granted as share-based payments and bonds, and the amount of these instruments depends on the Bank's performance. The agreement on the right to buy was established on 17 November 2017 between MKB Bank Zrt. and the special purpose entity. MKB Bank controls the MRP organization, consolidates and discloses it as a special purpose entity in the Group financial statements.

### f) Other entities sold or deconsolidated during the financial year

In 2017, the Bank did not sell or deconsolidated any entities, hence the consolidation group has not changed during the year.

### g) Non-consolidated entities

Investees owned by the Group or the percentage of equity owned by the Group that are not material and therefore exempted from the group of consolidation are listed below:

Subsidiaries:

- Exter-Estate Kft.
- Medister Kft.
- Exter-Reál Kft.
- Exter-Immo Zrt.
- MKB Consulting Kft.
- Euroleasing Kft.
- I.C.E. Kft.
- MKB Inkubátor Kft.
- MKB Kockázati Tőkealapkezelő Kft.

Associates:

- Pannonhalmi Apátsági Pincészet Kft.

Other affiliated entities:

- Core-Solutions Kft.
- Trend Zrt.
- Garantiqa Hitelgarancia Zrt.
- Kisvállalkozásfejlesztő Pénzügyi Zrt.
- SWIFT
- Budapesti Értéktőzsde Zrt.
- Arete Zrt.
- CIG Pannónia Életbiztosító Nyrt.
- Elevator Lending Kft.
- Family Finances Kft.
- Fintechblocks Kft.
- Primus Capital Kockázati Tőkealap-kezelő Zrt.

# 6 Risk management

## a, Introduction and overview

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

Risk management is an integral part of the Group's operations and a crucial component of its business and overall financial performance. The MKB Group's risk management framework has been designed to foster 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 Group'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 Group 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 Group.

The Group 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 stemming 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 akin 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 and reputational 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 stemming 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.

- real estate risk:
  Real estate risk covers potential losses that could result from fluctuations in the market value of real estate owned by MKB Group. 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 Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

## b, Risk management governance

The Group'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 aim at ensuring 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 Group 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 Group 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;<br>- Management of the company, and steers the company's internal audit organization;<br>- 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;<br>- Tasks related to the shares and dividend;<br>- Tasks related to the company's organization and scope of activities;<br>- Tasks related to strategic planning (preparation of the business policy and financial plan, and approval of the risk strategy);<br>- Approves the policies related to risk assumptions;<br>- Evaluation of regular and ad-hoc risk reports. |
| **Managing Committee** | - Highest level operational decision preparation and decision making body;<br>- 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;<br>- 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;<br>- Decision-making competency for credit decisions on deals handled by the Directorate according to the Risk Decision Competence Regulation;<br>- 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;<br>- 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:<br>▪ measurement guidelines and limit system for the above risks;<br>▪ competence and decision-making mechanism;<br>▪ 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;<br>- Assesses the position of the banking group through industry and competition analyzes;<br>- Embracing new business, digital and other innovative initiatives, as well as product development proposals;<br>- 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;<br>- 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;<br>- 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 Group'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 Group considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

### *Credit risk management*

The members of the Group have standards, policies and procedures dedicated to the effective monitoring and managing risk from lending (including debt securities) activities. The Bank sets a requirement for the Group members to elaborate and publish their own regulations that comply with the Group-level rules approved by it. The risk management of the members of the MKB Group control and manage credit risks at high standards, in a centralised manner. Its responsibilities include:

- Formulating the Group member'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 Group.

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

- Establishing and maintaining the Group members' 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 Group members' 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 Group members in credit risk management.

Each group member must implement and apply the credit policy, harmonised at group level, with credit approval authorities delegated by the authorised decision maker bodies. Each Group member must prepare regular and ad hoc reports to the local management and, in certain cases, to the Group leader covering the major cases and events of lending. Each group member is responsible for the quality and results of its credit portfolio and for monitoring and controlling all credit risks in its portfolios. This includes managing its own risk concentrations by market sector, geography and product. The control systems applied by the Group enable the Group members 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.

With regards to the management of concentration risks, MKB Bank Group 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 avoiding 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 Group, available on our website www.mkb.hu.

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

Data in HUF million except stated otherwise

## 6.1

| 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 |
|---|---|---|---|---|---|---|
| ***Individually impaired*** | | | | | | |
| Non-default | - | - | 8 123 | - | - | 2 021 |
| Default | - | - | 101 880 | - | - | 1 049 |
| Total individually impaired gross amount | - | - | 110 003 | - | - | 3 070 |
| Total individually impaired allowance for impairment | - | - | (71 990) | - | - | (1 585) |
| **Total individually impaired carrying amount** | **-** | **-** | **38 013** | **-** | **-** | **1 485** |
| ***Collectively impaired*** | | | | | | |
| Non-default | - | 19 105 | 736 707 | - | - | 440 362 |
| Default | - | - | 124 | - | - | - |
| Total collectively impaired gross amount | - | 19 105 | 736 831 | - | - | 440 362 |
| Total collectively impaired allowance for impairment | - | (8) | (7 769) | - | - | (4 531) |
| **Total collectively impaired carrying amount** | **-** | **19 097** | **729 062** | **-** | **-** | **435 831** |
| ***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 | - | - | 207 | - | - | - |
| **Total past due but not impaired carrying amount** | **-** | **-** | **384** | **-** | **-** | **-** |
| ***Neither past due nor impaired*** | | | | | | |
| Non-default | 31 599 | 58 920 | 91 253 | 902 010 | 19 757 | 112 492 |
| Default | - | - | 57 | - | - | 1 948 |
| **Total neither past due nor impaired carrying amount** | **31 599** | **58 920** | **91 310** | **902 010** | **19 757** | **114 440** |
| Includes receivables with renegotiated terms | | | | | | |
| **Total gross amount** | **31 599** | **78 025** | **938 351** | **902 010** | **19 757** | **557 872** |
| **Total allowance for impairment** | **-** | **(8)** | **(79 759)** | **-** | **-** | **(6 116)** |
| **Total carrying amount** | **31 599** | **78 017** | **858 592** | **902 010** | **19 757** | **551 756** |

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

| 2016 | 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 |
|---|---|---|---|---|---|---|
| ***Individually impaired*** | | | | | | |
| Non-default | - | - | 41 537 | - | - | 253 |
| Default | - | - | 162 003 | - | - | 1 787 |
| Total individually impaired gross amount | - | - | 203 540 | - | - | 2 040 |
| Total individually impaired allowance for impairment | - | - | (100 086) | - | - | (1 842) |
| **Total individually impaired carrying amount** | **-** | **-** | **103 454** | **-** | **-** | **198** |
| ***Collectively impaired*** | | | | | | |
| Non-default | - | 16 289 | 721 580 | - | - | 247 887 |
| Default | - | - | 4 344 | - | - | 667 |
| Total collectively impaired gross amount | - | 16 289 | 725 924 | - | - | 248 554 |
| Total collectively impaired allowance for impairment | - | (7) | (11 645) | - | - | (5 278) |
| **Total collectively impaired carrying amount** | **-** | **16 282** | **714 279** | **-** | **-** | **243 276** |
| ***Past due but not impaired*** | | | | | | |
| Non-default | - | - | 1 | - | - | - |
| Default | - | - | 217 | - | - | - |
| **Total past due but not impaired carrying amount** | **-** | **-** | **218** | **-** | **-** | **-** |
| *Past due comprises:* | | | | | | |
| up to 30 days | - | - | - | - | - | - |
| 30 to 90 days | - | - | - | - | - | - |
| over 90 days | - | - | 218 | - | - | - |
| **Total past due but not impaired carrying amount** | **-** | **-** | **218** | **-** | **-** | **-** |
| ***Neither past due nor impaired*** | | | | | | |
| Non-default | 97 914 | 50 757 | 36 552 | 923 590 | 14 372 | 219 470 |
| Default | - | - | 3 569 | - | - | 822 |
| **Total neither past due nor impaired carrying amount** | **97 914** | **50 757** | **40 121** | **923 590** | **14 372** | **220 292** |
| **Total gross amount** | **97 914** | **67 046** | **969 803** | **923 590** | **14 372** | **470 886** |
| **Total allowance for impairment** | **-** | **(7)** | **(111 731)** | **-** | **-** | **(7 120)** |
| **Total carrying amount** | **97 914** | **67 039** | **858 072** | **923 590** | **14 372** | **463 766** |

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

Data in HUF million except stated otherwise

### *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 2017 the Group 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 isenforceable only in case of the following events such as a default, insolvency or bankruptcy of the Group or its counterparties. In addition the Group 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 Group 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.

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.

6.2

| 31 December 2017 | IAS 32.42 | | | similar netting arrangement | | | Net amount of financial assets after offsetting/ similar agreement /collaterals 12/2017 |
|---|---|---|---|---|---|---|---|
| Offsetting financial assets | 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 | IAS 32.42 | | | similar netting arrangement | | | Net amount of financial liabilities after offsetting/ similar agreement /collaterals 12/2017 |
|---|---|---|---|---|---|---|---|
| Offsetting financial liabilities | 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** |

Data in HUF million except stated otherwise

| 31 December 2016<br>Offsetting financial assets | IAS 32.42 | | | similar netting arrangement | | | Net amount of financial assets after offsetting/ similar agreement /collaterals 12/2015 |
|---|---|---|---|---|---|---|---|
| | 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 | 5 042 | - | 5 042 | 772 | 506 | 1 278 | 3 764 |
| **Receivables concerning repos** | | | | | | | |
| Loans and advances to customers | 1 951 | - | 1 951 | - | 2 229 | 2 229 | (278) |
| **Financial assets under netting agreements** | **6 993** | **-** | **6 993** | **772** | **2 735** | **3 507** | **3 486** |

| 31 December 2016<br>Offsetting financial liabilities | IAS 32.42 | | | similar netting arrangement | | | Net amount of financial liabilities after offsetting/ similar agreement /collaterals 12/2015 |
|---|---|---|---|---|---|---|---|
| | 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 | 10 628 | - | 10 628 | 771 | 8 080 | 8 851 | 1 777 |
| **Liabilities concerning repos** | | | | | | | |
| Deposit and current accounts | 2 470 | - | 2 470 | - | 2 482 | 2 482 | (12) |
| **Financial liabilities under netting agreements** | **13 098** | **-** | **13 098** | **771** | **10 562** | **11 333** | **1 765** |

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.j) )
- Negative fair values of derivative financial instruments – fair value (please refer to Note 4.j) )
- Loans and advances to customers – amortized cost, pledged collateral – fair value
- Deposits and current accounts – amortized cost, pledged collateral – fair value

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

6.3

| 31 December 2017<br>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 | - | 858 592 | 858 592 |

| 31 December 2017<br>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 | 1 539 140 | 1 538 651 |

| 31 December 2016<br>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 | 5 042 | 75 210 | 70 168 |
| Loans and advances to customers | 1 951 | 858 072 | 856 121 |

| 31 December 2016<br>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 | 10 628 | 29 983 | 19 355 |
| Deposits and current accounts | 2 470 | 1 519 868 | 1 517 399 |

### *Credit (deal) classification system*

The Group'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 accounts, classifications are reviewed regularly and amendments, where necessary, are implemented at least quarterly in terms of provisions or exposure classification. Exposures below specific amounts are assessed in groups, in relation to which the provisions are reviewed at least yearly or, more frequently if required, in line with the changes of the main economic conditions. The possible types of exposure handling are: normal, intensive and problematic. The type of exposure handling is determined by a set of criteria defined in internal regulation based on relevant indicators warning of the customer or the transaction being problematic. There is a correlation between the provision amount and handling types. Only such customers may be managed within the framework of the normal or intensive procedures, related to whom there is no individual (not Incurred Loss) provision booked. Individual provision making involves problematic handling parallel in each and every case.

The units responsible for the customers monitor exposures on an ongoing basis and in the case of default it has to be ensured that the customer is transferred to the appropriate type of customer handling (intensive or problematic).

Periodic risk-based audits of the Group's credit processes and portfolios are undertaken by the Group's Internal Audit function. During the audits, the auditors check the adequacy, and consistency with the regulations, as well as clarity, of credit regulations and the consistency between the regulations and the practice; an in-depth analysis of a representative sample of accounts; consideration of any oversight or review work performed by credit risk management functions and the adequacy of impairment calculations and a check that Group and local standards and policies are adhered to in the approval and management of credit facilities.

### *Impaired loans and securities, off-balance sheet items with provision allocated*

Impaired loans and securities are those for which the Group estimates that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan / securities agreement(s).

When impairment losses occur, the Group reduces the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets occurs, the carrying amount of the asset is reduced directly against net profit. Two types of impairment allowance are in place: individually assessed and collectively assessed, as discussed below.

In determining the provision of off-balance sheet items, for items subject to individual assessment, the probability of the potential losses is taken into account.

#### Individually allocated impairment and provision

In determining the level of allowances on individually significant loans, the Group applies the discounted cash flow method. The amount and timing of expected receipts and recoveries and the value of collateral and likelihood of successfully realizing it are considered in estimating the allowance.

Cash-flow calculations for items in normal care management, are not mandatory to be performed in cases if no predefined Impairment Trigger occurred, and a current limit review proposal or monitoring report not older than three months is available.

Individually assessed impairment allowances and provisions are only reversed when there is reasonable and objective evidence of a reduction in the established loss estimate.

In case of provision calculation of contingent liabilities the likelihood of turning into a balance sheet item is to be defined and taken into consideration.

**Collectively allocated impairment and provision**

Collectively assessed provision is allocated for the following three main portfolios:

- retail customer exposures
- wholesale customers that are not considered individually significant, such as
    - balances up to HUF 250 million in the case of wholesale customers managed by Wholesale Risk departments,
    - customers with less than HUF 125 million total exposures in the case of wholesale customers managed by Corporate Restructuring and Debt Management Directorate, or
- Deals for which provisions have not been allocated individually (rated as Pass).

*Homogeneous groups of loans (group assessment)*

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.

In case of retail 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 Provision (SLLP) is accumulated.

*Collectively assessed provision for wholesale customers*

In case of individually not significant wholesale customers the calculated impairment and provision are based on internal rating based method:

The required provisioning rates are calculated based on the statistical analysis of default (PD), the value of loss given default (LGD) and the credit conversion factor (CCF).

In case of individually assessed items where no specific provision has been set aside the impairment and provision have to be calculated based on the above detailed method.

On the performing wholesale clients Incurred Loss is calculated, whilst on the default clients Specific Loan Loss Provision (SLLP) is calculated on monthly basis.

### *Past due but not impaired loans*

Loans and securities are presented as past due but not impaired where contractual interest or principal payments are past due but the Group believes that the allocation of provision is not appropriate on the basis of the level of security / collateral available and/or the stage of collection of amounts owed to the Group.

### *Write-off policy*

The Group, 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 Group 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:

6.4

| 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** |

| 2016 | Loans and advances | Guarantees and contingencies | Letter of credit | Undrawn credit |
|---|---|---|---|---|
| **Cash deposit** | 11 792 | 9 893 | 17 | 298 |
| **Debt securities issued by** | | | | |
| Central governments | 26 802 | 214 | - | - |
| Companies | 4 186 | 57 | - | 420 |
| **Mortgage** | | | | |
| Building (incl. plot) | 325 695 | 7 163 | 5 717 | 19 698 |
| Other (ship, patent, chattel, goods stock, lien on assets over total assets, etc.) | 40 356 | 2 638 | 202 | 5 258 |
| **Guarantees from** | | | | |
| Central governments | 93 926 | 47 029 | 10 986 | 25 377 |
| Other banks | 1 406 | 772 | - | - |
| Companies | 11 435 | 5 125 | - | 426 |
| **Others** | 72 840 | - | 10 | 12 969 |
| **Total collateral** | **588 438** | **72 891** | **16 932** | **64 446** |

**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).

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 tha 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 Group obtained the following assets by taking possession of collateral held as security, or exercising other credit enhancement options:

6.5

| | 2017 | 2016 |
|---|---|---|
| *Non-financial assets* | | |
| Inventories | 26 | 18 |
| **Total assets obtained** | **26** | **18** |

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

### *Concentrations*

The Group 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:

Data in HUF million except stated otherwise

6.6

| 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 | 9 141 | - | 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** | **49 116** | **112 275** | **9 956** | **12 347** |

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

| 2016 | 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 | - | 13 154 | 11 809 | - | 739 | 3 137 |
| Category II - with low to medium country risk | - | 4 590 | 29 486 | - | 2 341 | 3 770 |
| Category III - with medium to high country risk | - | 584 | 4 600 | - | 5 | 112 |
| **Total exposure** | **-** | **18 328** | **45 895** | **-** | **3 085** | **7 019** |

* 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

6.7

| 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 | 14 499 | 846 609 | 79 | 58 650 |
| Private | - | - | 273 370 | - | 902 | 10 331 |
| Financial institution | - | 23 981 | 59 972 | 40 136 | 11 462 | 42 457 |
| Real estate | - | - | 79 190 | - | 4 122 | 10 635 |
| Other | 21 446 | 10 306 | 511 320 | 15 967 | 3 192 | 435 799 |
| **Total exposure** | **31 599** | **78 025** | **938 351** | **902 712** | **19 757** | **557 872** |

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

| 2016 | 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 | 64 322 | 40 429 | 6 203 | 901 925 | 783 | 64 737 |
| Private | - | - | 342 739 | - | 166 | 8 043 |
| Financial institution | - | 23 625 | 37 850 | 6 151 | 5 329 | 27 944 |
| Real estate | - | - | 120 156 | - | 4 730 | 3 964 |
| Other | 33 592 | 2 992 | 462 854 | 16 061 | 3 364 | 368 174 |
| **Total exposure** | **97 914** | **67 046** | **969 802** | **924 137** | **14 372** | **472 862** |

* 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, manufactoring and engineering sectors.

## d, Liquidity risk

Liquidity risk is the risk that the Group'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 Group'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 Group's reputation.

Data in HUF million except stated otherwise

The Group requires its operating entities to maintain a strong liquidity position and to manage the liquidity profile of their assets, liabilities and commitments with the objective of ensuring that cash flows are appropriately balanced and all obligations can be met when due.

The management of liquidity and funding is primarily carried out locally in the operating entities of the Group in accordance with practices and limits set by the Board of Directors. These limits vary by entity to take account of the depth and liquidity of the market in which the entity operates. It is the Group's general policy that each banking entity should be self-sufficient with regards to funding its own operations.

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

6.8

| 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 | (239 312) | (251 494) | (11 658) | (843) | (23 497) | (101 593) | (113 903) |
| Deposits and current accounts | (1 539 140) | (1 532 055) | (1 323 330) | (60 918) | (69 277) | (78 471) | (59) |
| Issued debt securities | (10 624) | (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) |
| *Loans and advances* | 936 609 | - | - | - | - | - | - |

| 2016 | 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 | (376 262) | (386 511) | (163 229) | (3 236) | (7 626) | (129 297) | (83 123) |
| Deposits and current accounts | (1 519 868) | (1 498 905) | (1 294 518) | (115 649) | (43 419) | (44 654) | (665) |
| Issued debt securities | (12 892) | (12 702) | - | - | (1 739) | (10 963) | - |
| *Financial liabilities measured at FVTPL* | | | | | | | |
| Trading: outflow | - | (388 479) | (141 873) | (107 427) | (84 878) | (33 664) | (20 637) |
| Trading: inflow | - | 364 165 | 132 961 | 98 817 | 70 052 | 38 574 | 23 761 |
| *Loan commitments* | - | (236 124) | (3 693) | (17 496) | (120 846) | (63 440) | (30 649) |
| *Loans and advances* | 925 111 | - | - | - | - | - | - |

The above table shows the undiscounted cash flows of the Group'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 Group'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 Group's risk management department use both analyses to manage liquidity risk. The expected, undiscounted cash-flows of the Group's financial liabilities were as follows:

Data in HUF million except stated otherwise

## Expected maturity of liabilities

6.9

| 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 | (239 312) | (251 494) | (11 658) | (843) | (23 497) | (101 593) | (113 903) |
| Deposits and current accounts | (1 539 140) | (1 533 757) | (124 437) | (4 903) | (10 270) | (9 721) | (1 384 426) |
| Issued debt securities | (10 624) | (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* | - | (46 477) | (16 492) | (29 985) | - | - | - |
| *Loans and advances* | 936 609 | | - | - | - | - | - |

| 2016 | 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 | (376 262) | (386 511) | (163 229) | (3 236) | (7 626) | (129 297) | (83 123) |
| Deposits and current accounts | (1 519 868) | (1 502 095) | (107 796) | (14 501) | (4 951) | (11 682) | (1 363 165) |
| Issued debt securities | (12 892) | (12 702) | - | - | (1 739) | (10 963) | - |
| *Financial liabilities measured at FVTPL* | | | | | | | |
| Trading: outflow | - | (388 479) | (141 873) | (107 427) | (84 878) | (33 664) | (20 637) |
| Trading: inflow | - | 364 165 | 132 961 | 98 817 | 70 052 | 38 574 | 23 761 |
| *Loan commitments* | - | (37 780) | (12 987) | (24 793) | - | - | - |
| *Loans and advances* | 925 111 | - | - | - | - | - | - |

The decision of the Management of the Group, 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.

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

6.10

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Up to 1 year | Over 1 year | Up to 1 year | Over 1 year |
| Loans and advances to banks | 65 579 | 12 446 | 60 658 | 6 388 |
| Loans and advances to customers | 132 425 | 805 927 | 121 683 | 848 119 |
| Financial assets measured at FVTPL | 52 398 | 19 921 | 48 012 | 27 198 |
| Investments in AFS securities | 158 465 | 184 929 | 152 963 | 420 428 |
| HTM Debt securities | 152 | 559 167 | 3 344 | 347 402 |

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 79,759 million (2016: HUF 111,731 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 Group'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 Group 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 Group. At the operational level, market risk is managed by the Money and Capital Markets Directorate on a group-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 Group 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 Group 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 Group's retail and commercial banking activity and the interest rate management of the Group's retail and commercial banking assets and liabilities. The Group'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 Group 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 Group 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 Group 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 Group 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.

Data in HUF million except stated otherwise

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.
- The VaR measure is dependent upon the Group'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 Group's Risk Unit and regular summaries are submitted to ALCO.

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

6.11

| 2017 | Average | Maximum | Minimum | Stress (15%) |
|---|---|---|---|---|
| Foreign currency risk | 38 | 126 | 4 | 420 |
| Interest rate risk | 41 | 79 | 8 | - |
| Equity risk | - | 1 | - | - |
| **Overall market risk of trading book** | **79** | **206** | **12** | **420** |
| Credit spread risk of trading book | 50 | 92 | 17 | - |

| 2016 | Average | Maximum | Minimum | Stress (15%) |
|---|---|---|---|---|
| Foreign currency risk | 42 | 131 | 2 | 513 |
| Interest rate risk | 46 | 102 | 15 | - |
| **Overall market risk of trading book** | **88** | **233** | **17** | **513** |
| Credit spread risk of trading book | 62 | 86 | 23 | - |

**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 the MKB Group position.
- MKB Group 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 420 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 Group'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 Group's interest-bearing financial instruments was:

6.12

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 | 1 096 318 | 7 516 | 244 287 | 3 944 | 2 408 |
| Financial liabilities | (1 059 946) | (4 802) | (252 565) | (86 260) | (10 334) |
| **Total variable rate financial instruments** | **36 372** | **2 714** | **(8 278)** | **(82 316)** | **(7 926)** |

As at 31 December 2016

| Fixed rate instruments | in HUF millions |
|---|---|
| Financial assets | 855 786 |
| Financial liabilities | (1 060 946) |
| **Total fixed rate instruments** | **(205 160)** |

| Variable rate instruments | Denominated in HUF | CHF | EUR | USD | Other currencies |
|---|---|---|---|---|---|
| Financial assets | 904 736 | 26 478 | 217 906 | 2 881 | 3 729 |
| Financial liabilities | (625 795) | (5 428) | (240 219) | (67 210) | (8 284) |
| **Total variable rate financial instruments** | **278 941** | **21 050** | **(22 313)** | **(64 329)** | **(4 555)** |

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

6.13

As at 31 December 2017

| 2017 | Effect on equity | Effect on P/L |
|---|---|---|
| *HUF* | | |
| 200 bp increase | (15 742) | (1 992) |
| 200 bp decrease | 8 743 | (10 958) |
| *CHF* | | |
| 200 bp increase | (10) | (244) |
| 200 bp decrease | - | (58) |
| *EUR* | | |
| 200 bp increase | (275) | (107) |
| 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 | (6) |
| 200 bp decrease | (5) | (98) |

This report contains those subsidiaries which are monitored directly by MKB on monthly basis.

**2017**

| | | | in HUF millions |
|---|---|---|---|
| FCY | Yield curve stress + 200 Bp | Yield curve stress - 200 Bp | Adverse case |
| EUR | (275) | (266) | (275) |
| USD | 1 090 | (1 167) | (1 167) |
| CHF | (10) | - | (10) |
| GBP | 3 | (1) | (1) |
| JPY | 3 | - | - |
| Others | (15 737) | 8 739 | (15 742) |
| **Total** | **(14 926)** | **7 305** | **(17 195)** |

As at 31 December 2016

| 2016 | Effect on equity | Effect on P/L |
|---|---|---|
| *HUF* | | |
| 200 bp increase | (6 142) | (1 673) |
| 200 bp decrease | 4 504 | (10 406) |
| *CHF* | | |
| 200 bp increase | 5 | (418) |
| 200 bp decrease | - | (368) |
| *EUR* | | |
| 200 bp increase | (558) | 1 528 |
| 200 bp decrease | 104 | (1 545) |
| *USD* | | |
| 200 bp increase | 1 387 | (528) |
| 200 bp decrease | (1 096) | (211) |
| *Other currencies* | | |
| 200 bp increase | 25 | 10 |
| 200 bp decrease | (16) | (69) |

This report contains those subsidiaries which are monitored directly by MKB on monthly basis.

| 2016 | | | |
|---|---|---|---|
| | | | in HUF millions |
| FCY | Yield curve stress + 200 Bp | Yield curve stress - 200 Bp | Adverse case |
| EUR | (558) | 104 | (558) |
| USD | 1 387 | (1 096) | (1 096) |
| CHF | 5 | - | - |
| GBP | 6 | (3) | (3) |
| JPY | 4 | (0) | (0) |
| Others | (6 127) | 4 491 | (6 127) |
| **Total** | **(5 283)** | **3 496** | **(7 784)** |

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:

6.14

| Effect of credit risk changes of liabilities measured at Fair Value Through Profit or Loss | 2017 | 2016 |
|---|---|---|
| Changes during the reporting period | 235 | 248 |
| Changes cumulatively (since designation of the financial liabilities) | (151) | (386) |
| Difference between the financial liability's carrying amount and the amount contractually required to pay at maturity | 30 | 151 |

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 Group 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 Group's financial position in foreign currencies at the end of the reporting periods was as follows:

6.15

| 2017 | In functional currencies | In foreign currencies USD | EUR | CHF | Other | Total |
|---|---|---|---|---|---|---|
| Financial assets except for derivatives | 1 671 957 | 11 236 | 351 751 | 8 154 | 3 341 | 2 046 439 |
| Financial liabilities except for derivatives | 1 535 974 | 120 740 | 367 046 | 7 361 | 15 318 | 2 046 439 |
| Net derivative and spot instruments (short) / long position | (137 072) | 111 300 | 14 609 | (771) | 11 934 | - |
| **Total net currency positions** | **(1 089)** | **1 796** | **(686)** | **22** | **(43)** | **-** |

| 2016 | In functional currencies | In foreign currencies USD | EUR | CHF | Other | Total |
|---|---|---|---|---|---|---|
| Financial assets except for derivatives | 1 752 897 | 8 105 | 307 729 | 28 336 | 4 549 | 2 101 616 |
| Financial liabilities except for derivatives | 1 603 262 | 118 979 | 353 811 | 9 089 | 16 475 | 2 101 616 |
| Net derivative and spot instruments (short) / long position | (150 175) | 109 659 | 45 360 | (19 277) | 14 433 | - |
| **Total net currency positions** | **(540)** | **(1 215)** | **(722)** | **(30)** | **2 507** | **-** |

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:

6.16

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| ***Assets of the reporting institution*** | | | | |
| Loans on demand | 431 | 431 | 49 192 | 49 192 |
| Debt securities | 145 639 | 148 237 | 288 494 | 288 149 |
| Loans and advances other than loans on demand | 53 901 | - | - | - |
| **Total encumbered assets** | **199 971** | **148 668** | **337 686** | **337 341** |

6.17

| | | 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 2017** | | | |
| *Collateral received by the reporting institution* | | | |
| Loans on demand | - | 1 842 | - |
| Other collateral received | - | - | 375 218 |
| **Collateral received and own debt securities issued** | **-** | **1 842** | **375 218** |
| **31 December 2016** | | | |
| *Collateral received by the reporting institution* | | | |
| Loans on demand | - | 2 336 | - |
| Other collateral received | - | - | 419 969 |
| **Collateral received and own debt securities issued** | **-** | **2 336** | **419 969** |

6.18

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | 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* | *153 613* | *199 971* | *289 501* | *337 686* |
| Derivatives | 35 155 | 95 298 | 24 842 | 49 936 |
| Deposits | 118 458 | 104 673 | 264 659 | 287 750 |
| Repurchase agreements | 489 | 514 | 2 471 | 2 485 |
| Collateralised deposits other than repurchase agreements | 117 969 | 104 159 | 262 188 | 285 265 |
| **Total Sources of encumbrance** | **153 613** | **199 971** | **289 501** | **337 686** |

At the end of 2017 the total size of encumbered assets was 9,76% of the total balance sheet. The majority of MKB Group'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 Group’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 Directorate. Group’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 Group 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 and on MKB-group level.

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

## *Capital allocation*

The Bank measures the pillar 1 and pillar 2 risks and the Group'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 Group operational risk capital requirements.

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.

Data in HUF million except stated otherwise

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.

6.19

| | 2017 Basel III IFRS | 2016 Basel III IFRS |
|---|---|---|
| Share capital | 100 000 | 100 000 |
| *Outstanding share capital* | *100 000* | *100 000* |
| Reserves | 37 124 | 21 899 |
| Intangible assets | (12 567) | (8 446) |
| AVA - additional valuation adjustments | (464) | (689) |
| **Additional Tier 1** | **-** | **-** |
| **Tier 1: Net core capital** | **124 093** | **112 764** |
| Subordinated debt | 22 307 | - |
| **Tier 2: Supplementary capital** | **22 307** | **-** |
| **Regulatory capital** | **146 400** | **112 764** |
| Risk-weighted assets (RWA) | 750 832 | 758 269 |
| Operational risk (OR) | 173 370 | 165 167 |
| Market risk positions (MR) | 6 549 | 13 368 |
| **Total risk weighted assets** | **930 751** | **936 804** |
| Regulatory capital / Total assets | 7,16% | 5,37% |
| Tier1 ratio | **13,33%** | **12,04%** |
| **Capital adequacy ratio** | **15,73%** | **12,04%** |

The table above contains the MKB Bank's consolidated capital adequacy ratio. Unconsolidated capital adequacy ratio is 20.1 % based on HAS.

As at 31 December 2017, as an actual figure of the Group regulatory capital was HUF 146.4 billion based on Basel III IFRS under Supervisory Regulation. The increase of regulatory capital - by HUF 33.6 billion – is derived from the increase of profit and subordinated debt, 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 0.65 % from HUF 936.8 billion in 2016 to HUF 930.8 besides approximately 0.28 % strengthening of domestic currency. The main part of the decrease derived from the decreasing market risk capital requirement and decrease of business volumes in work out and CRE segment 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 Group 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 Group, 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 Group 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 Group 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 Group generally applies the following types of forbearance measures:

Data in HUF million except stated otherwise

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

Besides the Group’s internal forbearance initiatives, the home protection measures in the retail clientele launched by the Hungarian government, and set by legal regulations also result in forborn assets. Such assets include the preferential buffer account facility (“árfolyamgát”) granted pursuant to the act LXXV of 2011 on FX loans and the related original FX loan.
Such exposures and associated credit risks are managed, monitored and reported distinctly by specific restructuring and debt management units of the Group 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 by IAS 39.

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

6.20

| | Balance at 31.12.2017 | Balance at 31.12.2016 |
|---|---|---|
| **Corporate Banking** | | |
| Forbearence loans and advances based on actual restructured status | 17 688 | 28 994 |
| Allowances for impairment | (12 708) | (20 204) |
| Carrying amount | 4 980 | 8 790 |
| | | |
| **Retail and Private Banking** | | |
| Forbearence loans and advances based on actual restructured status | 36 816 | 50 862 |
| Provision | (17 366) | (16 350) |
| Carrying amount | 19 450 | 34 512 |
| **Total carrying amount** | **24 430** | **43 302** |

Data in HUF million except stated otherwise

# 7 Cash reserves

7.1

| | 2017 | 2016 |
|---|---|---|
| Cash and balances with Central Banks | 31 599 | 97 914 |
| **Cash reserves** | **31 599** | **97 914** |

The Group is required to maintain a minimum reserve with the National Bank of Hungary (NBH) equivalent to 1 % (2016: 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 14,572 million as at 31 December 2017 (2016: HUF 11,560 million). As at 31 December 2017, cash on hand amounted to HUF 14,823 million (2016: HUF 13,217 million).

# 8 Loans and advances to banks

8.1

| | 2017 | 2016 |
|---|---|---|
| Current and clearing accounts | 13 212 | 63 629 |
| Money market placements | 53 901 | - |
| Loans and advances | 10 912 | 3 417 |
| Less collective allowances for impairment | (8) | (7) |
| **Loans and advances to banks** | **78 017** | **67 039** |

***Collective allowances for impairment***

| | 2017 | 2016 |
|---|---|---|
| **Balance at 1 January** | **(7)** | **(50)** |
| Impairment loss for the year: | | |
| Charge for the year | (4) | (3) |
| Reversal | 3 | 45 |
| Effect of foreign currency movements | - | 1 |
| **Balance at 31 December** | **(8)** | **(7)** |

Data in HUF million except stated otherwise

# 9 Financial assets measured at FVTPL

9.1

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Cost | Fair value adjustment | Book value | Cost | Fair value adjustment | Book value |
| ***Debt and equity instruments*** | | | | | | |
| Government Treasury bills | 49 893 | 998 | 50 891 | 44 361 | 917 | 45 278 |
| Government bonds | 1 451 | 8 | 1 459 | 14 878 | 76 | 14 954 |
| Hungarian corporate sector bonds | 210 | 2 | 212 | 390 | 10 | 400 |
| Hungarian equities | - | - | - | 168 | 38 | 206 |
| **Total debt and equity instruments** | **51 554** | **1 008** | **52 562** | **59 797** | **1 041** | **60 838** |
| ***Derivative instruments by type*** | | | | | | |
| FX-based derivatives instruments | - | 2 555 | 2 555 | - | 3 176 | 3 176 |
| Index-based derivative instruments | - | 1 | 1 | - | 9 | 9 |
| Interest-based derivative instruments | - | 16 746 | 16 746 | - | 10 200 | 10 200 |
| Options | - | 455 | 455 | 1 472 | (485) | 987 |
| **Total derivative instruments** | **-** | **19 757** | **19 757** | **1 472** | **12 900** | **14 372** |
| **Total financial assets measured at FVTPL** | **51 554** | **20 765** | **72 319** | **61 269** | **13 941** | **75 210** |

# 10 Investments in securities

10.1

| | 2017 | 2016 |
|---|---|---|
| *Available-for-sale* | | |
| Hungarian Government bonds | 324 880 | 566 624 |
| Hungarian corporate sector bonds | 17 811 | 6 220 |
| Hungarian equities | 33 | 33 |
| Foreign equities | 702 | 547 |
| Less specific allowances for impairment | (33) | (33) |
| *Held-to-maturity* | | |
| Hungarian Government bonds | 484 676 | 283 569 |
| Hungarian corporate sector bonds | 74 643 | 67 177 |
| Less specific allowances for impairment | - | - |
| **Investment in securities** | **902 712** | **924 137** |
| ***Specific allowances for impairment*** | | |
| **Balance at 1 January** | (33) | (33) |
| Impairment loss for the year | - | - |
| **Balance at 31 December** | **(33)** | **(33)** |

Data in HUF million except stated otherwise

As at 31 December 2017, HUF 279,972 million (2016: HUF 384,281 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 2,466 million gain (2016: HUF 6,606 million gain) and NIL deferred tax asset and HUF 112 million deferred tax liability (2016: HUF 3 million deferred tax asset and HUF 12 million deferred tax liability) is disclosed.

In 2017, HUF 17,148 million (2016: HUF 16,236 million) gain was recognized in the income statement relating to AFS securities, which is a reclassification from other comprehensive income into profit or loss.

Related to the Held-to-maturity investments HUF 7,302 million (2016: HUF 4,549 million) interest income was recognized in the Statement of profit or loss during the year.

Until the end of the previous year, the Group reclassified debt securities out of Available-for-sale into Held-to-maturity category. The carrying amount of the investments reclassified amounted to HUF 243,467 million. The reclassification was the result of the decision made by ALCO, concerning the structure of the balance sheet of the Bank.

As at 31 December 2017, the carrying amount, the fair value and the amortized cost of all investments in debt instruments (included either in cash reserves or investments in securities), other than those classified as FVTPL are as follows:

10.2

| 2017 | Carrying amount | Fair value | Amortized cost |
|---|---|---|---|
| Investments in debt instruments classified as: | | | |
| Held-to-maturity investments | 559 319 | 564 322 | 559 319 |
| AFS financial assets | 343 393 | 343 393 | 340 351 |
| **Total** | **902 712** | **907 715** | **899 670** |

| 2016 | Carrying amount | Fair value | Amortized cost |
|---|---|---|---|
| Investments in debt instruments classified as: | | | |
| Held-to-maturity investments | 350 746 | 349 147 | 350 746 |
| AFS financial assets | 573 391 | 573 391 | 566 326 |
| **Total** | **924 137** | **922 538** | **917 072** |

Data in HUF million except stated otherwise

# 11 Loans and advances to customers

## Loans and advances to customers at amortised cost

11.1

| 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 | | | | |
| *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** |

| 2016 | Gross amount | Specific allowances for impairment | Collective allowances for impairment | Carrying amount |
|---|---|---|---|---|
| **Core business** | | | | |
| *Wholesale* | | | | |
| Refinancing | 52 172 | (947) | (515) | 50 710 |
| Funding for Growth Scheme | 81 963 | (429) | (965) | 80 569 |
| Factoring | 24 661 | (284) | (1 175) | 23 202 |
| Overdraft | 44 156 | (2 397) | (367) | 41 392 |
| Széchenyi Loans | 20 567 | (458) | (221) | 19 888 |
| Other | 297 894 | (31 254) | (3 102) | 263 538 |
| ***Total Wholesale*** | ***521 413*** | ***(35 769)*** | ***(6 345)*** | ***479 299*** |
| *Retail* | | | | |
| Residental mortgage | | | | |
| *HUF* | *4 849* | *(2 016)* | *(71)* | *2 762* |
| *Foreign currency* | *259 940* | *(37 436)* | *(3 380)* | *219 124* |
| Credit card | 2 672 | (145) | (67) | 2 460 |
| Overdraft | 2 107 | (580) | (54) | 1 473 |
| Personal loan | 1 281 | (100) | (34) | 1 147 |
| Car finance | 21 270 | (4 385) | (132) | 16 753 |
| Other | 52 744 | (3 999) | (79) | 48 666 |
| ***Total Retail*** | ***344 863*** | ***(48 661)*** | ***(3 817)*** | ***292 385*** |
| **Total Core business** | **866 276** | **(84 430)** | **(10 162)** | **771 684** |
| **Non-core business** | | | | |
| ***CRE*** | ***103 527*** | ***(15 656)*** | ***(1 483)*** | ***86 388*** |
| **Total** | **969 803** | **(100 086)** | **(11 645)** | **858 072** |

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.

In 2016, other items included HUF 110,956 million working capital loans, HUF 12,070 million investment loans, HUF 68,705 million syndicated loans, HUF 38,595 million loans relating to Funding for Growth Scheme and investment SME bonds in the amount of HUF 8,418 million.

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

**Spin off**

**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.

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 with selling non-performing portfolio to third parties. MKB fulfilled the commitment by the end of 2017, further steps for dismantling the portfolio is not necessary. Nevertheless any new CRE type of business can not be approved until 2020 based on the EU commitments.

On 31 December 2017 the balance of the CRE portfolio amounted to HUF 25,323 million. (See Table 11.1)

**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.

**<u>Effects of the Act on Consumer Loan Contracts of Financial Institutions</u>**

**Settlement**

Based on the requirements of the act XXXVIII of 2014, which objective was to settle disputes on the Curia's civil law uniformity decision on consumer loan contracts and the act XL of 2014 enacting the method of regulations on the settlement and other related directions, repayment obligation arose at MKB Group if the consumer loan contract commenced after 1 May 2004 and before 26 July 2014 and have not been terminated before 26 July 2009 and if the Bank has charged foreign currency exchange rate spread (margin) on the client or applied unilateral commission or interest increase. The repayment obligation covers those consumer loan contracts as well, which expired before 26 July 2009, however the Group is aware of the fact, that its claims against the consumers have not barred yet, or the consumers can prove, that the claims previously transferred by the Group are due to a credit management company, which is not obliged to the settlement.

Data in HUF million except stated otherwise

In 2015, 120 thousand clients of the Group have been effected by the settlement related to the regulations above, of which 7 thousand were transferred to a credit management company. The Group allocated HUF 43,107 million provision among other provisions as at 2014 year-end.

The repayment obligation of the Group has been carried out during 2015, except for the claims assigned to credit management companies – in this case the clients could apply for the settlement by 31 December 2015.

By the end of previous year the deadline for submitting settlement claims expired, so the Bank does not have any settlement obligations remained. However in case of receivables sold and non-consumer loan agreements the release of the provision required further legal and business considerations, as a result of this on 31 December 2016, HUF 1,000 million provision was maintained by the Group. During the current year, the amount of the provision decreased by approximately HUF 1,000 million due to lack of relevance to the settlement.

## Allowances for impairment

11.2

| | 2017 | 2016 |
|---|---|---|
| ***Specific allowances for impairment on loans and advances to customers*** | | |
| **Balance at 1 January** | 100 086 | 155 458 |
| Impairment loss for the year: | | |
| Charge for the year | 25 785 | 26 166 |
| Reversal | (12 118) | (23 876) |
| Utilisation | (7 938) | (56 012) |
| Effect of foreign currency movements | (296) | (294) |
| Unwinding of discount | (1 080) | (1 356) |
| Reclassification | (11) | - |
| Reclassification to Non-current assets held for sale | (32 438) | - |
| **Balance at 31 December** | **71 990** | **100 086** |
| ***Collective allowances for impairment on loans and advances to customers*** | | |
| **Balance at 1 January** | 11 645 | 4 271 |
| Impairment loss for the year: | | |
| Charge for the year | 5 390 | 11 339 |
| Reversal | (9 282) | (3 327) |
| Utilisation | (12) | (24) |
| Effect of foreign currency movements | (22) | (56) |
| Unwinding of discount | 106 | (558) |
| Reclassification | (56) | - |
| **Balance at 31 December** | **7 769** | **11 645** |

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:

11.3

| Sectors 2017 | Gross amount | Specific allowances for impairment | Collective allowances for impairment | Carrying amount |
|---|---|---|---|---|
| Sovereign | 1 058 | (83) | (7) | 968 |
| Private | 405 568 | (22 875) | (1 193) | 381 500 |
| Financial institution | 178 399 | (39) | (169) | 178 191 |
| Real estate | 34 590 | (2 630) | (304) | 31 656 |
| Other | 318 736 | (46 363) | (6 096) | 266 277 |
| **Loans and advances to customers** | **938 351** | **(71 990)** | **(7 769)** | **858 592** |

| Sectors 2016 | Gross amount | Specific allowances for impairment | Collective allowances for impairment | Carrying amount |
|---|---|---|---|---|
| Sovereign | 558 | (93) | (3) | 462 |
| Private | 581 791 | (61 859) | (4 945) | 514 987 |
| Financial institution | 23 284 | (112) | (35) | 23 137 |
| Real estate | 115 487 | (11 187) | (1 625) | 102 675 |
| Other | 248 682 | (26 881) | (5 037) | 216 764 |
| **Loans and advances to customers** | **969 802** | **(100 132)** | **(11 645)** | **858 025** |

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

As at 31 December 2017 there were no loans designated as hedged item in a fair value hedge relationship.

Data in HUF million except stated otherwise

## Finance lease receivables

As part of its financing activities, the Group enters into finance lease transactions as a lessor. As at 31 December 2017 and 2016, the reconciliation of the Group's gross investment in the lease, and the net present value of minimum lease payments receivable by relevant remaining maturity periods are as follows:

11.4

| 2017 | up to 1 year | 1 year to 5 years | over 5 years | Total |
|---|---|---|---|---|
| Gross investment in the lease | 42 341 | 85 296 | 1 957 | 129 594 |
| Unearned finance income | (4 469) | (5 462) | (77) | (10 008) |
| Present value of minimum lease payments | 37 872 | 79 834 | 1 880 | 119 586 |
| **Finance leases as per balance sheet date** | **37 872** | **79 834** | **1 880** | **119 586** |

| 2016 | up to 1 year | 1 year to 5 years | over 5 years | Total |
|---|---|---|---|---|
| Gross investment in the lease | 36 944 | 63 776 | 1 528 | 102 248 |
| Unearned finance income | (4 095) | (5 036) | (71) | (9 202) |
| Present value of minimum lease payments | 32 849 | 58 740 | 1 457 | 93 046 |
| **Finance leases as per balance sheet date** | **32 849** | **58 740** | **1 457** | **93 046** |

In 2017, HUF -224 million contingent rents were recognized in finance income (2016: HUF - 116 million), and unguaranteed residual value amounted to HUF 8,381 million (2016: HUF 4,869 million). At 31 December 2017, no accumulated allowance for uncollectible minimum lease payments were recognised (2016: HUF 0 million).

Finance lease has been provided for individuals and legal persons as closed and open-ended arrangement. For individuals the contracts original maturity ranges from 12-84 months and for companies from 12-96 months. In general vehicles are leased. No guaranteed residual value exists.

Data in HUF million except stated otherwise

# 12 Other assets

12.1

| | 2017 | 2016 |
|---|---|---|
| Prepayments and other debtors | 26 036 | 27 079 |
| Inventory | 571 | 626 |
| Collaterals held in possession | 86 | - |
| Corporate income tax refundable | 163 | 31 |
| Other taxes refundable | 783 | 514 |
| Specific allowances for impairment | (170) | (169) |
| **Other assets** | **27 469** | **28 081** |

***Specific allowances for impairment***

| | | |
|---|---|---|
| **Balance at 1 January** | (169) | (213) |
| Impairment loss for the year: | | |
| Charge for the year | (61) | (27) |
| Reversal | 3 | 71 |
| Utilization | 57 | - |
| **Balance at 31 December** | **(170)** | **(169)** |

# 13 Investments in jointly controlled entities and associates

13.1

| | 2017 | 2016 |
|---|---|---|
| Cost | 2 643 | 1 651 |
| **Investments in jointly controlled entities and associates** | **2 643** | **1 651** |

The goodwill arising on acquisition belonged to MKB-Euroleasing Zrt., which was impaired formerly.

In 2016, no general and financial data are disclosed, as the investments held in MKB-Euroleasing Autópark Zrt. and MKB Autopark OOD were sold by the Bank on 30 June 2016. In addition, the Bank’s participation in MKB-Euroleasing Zrt. increased to 100% during 2015 and, as a consequence, it is presented as a subsidiary in the Group’s financial statements.

On 19 October 2017, MKB Bank Zrt. acquired 49% minority shareholding in Pannónia CIG Alapkezelő Zrt. by way of capital increase. MKB is not in the position to exercise significant influence over the management of the company, it was therefore consolidated with the equity method and the year-end profit is shared according to profit allocation. The company was renamed to MKB-Pannónia Alapkezelő Zrt. and moved to a new registered seat. The assets managed by MKB Befektetési Alapkezelő Zrt. were transferred to MKB-Pannónia Alapkezelő Zrt. on 1 December 2017.

Data in HUF million except stated otherwise

# 14 Intangibles, property and equipment

14.1

| 2017 | Intangible assets | Freehold property | Equipment | Total |
|---|---|---|---|---|
| *Cost* | | | | |
| Balance at 1 January | 50 929 | 45 203 | 25 572 | 121 704 |
| Additions – including internally developed | 6 403 | 414 | 2 312 | 9 129 |
| Disposals | (1 021) | (4 914) | (3 109) | (9 044) |
| **Balance at 31 December** | **56 311** | **40 703** | **24 775** | **121 789** |
| *Amortization and depreciation and impairment losses* | | | | |
| Balance at 1 January | 42 484 | 13 954 | 19 383 | 75 821 |
| Amortization and depreciation for the year | 1 482 | 1 226 | 1 612 | 4 320 |
| Impairment loss | 181 | 10 | 35 | 226 |
| Disposals | (404) | (2 393) | (2 454) | (5 251) |
| Other additions | - | (3) | - | (3) |
| **Balance at 31 December** | **43 743** | **12 794** | **18 576** | **75 113** |
| *Carrying amounts* | | | | |
| At 1 January | 8 445 | 31 249 | 6 189 | 45 883 |
| **Balance at 31 December** | **12 568** | **27 909** | **6 199** | **46 676** |

| 2016 | Intangible assets | Freehold property | Equipment | Total |
|---|---|---|---|---|
| *Cost* | | | | |
| Balance at 1 January | 47 326 | 47 261 | 25 279 | 119 866 |
| Additions – including internally developed | 3 623 | 238 | 1 957 | 5 818 |
| Disposals | (20) | (2 296) | (1 664) | (3 980) |
| **Balance at 31 December** | **50 929** | **45 203** | **25 572** | **121 704** |
| *Amortization and depreciation and impairment losses* | | | | |
| Balance at 1 January | 40 423 | 13 095 | 19 336 | 72 854 |
| Amortization and depreciation for the year | 2 075 | 1 297 | 1 604 | 4 976 |
| Impairment loss | 5 | 397 | 29 | 431 |
| Disposals | (19) | (835) | (1 586) | (2 440) |
| **Balance at 31 December** | **42 484** | **13 954** | **19 383** | **75 821** |
| *Carrying amounts* | | | | |
| At 1 January | 6 903 | 34 166 | 5 943 | 47 012 |
| **Balance at 31 December** | **8 445** | **31 249** | **6 189** | **45 883** |

Depreciation, amortization and impairment are presented among the Operating expenses.

Data in HUF million except stated otherwise

In 2016, as a part of the cost cutting and restructuring program, the Bank sold its educational and leisure center in Balatonfüred.

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

In 2016 and 2017, the most significant component of the investments and developments was the costs related to the on-going Core system replacement process at the Bank. In addition, the Group disclosed several other items here concerning capitalisations of functional developments of other IT systems.

## 15 Amounts due to other banks

15.1

| | 2017 | 2016 |
|---|---|---|
| Due on demand | 5 485 | 4 608 |
| Money market deposits | 6 000 | 160 846 |
| Borrowings | 227 827 | 210 808 |
| **Amounts due to other banks** | **239 312** | **376 262** |

The largest balance of the amount due to other banks is HUF 120,898 million, which is the re-financing loans relating to Funding for Growth Scheme at National Bank of Hungary.

## 16 Deposits and current accounts

16.1

| | 2017 | 2016 |
|---|---|---|
| From corporate clients | 1 235 242 | 1 196 011 |
| From retail clients | 303 898 | 323 857 |
| **Deposits and current accounts** | **1 539 140** | **1 519 868** |

As at 31 December 2017, from the amount of current and deposit accounts, HUF 1,658 million (2016: HUF 8,688 million) has been measured as a fair value through profit or loss.

### Finance leases as a lessee

As part of its business activities, the Group enters into finance lease transactions as a lessee. At 31 December 2017 and 2016, the reconciliation of the Group's future minimum lease payments at the end of the reporting period and their present value by relevant remaining maturity periods was the following:

Data in HUF million except stated otherwise

16.2

| 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** |

| 2016 | up to 1 year | 1 year to 5 years | over 5 years | Total |
|---|---|---|---|---|
| Future minimum lease payments | 1 425 | 6 868 | 18 819 | 27 112 |
| Unpaid finance expense | (1 277) | (6 302) | (8 923) | (16 502) |
| **Present value of minimum lease payments** | **148** | **566** | **9 896** | **10 610** |
| **Finance leases as a lessee** | **148** | **566** | **9 896** | **10 610** |

In 2017, no contingent rents were recognized in finance income (2016: HUF NIL). The net carrying amount of the leased office (IT) equipment amounted to HUF 255 million at the end of previous period. In August 2017, the Bank decided to withdraw from the lease agreement, which resulted in the derecognition of its assets of HUF 125.4 million and liabilities of HUF 122 million and the profit effect amounted to HUF 3.4 million. The net carrying amount of the lands and buildings used by the reporting entity was HUF 2,591 million at the end of 2017 (2016: HUF 5,300 million). In case of building the contractual maturity is 25 years, with no residual value.

# 17 Financial liabilities measured at FVTPL

17.1

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Cost | Fair value adjustment | Book value | Cost | Fair value adjustment | Book value |
| ***Derivative instruments by type*** | | | | | | |
| FX-based derivatives instruments | - | 4 265 | 4 265 | - | 2 867 | 2 867 |
| Index-based derivative instruments | - | - | - | - | 10 | 10 |
| Interest-based derivative instruments | - | 38 846 | 38 846 | - | 26 623 | 26 623 |
| Options | 179 | 76 | 255 | 134 | 349 | 483 |
| **Total derivative instruments** | **179** | **43 187** | **43 366** | **134** | **29 849** | **29 983** |
| **Financial liabilities measured at FVTPL** | **179** | **43 187** | **43 366** | **134** | **29 849** | **29 983** |

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

# 18 Derivative liabilities held for risk management

The Group 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.

Data in HUF million except stated otherwise

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

***Other derivatives held for risk management***

The Group 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.

# 19 Other liabilities and provisions

19.1

| | 2017 | 2016 |
|---|---|---|
| Accruals and other creditors | 41 593 | 27 560 |
| Corporate income tax payable | 16 | 19 |
| Other taxes payable | 2 128 | 2 498 |
| Provision for contingencies and commitments | 6 116 | 6 120 |
| Provision for settlement of FX consumer loans | - | 1 000 |
| **Other liabilities and provisions** | **49 853** | **37 197** |

General description of provision for settlement of FX consumer loans is defined in Note 11.

### Provision for contingencies and commitments

19.2

| | 2017 | 2016 |
|---|---|---|
| Balance at 1 January | 7 120 | 6 320 |
| Provisions made during the year | 2 364 | 4 115 |
| Provisions used during the year | (6) | (210) |
| Provisions reversed during the year | (3 279) | (3 080) |
| Effect of foreign currency movements | (83) | (25) |
| **Balance at 31 December** | **6 116** | **7 120** |

Provisions recognized for different type of products are disclosed in Note 34, except for provision settlement of FX consumer loans in Note 11.

### Operating lease as a lessee

The Group leases some of its branches in the form of operating lease. At 31 December 2017 and 2016, the total amount of future minimum lease payments under non-cancellable operating leases by relevant remaining period was the following:

Data in HUF million except stated otherwise

19.3

| 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** |

| 2016 | up to 1 year | 1 year to 5 years | over 5 years | Total |
|---|---|---|---|---|
| Minimum lease payments | 1 129 | 3 187 | 2 632 | 6 948 |
| **Non-cancellable operating leases** | **1 129** | **3 187** | **2 632** | **6 948** |

In 2017, lease were recognised as an expense in the period amounted to HUF 1,505 million (2016: HUF 1,281 million). Furthermore no contingent rents (2016: 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.

# 20 Issued debt securities

The table below shows the new issuance, repayment and other changes during the year:

20.1

| Interest | Balance at 1 January | Repurchased debt securities | Repaid debt securities | Revaluation result | Balance at 31 December |
|---|---|---|---|---|---|
| **31 December 2017** | | | | | |
| Fixed rate | 1 646 | 82 | (240) | (212) | 1 276 |
| Structured | 11 209 | (30) | (1 704) | (160) | 9 315 |
| Accrued interest | 37 | - | - | - | 33 |
| **Total** | **12 892** | **52** | **(1 944)** | **(372)** | **10 624** |
| **31 December 2016** | | | | | |
| Fixed rate | 42 767 | 5 613 | (46 831) | 97 | 1 646 |
| Structured | 23 045 | 17 | (11 935) | 82 | 11 209 |
| Floating rate | 18 195 | 4 581 | (22 776) | - | - |
| Accrued interest | 1 618 | - | - | - | 37 |
| **Total** | **85 625** | **10 211** | **(81 542)** | **179** | **12 892** |

The Group 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 2017, the carrying amount of FVTPL own issued bonds amounted to HUF 9,332 million (2016: HUF 11,227 million).

# 21 Subordinated debt

21.1

| 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** | | | | | **22 307** |

Subordinated debts are direct, unconditional and unsecured obligations of the Group, and are subordinated to the claims of the Group'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.

On 31 December 2017, the Group had HUF 22,307 million subordinated debt obligations (2016: NIL).

# 22 Share capital

On 25 July 2016 the extraordinary General Meeting made a decision to reduce the Share capital of the Bank from HUF 225,490 million to HUF 100,000 million. This action was the result of the commitment required by the authorities and assigned to the new owners in course of the resolution process in order to meet respective legal requirements. The capital reduction was carried out in the form of a reclassification between the elements of the Equity (see Consolidated Statement of Changes in Equity).

The Bank’s authorised, issued, called up and fully paid share capital comprises 100 million (2016:100 million) ordinary shares of HUF 1,000 (2016: HUF 1,000) each. All issued shares rank pari passu in the event of a winding up.

# 23 Reserves

## Currency translation reserve

The currency translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. In 2016, due to the sale and deconsolidation of MKB Autopark OOD HUF 4 million gain was reclassified from Currency translation reserve to Statement of profit or loss.

### 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 Group less any dividend payment. There is no available Retained Earnings for distribution for the parent of the holding company.

### 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 Group discloses general reserve as part of retained earnings. In 2017, MKB recognized general reserve of HUF 4,097 million (2016: HUF 1,014 million).

### Revaluation reserves

AFS financial assets' revaluation reserve includes the cumulative net change in the fair value of available-for-sale investments until the investment is derecognized or impaired.

The Group did not apply any reclassification adjustments relating to components of other comprehensive income.

### Share-based payments

31 December 2017 the Bank discloses HUF 54 million HUF Share-based payments as change in reserves, which came from the result of equity-settlement, share-based compensation, taking into account the lapse. At 31 December 2017 vesting conditions of ESOP/MRP are foreseen valid by the management (1. three years of prudential operation according to efficient and effective risk management prescribed by law ; 2. admission of MKB shares to regulated market).

## 24 Non-controlling interest

For the year ended 31 December 2016, there were no material non-controlling interests related to non-wholly owned subsidiaries of the Group. Non material non-controlling interest existed in case of MKB Jelzálogbank Zrt. where the main shareholder was MKB Bank Zrt. with a 99 % participation, while Gránit Bank Zrt. held 1 % of the shares. In October 2017, MKB Bank acquired 100 % ownership in Jelzálogbank by acquisition of 1 % of the shares. resulting decrease in Non-controlling interest at the end of 2017.

The Group discloses also a Non-controlling interest of HUF 5,550 million related to the special purpose entity for Employee Share Ownership Program (ESOP) (2016: HUF 5,550 million related). This amount represents the contribution of the participating members.

Data in HUF million except stated otherwise

# 25 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

25.1

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Assets | Liabilities | Net | Assets | Liabilities | Net |
| Intangibles, property and equipment | - | 515 | (515) | - | 495 | (495) |
| Investments in subs., jointly contr. entities and associates | 137 | - | 137 | 117 | - | 117 |
| Available-for-sale securities | 891 | 112 | 779 | 3 | 201 | (198) |
| Loans and advances to customers | 690 | 122 | 568 | 656 | 151 | 505 |
| Allowances for loan losses | 67 | 668 | (601) | 67 | 629 | (562) |
| Amounts due to customers | 479 | - | 479 | 468 | - | 468 |
| Issued debt securities | - | 36 | (36) | - | 8 | (8) |
| Provisions (included general risk reserve) | 300 | - | 300 | 213 | 244 | (31) |
| Derivatives | 122 | 6 | 116 | 162 | 50 | 112 |
| Other items | 264 | 44 | 220 | 232 | 17 | 215 |
| Tax loss carry-forwards | 1 820 | - | 1 820 | 3 191 | - | 3 191 |
| Offsetting | (1 498) | (1 498) | - | (1 789) | (1 789) | - |
| Non-current assets held for sale and discontinued operations | 40 | - | 40 | - | - | - |
| **Net tax assets / liabilities** | **3 312** | **5** | **3 306** | **3 320** | **6** | **3 314** |

# 26 Interest income

26.1

| | 2017 | 2016 |
|---|---|---|
| Cash reserves | 400 | 338 |
| Loans and advances to banks | 46 | 49 |
| Loans and advances to customers | 30 986 | 32 226 |
| Derivatives | 6 844 | 9 110 |
| Investments in securities | 17 969 | 20 753 |
| **Interest income** | **56 245** | **62 476** |

Included within various captions under interest income for the year ended 31 December 2017 is a total of HUF 974 million (2016: 1,914 million) accrued on impaired financial assets.

Data in HUF million except stated otherwise

# 27 Interest expense

27.1

| | 2017 | 2016 |
|---|---|---|
| Amounts due to other banks | 583 | 2 649 |
| Deposits from customers | 3 320 | 9 224 |
| Issued debt securities | 232 | 1 029 |
| Subordinated liabilities | 595 | - |
| Other fees and commisions similar to interest expenses | - | 29 |
| Derivatives | 11 935 | 10 873 |
| **Interest expense** | **16 665** | **23 804** |

The Bank did not realise neither interest income nor expense from derivatives held in a qualifying fair value hedging relationship in 2017. In contrast, in 2016 there was HUF 4,526 million interest income and HUF 7,112 million expense from derivatives held in a qualifying fair value hedging relationship. These derivatives were designated as fair value hedges to hedge changes in the fair value of certain investments.

# 28 Net income from commissions and fees

28.1

| | 2017 | 2016 |
|---|---|---|
| ***Commission and fee income*** | **37 997** | **37 406** |
| Payment and account services | 19 972 | 19 152 |
| Credit related fees | 1 793 | 1 639 |
| Card services | 2 678 | 2 377 |
| Brokerage fees and other securities business | 9 740 | 10 646 |
| Other commission and fee income | 3 814 | 3 592 |
| ***Commission and fee expense*** | **9 151** | **8 742** |
| Payment and account services | 2 586 | 2 837 |
| Credit related fees | 1 057 | 1 090 |
| Card services | 1 555 | 1 436 |
| Brokerage fees and other securities business | 1 380 | 1 229 |
| Other commission and fee expense | 2 573 | 2 150 |
| **Net income from commissions and fees** | **28 846** | **28 664** |

At the end of the reporting period brokerage fees do not include fees from trust management and other securities services (2016: HUF 2,151 million). For further information on the Group’s fund management activity, please see Note 38.

Data in HUF million except stated otherwise

## 29 Other operating income / (expense), net

29.1

| | 2017 | 2016 |
|---|---|---|
| Gain on trading securities | 2 215 | 2 579 |
| Gain / (loss) on sale of available-for-sale securities | 17 129 | 9 361 |
| Net gain on trading derivative transactions | 8 977 | 6 111 |
| Gains and losses on fair value hedges | | |
| *Gains and losses on hedging instruments* | *-* | *(11 174)* |
| *Gains and losses on underlyying transactions* | *-* | *9 124* |
| Fair Value results from FVTPL revaluation (FVO) | (124) | (486) |
| Net income from collaterals held in possession | - | (2) |
| Expenses relating to bank levies | (2 101) | (6 257) |
| Transaction duty | (11 463) | (11 020) |
| Other taxes | (3 438) | (3 063) |
| Other | (976) | (1 459) |
| **Other operating income / (expense), net** | **10 219** | **(6 286)** |

The result from fair value revaluation of structured bonds designated at fair value through profit or loss was HUF 152 million gain (2016: 95 million loss), and it amounted to HUF 145 million gain regarding long term deposits designated at fair value (2016: 430 million gain).

In 2010 the government levied special tax for financial institutions called banking tax. This special tax has different tax base depending on the type of the financial institutions:

- in the case of banks, the adjusted balance-sheet total calculated based on the annual local account for 2009;
- in the case of other financial institutions the sum of net interest income and income from fees, charges and commissions, but charges and commission expenses cannot exceed the income from fees and commission. Calculation must be based on the annual local account for 2009.
- for investment fund management companies, the combined total of the net asset value of the funds they manage, shown on 31 December 2009 and the value of assets of funds and other portfolios shown on 31 December 2009.

The rate of special tax used by the entities in the group is also different depending on the tax base. This banking tax is shown under other expenses as it does not meet the criteria of current income tax.

Financial institutions operating on 1 January 2017 shall be liable to pay this tax in the whole amount also in 2017 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 2017, the credit institutions providing also investment and supplementary services were levied an additional banking tax concerning these services.

Data in HUF million except stated otherwise

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.

## 30 Net impairments and provisions for losses

30.1

| | Note | 2017 | 2016 |
|---|---|---|---|
| *Impairment loss on* | | | |
| Loans and advances to banks | **8** | 1 | (42) |
| Loans and advances to customers | **11** | 9 775 | 10 302 |
| Other assets | **12** | 58 | (44) |
| Realised loss on sale of loans | | 692 | 3 600 |
| *Provision on* | | | |
| Guarantees and contingencies | **19** | (915) | 1 420 |
| **Net impairments and provisions for losses** | | **9 611** | **15 236** |

## 31 Operating expenses

31.1

| | 2017 | 2016 |
|---|---|---|
| General and administration expenses | 6 204 | 3 062 |
| Legal and advisory services | 4 265 | 2 507 |
| Wages and salaries | 16 494 | 12 642 |
| Termination benefits | 1 260 | 427 |
| Compulsory social security obligations | 4 863 | 4 270 |
| Occupancy costs | 9 115 | 9 511 |
| Marketing and public relations | 1 093 | 1 087 |
| Communication and data processing | 5 391 | 4 777 |
| **Operating expenses** | **48 685** | **38 283** |

In 2017, the Group's average statistical employee number was 2,031 (2016: 1,996).

# 32 Income tax

## Income tax expense recognized in the Statement of Comprehensive Income

32.1

| | 2017 | 2016 |
|---|---|---|
| *Current tax expense* | *1 633* | *440* |
| Hungarian corporation tax charge – on current year profit | 1 633 | 440 |
| *Deferred tax expense/(income)* | *(96)* | *(2 132)* |
| Origination (reversal) of temporary differences | *(96)* | *(3 120)* |
| Effect of changes in deferred tax rates | - | 988 |
| **Income tax expense / (credit)** | **1 537** | **(1 692)** |

In the previous period 10 % income tax rate was applied under HUF 500 million taxable profit and 19 % tax rate above this amount in Hungary. Due to this calculation method 10 % current income tax rate was applied in the Hungarian market as previous income tax rate, and 9 % deferred tax rate applied based on the available future plans, since after 1 January 2017 the tax rate had been changed to 9%.

## Reconciliation of effective tax rate

32.2

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | % | HUF million | % | HUF million |
| *Profit / Loss before income tax* | | 20 738 | | 12 765 |
| Income tax using the domestic corporation tax rate | 10,00% | 2 074 | 10,00% | 1 277 |
| Effect of tax rates in foreign jurisdictions | 0,00% | - | 0,00% | - |
| Effect of changes in tax rates | 0,00% | - | 8,78% | 1 121 |
| Movement of unrecognized temporary differences | -0,70% | (145) | -30,68% | (3 917) |
| Unrecognized tax losses for the reporting period | 0,61% | 127 | 1,35% | 172 |
| Tax Losses expiring in current year | 0,01% | 1 | -3,44% | (439) |
| Non-deductible expenses | 0,79% | 163 | 36,26% | 4 629 |
| Tax exempt income | -3,25% | (675) | -13,82% | (1 764) |
| Re-assessment of unrecognised tax losses/interest carryforwards | 0,00% | - | -20,43% | (2 608) |
| Other tax effects | -0,04% | (8) | -1,27% | (163) |
| **Income tax** | **7,41%** | **1 537** | **-13,26%** | **(1 692)** |

MKB 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 4,811 million (2016: 5,108 million) before offsetting (see Table 32.4).

Data in HUF million except stated otherwise

On 31 December 2017, the Group had unused tax losses amounting to HUF 363,817 million (2016: HUF 375,918 million) with the following maturity:

32.3

| | 2017 | 2016 |
|---|---|---|
| Maturity between 1 and 5 years | 66 073 | 66 222 |
| Mature between 5 and 10 years | 297 744 | 309 696 |
| **Tax loss carryforwards** | **363 817** | **375 918** |

The Group has HUF 345,372 million (2016: HUF 343,962 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.

In 2017, the Group booked HUF 112 million deferred tax liability (2016: HUF 3 million deferred tax asset and HUF 12 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:

32.4

| P/L-effective and neutral effects on deferred tax assets (DTA) and deferred tax liabilities (DTL) | Opening balance DTA/DTL | Tax Rate change | P/L-effective movement of DTA/DTL | P/L-neutral movement of DTA/DTL | Closing balance DTA/DTL |
|---|---|---|---|---|---|
| **Deferred Tax Assets - due to deductible temporary differences** | | | | | |
| **Assets** | | | | | |
| Loans and advances to bank, Loans and advances to customers | 656 | - | 33 | - | 689 |
| Provision for losses on loans and advances | 68 | - | (1) | - | 67 |
| Financial assets measured at FVTPL | 161 | - | (39) | - | 122 |
| Investments | 118 | - | 913 | (3) | 1 028 |
| Property, plant and equipment and investment property | 1 | - | - | - | 1 |
| 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 | - | 4 | - | 54 |
| **Liabilities** | | | | | |
| Amounts due to other banks, Deposits and current accounts | 468 | - | 12 | - | 480 |
| Provisions | 213 | - | 87 | - | 300 |
| Other liabilities | 1 | - | (1) | - | - |
| **Deferred Tax Assets - due to tax losses (total)** | 3 191 | - | (1 371) | - | 1 820 |
| **Subtotal DTA before netting** | **5 108** | **-** | **(294)** | **(3)** | **4 811** |
| **Deferred Tax Liabilities - due to deductible temporary differences** | | | | | |
| **Assets** | | | | | |
| Loans and advances to bank, Loans and advances to customers, Receivables held for trading | (150) | - | 29 | - | (121) |
| Provision for losses on loans and advances | (629) | - | (39) | - | (668) |
| Investments | (189) | - | 189 | - | - |
| Property, plant and equipment and investment property | (495) | - | (20) | - | (515) |
| Other Assets | (17) | - | 1 | - | (16) |
| **Liabilities** | | | | | |
| Securitized liabilities | (9) | - | (28) | - | (37) |
| Negative fair values of derivative financial instruments | (50) | - | 44 | - | (6) |
| Provisions | (244) | - | 244 | - | - |
| Other liabilities | - | - | (27) | - | (27) |
| **Subtotal DTL before netting** | **(1 783)** | **-** | **393** | **-** | **(1 390)** |
| Netting of short-term DTA | (50) | - | 44 | - | (6) |
| Netting of short-term /DTL | 50 | - | (44) | - | 6 |
| **Subtotal DTA after netting of balance sheet positions** | **5 058** | **-** | **(250)** | **(3)** | **4 805** |
| Netting of p/l-effective DTA with p/l-effective DTL (per earning reserves) | (1 738) | - | 245 | - | (1 493) |
| **Subtotal DTL after netting of balance sheet positions** | **(1 733)** | **-** | **349** | **-** | **(1 384)** |
| Netting of p/l-effective DTL with p/l-effective DTA (per earning reserves) | 1 727 | - | (348) | - | 1 379 |
| **Subtotal DTA after netting completely with DTL** | **3 320** | **-** | **(5)** | **(3)** | **3 312** |
| **Subtotal DTL after netting completely with DTA** | **(6)** | **-** | **1** | **-** | **(5)** |

Data in HUF million except stated otherwise

| 2016<br>P/L-effective effects on deferred tax assets (DTA) and deferred tax liabilities (DTL) | Opening balance DTA/DTL | Tax Rate change | P/L-effective movement of DTA/DTL | P/L-neutral movement of DTA/DTL | Closing balance DTA/DTL |
|---|---|---|---|---|---|
| **Deferred Tax Assets - due to deductible temporary differences** | | | | | |
| **Assets** | | | | | |
| Loans and advances to bank, Loans and advances to customers | 587 | (303) | 372 | - | 656 |
| Provision for losses on loans and advances | 32 | (3) | 39 | - | 68 |
| Financial assets measured at FVTPL | 513 | (265) | (87) | - | 161 |
| Investments | 1 184 | (305) | (288) | (473) | 118 |
| Property, plant and equipment and investment property | 2 | - | (1) | - | 1 |
| Intangible Assets | 496 | (256) | (59) | - | 181 |
| Other Assets | 105 | (54) | (1) | - | 50 |
| **Liabilities** | | | | | |
| Amounts due to other banks, Deposits and current accounts | 976 | (503) | (5) | - | 468 |
| Provisions | 407 | (193) | (1) | - | 213 |
| Other liabilities | - | - | 1 | - | 1 |
| **Deferred Tax Assets - due to tax losses (total)** | 1 013 | (101) | 2 279 | - | 3 191 |
| **Subtotal DTA before netting** | **5 315** | **(1 983)** | **2 249** | **(473)** | **5 108** |
| **Deferred Tax Liabilities - due to deductible temporary differences** | | | | | |
| **Assets** | | | | | |
| Loans and advances to bank, Loans and advances to customers, Receivables held for trading | (248) | 25 | 73 | - | (150) |
| Provision for losses on loans and advances | (1 331) | 133 | 569 | - | (629) |
| Investments | - | - | (189) | - | (189) |
| Property, plant and equipment and investment property | (546) | 55 | (4) | - | (495) |
| Non-current assets or disposal groups as held vor Sale and assets from discontinued operations | (997) | 515 | 482 | - | - |
| Other Assets | (7) | 1 | (11) | - | (17) |
| **Liabilities** | | | | | |
| Securitized liabilities | (122) | 63 | 50 | - | (9) |
| Negative fair values of derivative financial instruments | (312) | 161 | 101 | - | (50) |
| Provisions | - | - | (244) | - | (244) |
| Other liabilities | (83) | 43 | 40 | - | - |
| **Subtotal DTL before netting** | **(3 646)** | **996** | **867** | **-** | **(1 783)** |
| Netting of short-term DTA | (312) | (161) | 423 | - | (50) |
| Netting of short-term /DTL | 312 | 161 | (423) | - | 50 |
| **Subtotal DTA after netting of balance sheet positions** | **5 003** | **(2 144)** | **2 672** | **(473)** | **5 058** |
| Netting of p/l-effective DTA with p/l-effective DTL (per earning reserves) | (2 436) | - | 698 | - | (1 738) |
| **Subtotal DTL after netting of balance sheet positions** | **(3 334)** | **1 157** | **444** | **-** | **(1 733)** |
| Netting of p/l-effective DTL with p/l-effective DTA (per earning reserves) | 2 434 | - | (707) | - | 1 727 |
| **Subtotal DTA after netting completely with DTL** | **2 567** | **(2 144)** | **3 370** | **(473)** | **3 320** |
| **Subtotal DTL after netting completely with DTA** | **(900)** | **1 157** | **(263)** | **-** | **(6)** |

# 33 Earnings per share

The calculation of basic earnings per share on 31 December 2017 based on the net income attributable to ordinary shareholders of HUF 19,202 million (2016: HUF 9,496 million) and a weighted average number of ordinary shares outstanding of 85,000 thousands (2016: 137,602 thousands).

**Basic value as at 31 December 2017**

$$\text{Earnings per Ordinary Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding (thousands)}} = \frac{\text{HUF 19,202 million}}{\text{85,000 thousands}} = \text{HUF 226}$$

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. In 2016, 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. At the end of 2017 there was a dilution effect because the vesting conditions are valid; HUF 2,501 thousands number of shares were equity-settled as share-based compensation.

**Diluted value as at 31 December 2017**

$$\text{Diluted Earnings per Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding taking into account the dilution factors (thousands)}} = \frac{\text{HUF 19,202 million}}{\text{87,501 thousands}} = \text{HUF 219}$$

## 34 Contingencies and commitments

34.1

| 2017 | Gross | Provision | Net |
|---|---|---|---|
| *Contingencies* | | | |
| Guarantees and similar obligations | 145 388 | (1 676) | 143 712 |
| Obligations from letters of credit and other short term trade related items | 13 881 | (22) | 13 859 |
| Other contingent liablities (including litigation) | 98 598 | (3 385) | 95 213 |
| **Total contingencies** | **257 867** | **(5 083)** | **252 784** |
| *Commitments* | | | |
| Undrawn commitments to extend credit | 300 005 | (1 033) | 298 972 |
| **Total commitments** | **300 005** | **(1 033)** | **298 972** |

Data in HUF million except stated otherwise

| 2016 | Gross | Provision | Net |
|---|---|---|---|
| *Contingencies* | | | |
| Guarantees and similar obligations | 121 439 | (1 852) | 119 587 |
| Obligations from letters of credit and other short term trade related items | 15 159 | (30) | 15 129 |
| Other contingent liablities (including litigation) | 100 044 | (3 758) | 96 286 |
| **Total contingencies** | **236 642** | **(5 640)** | **231 002** |
| *Commitments* | | | |
| Undrawn commitments to extend credit | 236 220 | (480) | 235 740 |
| **Total commitments** | **236 220** | **(480)** | **235 740** |

Concerning contingencies and commitments net amounts are disclosed in the table.

## 35 Use of estimates and judgements

Management discusses with the Group Supervisory Board the development, selection and disclosure of the Group'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 6).

### 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 4 i,).

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 Group’s accounting policies

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

### *Valuation of financial instruments*

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

The Group 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 Group 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:

Data in HUF million except stated otherwise

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 Group 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 Group 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.

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

35.1

| | Note | Quoted market prices in active markets | Valuation techniques - observable inputs | Total |
|---|---|---|---|---|
| ***31 December 2017*** | | | | |
| Financial assets measured at FVTPL | **9** | 242 | 72 077 | 72 319 |
| Investments in securities | **10** | 112 615 | 230 778 | 343 393 |
| Deposit and current accounts | **16** | - | 1 658 | 1 658 |
| Financial liabilities measured at FVTPL | **17** | - | 43 366 | 43 366 |
| Issued debt securities | **20** | - | 9 332 | 9 332 |
| Total | | 112 857 | 357 211 | 470 068 |
| ***31 December 2016*** | | | | |
| Financial assets measured at FVTPL | **9** | 14 999 | 60 211 | 75 210 |
| Investments in securities | **10** | 385 666 | 187 725 | 573 391 |
| Deposit and current accounts | **16** | - | 8 688 | 8 688 |
| Financial liabilities measured at FVTPL | **17** | - | 29 983 | 29 983 |
| Issued debt securities | **20** | - | 11 228 | 11 228 |
| Total | | 400 665 | 297 835 | 698 500 |

Data in HUF million except stated otherwise

The determination of fair value level and the transfers between levels are in line with accounting policy (see Note 4 g).
There were no transfers between fair value levels in the financial year ended on 31 December 2017.

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 Bank 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 Group 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 Group 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.

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

35.2

| | Note | Interest | Foreign exchange rate | Other |
|---|---|---|---|---|
| ***31 December 2017*** | | | | |
| Financial assets measured at FVTPL | **9** | 69 480 | 3 450 | 71 |
| Investments in securities | **10** | 342 692 | 58 190 | 702 |
| Deposit and current accounts | **16** | 1 658 | - | 1 658 |
| Financial liabilities measured at FVTPL | **17** | 39 003 | 4 517 | 4 |
| Issued debt securities | **20** | 9 332 | 3 050 | 9 332 |
| ***Total*** | | **462 165** | **69 207** | **11 767** |
| ***31 December 2016*** | | | | |
| Financial assets measured at FVTPL | **9** | 70 890 | 4 575 | - |
| Investments in securities | **10** | - | 35 132 | - |
| Deposit and current accounts | **16** | 8 688 | (5 540) | 8 688 |
| Financial liabilities measured at FVTPL | **17** | - | - | - |
| Issued debt securities | **20** | 21 728 | 11 227 | 11 227 |
| ***Total*** | | **101 306** | **45 394** | **19 915** |

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.

MKB Bank Zrt. Data in HUF million except stated otherwise

# 36 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 g, and Note 35), 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.

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

36.1

| 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 | 7 | - | - | - | - | 31 599 | 31 599 | 31 599 |
| Loans and advances to banks | 8 | - | 78 017 | - | - | - | 78 017 | 81 875 |
| *Measured at amortised cost* | | - | *78 017* | - | - | - | *78 017* | *81 875* |
| Financial assets measured at FVTPL | 9 | 72 319 | - | - | - | - | 72 319 | 72 319 |
| Investments in securities | 10 | - | - | 343 393 | 559 319 | - | 902 712 | 907 715 |
| Loans and advances to customers | 11 | - | 858 592 | - | - | - | 858 592 | 839 364 |
| *Measured at amortised cost* | | - | *858 592* | - | - | - | *858 592* | *839 364* |
| ***Total*** | | ***72 319*** | ***936 609*** | ***343 393*** | ***559 319*** | ***31 599*** | ***1 943 239*** | ***1 932 872*** |
| *Financial liabilities* | | | | | | | | |
| Amounts due to other banks | 15 | - | - | - | - | 239 312 | 239 312 | 251 877 |
| Deposits and current accounts | 16 | 1 658 | - | - | - | 1 537 482 | 1 539 140 | 1 544 009 |
| *Measured at fair value* | | *1 658* | - | - | - | - | *1 658* | *1 658* |
| *Measured at amortised cost* | | - | - | - | - | *1 537 482* | *1 537 482* | *1 542 351* |
| Financial liabilities measured at FVTPL | 17 | 43 366 | - | - | - | - | 43 366 | 43 366 |
| Issued debt securities | 20 | 9 332 | - | - | - | 1 292 | 10 624 | 11 139 |
| *Measured at fair value* | | *9 332* | - | - | - | - | *9 332* | *9 332* |
| *Measured at amortised cost* | | - | - | - | - | *1 292* | *1 292* | *1 807* |
| Subordinated debt | | - | - | - | - | 22 307 | 22 307 | 29 297 |
| ***Total*** | | ***54 356*** | - | - | - | ***1 800 393*** | ***1 854 749*** | ***1 879 688*** |

| 2016 | 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 | 7 | - | - | - | - | 97 914 | 97 914 | 97 914 |
| Loans and advances to banks | 8 | - | 67 039 | - | - | - | 67 039 | 61 139 |
| *Measured at amortised cost* | | - | *67 039* | - | - | - | *67 039* | *61 139* |
| Financial assets measured at FVTPL | 9 | 75 210 | - | - | - | - | 75 210 | 75 210 |
| Investments in securities | 10 | - | - | 573 391 | 350 746 | - | 924 137 | 922 538 |
| Loans and advances to customers | 11 | - | 858 072 | - | - | - | 858 072 | 853 533 |
| *Measured at amortised cost* | | - | *858 072* | - | - | - | *858 072* | *853 534* |
| ***Total*** | | ***75 210*** | ***925 111*** | ***573 391*** | ***350 746*** | ***97 914*** | ***2 022 372*** | ***2 010 334*** |
| *Financial liabilities* | | | | | | | | |
| Amounts due to other banks | 15 | - | - | - | - | 376 262 | 376 262 | 408 541 |
| Deposits and current accounts | 16 | 8 688 | - | - | - | 1 511 180 | 1 519 868 | 1 512 705 |
| *Measured at fair value* | | *8 688* | - | - | - | - | *8 688* | *8 688* |
| *Measured at amortised cost* | | - | - | - | - | *1 511 180* | *1 511 180* | *1 504 017* |
| Negative fair values of derivative financial instruments | 17 | 29 983 | - | - | - | - | 29 983 | 29 983 |
| Issued debt securities | 20 | 11 227 | - | - | - | 1 665 | 12 892 | 12 918 |
| *Measured at fair value* | | *11 227* | - | - | - | - | *11 227* | *11 227* |
| *Measured at amortised cost* | | - | - | - | - | *1 665* | *1 665* | *1 691* |
| ***Total*** | | ***49 898*** | - | - | - | ***1 889 107*** | ***1 939 005*** | ***1 964 147*** |

The disclosure does not contain the non-current asset held for sale portfolio for which MKB Group estimates that the fair value of non-current asset held for sale portfolio is near to it's carrying amount.

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, Negative fair values of derivative financial instruments and Derivative assets and liabilities held for risk management*

Fair values of Financial assets measured at FVTPL and Negative fair values of derivative financial instruments and Mikro hedge 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 Group determines fair values using valuation techniques. For further information, please see Note 35.

### *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 10 and Note 35.

### *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 2017 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. Concerning fair value estimation of FX loans see Note 11.

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.

Data in HUF million except stated otherwise

### *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.

# 37 Related parties

By 30 June 2016, the market-based sales procedure of MKB Bank was closed, and the ownership rights are exercised by the new shareholders. (Further information about the owners, please refer to 1. General information)

The Group'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 Group during the period as follows:

37.1

| | Parent company and its group | | Non-consolidated subsidiaries | | Associates | | Key Management Personnel | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 |
| *Assets* | | | | | | | | |
| Loans and advances to customers | - | - | 1 380 | 1 913 | 265 | 324 | 348 | 29 |
| *Liabilities* | | | | | | | | |
| Current and deposit accounts | 50 | - | 509 | 501 | 200 | 141 | 219 | 381 |
| *Income statement* | | | | | | | | |
| Interest income | - | - | 991 | 299 | 7 | 10 | 8 | 1 |
| Interest expense | - | - | 2 | 3 | (0) | - | - | - |
| Other net income / (expense) | 1 | - | 12 | 8 | 2 | 2 | (767) | (804) |
| *Contingencies and commitments* | | | | | | | | |
| Undrawn commitments to extend credit | - | - | 980 | 713 | 106 | 55 | - | - |
| Provision | - | - | 10 | 1 241 | 5 | 9 | - | - |

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.

Data in HUF million except stated otherwise

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.

Key management personnel compensation for the period comprised:

37.2

| | 2017 | 2016 |
|---|---|---|
| Short-term employee benefits | 767 | 804 |
| **Total** | **767** | **804** |

Dr Ádám Balog was appointed to take over the Chairman and Chief – Executive role of MKB Bank Zrt. from 23 July 2015. 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. At this time – continuing the reorganization procedure – the reorganizational commissioners were recalled, and further the Board of Directors has been exercising the control of the Bank.

## 38 Funds management

In 2016 the Group manages 20 close-ended and 24 open-ended investment fund via MKB Befektetési Alapkezelő Zrt, a fully owned and consolidated subsidiary. Az MKB Alapkezelő Zrt. transferred the managed assets to MKB-Pannónia Alapkezelő Zrt. on 1 December 2017. The acquirer is not fully consolidated, but on equity-method. For funds management services provided by the Group, funds pay certain fees and commission that is presented as „Commission and fee income” (see Note 28). In 2017 and 2016, the volume of the funds, and transactions with the funds themselves were as follows:

38.1

| | 2017 | 2016 |
|---|---|---|
| Managed funds (in HUF million) | | |
| Open-ended funds | - | 203 018 |
| Close-ended funds | - | 49 548 |
| Commission and fee income from funds | - | 2 151 |
| Deposits from funds | - | 73 017 |
| Interest expense on deposits from funds | - | 1 619 |

Open-ended funds represent the net asset value at the end of reporting period, close-ended funds represent the nominal amount at date of issuance.

# 39 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 Group is based on IFRS.

***Business segments***

The business segments identified by the Group represent the organizational structure as reflected in its internal management reporting systems. The Group 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 Group's overall strategic direction. As of 31 December 2017, the Group's business segments and their main products were:

***Corporate Banking***

The Group provides trade finance, a wide array of credit, account and deposit products, forfeiting and factoring, letters of credit, guarantees, international payments, portfolio management, project and structured finance, investment and financial advisory services to large Hungarian and regional public and private-sector entities through branches and electronic delivery channels.

***Institutional Banking***

MKB Group serves financial institutions and financial service companies with nostro and vostro account services, international and domestic payments, correspondent banking and participates in bank-to-bank finance, club and syndicated loans.

Data in HUF million except stated otherwise

## *Retail and Private Banking*

The Group 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 69 full-service branches and sub-branches (2016: 73 branches), ATMs, telephone and electronic channels.

## *Other*

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

39.1

| 2017 | Note | Corporate Banking | Institutional Banking | Retail and Private Banking | Other | Total |
|---|---|---|---|---|---|---|
| ***Assets*** | | | | | | |
| Cash reserves | **7** | - | 31 599 | - | - | 31 599 |
| Loans and advances to banks | **8** | - | 78 017 | - | - | 78 017 |
| Financial assets measured at FVTPL | **9** | - | 72 319 | - | - | 72 319 |
| Investments in securities | **10** | 855 900 | 46 317 | 495 | - | 902 712 |
| Loans and advances to customers | **11** | 615 964 | 1 496 | 241 132 | - | 858 592 |
| Assets from Discontinued opeartion as held for sale | **40** | - | - | 21 648 | - | 21 648 |
| Other assets | **12** | - | - | - | 27 469 | 27 469 |
| Deferred tax assets | **25** | - | - | - | 3 312 | 3 312 |
| Investments in jointly controlled entities and associates | **13** | 2 643 | - | - | - | 2 643 |
| Intangibles, property and equipment | **14** | - | - | - | 46 676 | 46 676 |
| | | **1 474 507** | **229 748** | **263 275** | **77 457** | **2 044 987** |
| ***Liabilities*** | | | | | | |
| Amounts due to other banks | **15** | - | 239 312 | - | - | 239 312 |
| Deposit and current accounts | **16** | 1 235 242 | - | 297 208 | 6 690 | 1 539 140 |
| Negative fair values of derivative financial instruments | **17** | - | 43 366 | - | - | 43 366 |
| Other liabilities and provisions | **19** | 3 042 | 961 | 139 | 45 711 | 49 853 |
| Deferred tax liabilities | **25** | - | - | - | 5 | 5 |
| Issued debt securities | **20** | 301 | 419 | 9 904 | - | 10 624 |
| Subordinated debt | **22** | - | 22 307 | - | - | 22 307 |
| Shareholders' equity | **22,23,24** | - | - | - | 140 380 | 140 380 |
| | | **1 238 585** | **306 365** | **307 251** | **192 786** | **2 044 987** |
| ***Income statement*** | | | | | | |
| Gross revenue - external customers | | 23 793 | 58 421 | 24 124 | 224 | 106 562 |
| Gross revenue - inter-segment | | (70) | 265 | (195) | - | - |
| Interest and commission expenditure | | (285) | (23 852) | (1 679) | - | (25 816) |
| Impairment and provisions for losses | **30** | (297) | (5) | (9 241) | (68) | (9 611) |
| Operating costs | **31** | (19 258) | (5 274) | (21 995) | (2 158) | (48 685) |
| Expenses related to bank levies | | - | - | - | (2 101) | (2 101) |
| Share of jointly controlled and associated companies' profit / (loss) | | 389 | - | - | - | 389 |
| **Profit / (Loss) before taxation** | | **4 272** | **29 555** | **(8 986)** | **(4 103)** | **20 738** |
| **Segment result** | | **4 272** | **29 555** | **(8 986)** | **(4 103)** | **20 738** |
| ***Other information*** | | | | | | |
| Capital expenditure | | - | - | - | 9 129 | 9 129 |
| Depreciation and amortisation | **14** | 3 467 | - | 834 | 19 | 4 320 |
| Other non-cash expenses | | 455 | 125 | 520 | 51 | 1 151 |

Data in HUF million except stated otherwise

| 2016 | Note | Corporate Banking | Institutional Banking | Retail and Private Banking | Other | Total |
|---|---|---|---|---|---|---|
| ***Assets*** | | | | | | |
| Cash reserves | **7** | - | 84 697 | - | 13 217 | 97 914 |
| Loans and advances to banks | **8** | - | 67 039 | - | - | 67 039 |
| Financial assets measured at FVTPL | **9** | - | 75 210 | - | - | 75 210 |
| Investments in securities | **10** | 707 054 | 217 083 | - | - | 924 137 |
| Loans and advances to customers | **11** | 564 429 | 1 258 | 292 385 | - | 858 072 |
| Assets from Discontinued opeartion as held for sale | **40** | - | - | - | 309 | 309 |
| Other assets | **12** | - | - | - | 28 081 | 28 081 |
| Deferred tax assets | **25** | - | - | - | 3 320 | 3 320 |
| Investments in jointly controlled entities and associates | **13** | 1 651 | - | - | - | 1 651 |
| Intangibles, property and equipment | **14** | - | - | - | 45 883 | 45 883 |
| | | **1 273 134** | **445 287** | **292 385** | **90 810** | **2 101 616** |
| ***Liabilities*** | | | | | | |
| Amounts due to other banks | **15** | - | 376 262 | - | - | 376 262 |
| Deposit and current accounts | **16** | 1 196 011 | - | 323 857 | - | 1 519 868 |
| Negative fair values of derivative financial instruments | **17** | - | 29 983 | - | - | 29 983 |
| Other liabilities and provisions | **19** | 2 545 | 788 | 320 | 33 544 | 37 197 |
| Deferred tax liabilities | **25** | - | - | - | 6 | 6 |
| Issued debt securities | **20** | 67 | 629 | 12 196 | - | 12 892 |
| Shareholders' equity | **22,23,24** | (55 346) | - | - | 180 754 | 125 408 |
| | | **1 143 277** | **407 662** | **336 373** | **214 304** | **2 101 616** |
| ***Income statement*** | | | | | | |
| Gross revenue - external customers | | 21 529 | 32 358 | 46 207 | (241) | 99 853 |
| Gross revenue - inter-segment | | 3 969 | (3 630) | (339) | - | - |
| Interest and commission expenditure | | (9 855) | (13 245) | (9 446) | - | (32 546) |
| Impairment and provisions for losses | **30** | (4 103) | 47 | (11 180) | - | (15 236) |
| Restructuring expenses | | 6 | - | - | (6) | - |
| Operating costs | **31** | (16 498) | (1 420) | (20 302) | (63) | (38 283) |
| Expenses related to bank levies | | - | - | - | (1 296) | (1 296) |
| Share of jointly controlled and associated companies' profit / (loss) | | 273 | - | - | - | 273 |
| **Profit / (Loss) before taxation** | | **(6 212)** | **12 841** | **2 781** | **(1 606)** | **7 804** |
| **Segment result** | | **(6 212)** | **12 841** | **2 781** | **(1 606)** | **7 804** |
| Other information | | | | | | |
| Capital expenditure | | - | - | - | 5 818 | 5 818 |
| Depreciation and amortisation | **14** | 3 237 | - | 1 739 | - | 4 976 |
| Other non-cash expenses | | 415 | 36 | 511 | 1 | 963 |

In 2016 and 2017, MKB Bank conducted financial services only in Hungary. The Group had indirect interests in the Bulgarian car financing market, besides its domestic subsidiaries, however the shares were disposed on 30 June 2016. Consequently both revenues and non-current assets can be connected to domestic activities based on geographical location.

## 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 consolidated 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.

Data in HUF million except stated otherwise

Since the Group'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.

# 40 Non-current assets held for sale and discontinued operations

On 31 December 2016, two of the Bank branches (Budapest, street Andrássy and Alagút) were disclosed as non-current assets held for sale in the amount of HUF 285 million. These branches did not serve any banking activities so they were closed and the management was committed for the sale of the properties. Furthermore related to the sale of the educational and leisure center in Balatonfüred, and sailboats were also disclosed in this line in the amount of HUF 24 million. In 2017, the real estates and the sailboats were sold.

For the year ended in December 2017, the net amount of non-current assets held for sale amounted to HUF 21,648 million; in the previous year it was HUF 309 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.

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

40.1

| | 2017 | 2016 |
|---|---|---|
| ***Assets*** | | |
| Loans and advances to customers | 21 648 | - |
| Intangibles, property and equipment | - | 309 |
| **Total assets** | **21 648** | **309** |

# 41 Government grants

The National Bank of Hungary 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 251,536 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 17,575 million) and to Other liabilities (HUF 13,863 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 74,931 million as of 31 December 2017 (2016: HUF 95,478million).

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.

## 42 Share based compensation

On 14 July, 2016 MKB Bank established the Employee Share Ownership Programme (ESOP) organization of the Bank. The organization was established in order to fulfil the objectives of the remuneration policy of the Bank. Based on the remuneration policy the eligible employees of the Bank is entitled to purchase the shares of the Bank given certain non-market vesting conditions. In certain group of eligible employees are entitled to cash compensation based on the actual sale of the shares held by the ESOP organization given certain non-market vesting conditions are met. The vesting conditions include employment during the vesting period and a successful listing process of the Bank's shares to a regulated capital market or three years of prudential operation according to efficient and effective risk management prescribed by law. The listing process should be closed until the end 2019 and the ESOP organization is required to sale the MKB shares held in two years after the successful listing process. The exercise price of the share program is the transaction price which the ESOP program purchased MKB shares on July 14, 2016.

Data in HUF million except stated otherwise

Details of the share based compensation:

42.1

| 2017 | Number of shares | Weighted average exercise price (HUF/share) |
|---|---|---|
| outstanding at the beginning of the period | 32 866 989 | 164 |
| modification due to capital reduction at the beginning of the period | 14 578 673 | 370 |
| forfeited at the beginning of the period | 196 325 | 370 |
| granted during the period | 225 000 | 370 |
| forfeited during the period | 665 159 | 370 |
| outstanding at the end of the period | 14 334 839 | 370 |
| distributable at the end of the period | 665 161 | 370 |

| 2016 | Number of shares | Weighted average exercise price (HUF/share) |
|---|---|---|
| outstanding at the beginning of the period | - | - |
| granted during the period | 33 823 499 | 164 |
| forfeited during the period | 449 152 | 164 |
| outstanding at the end of the period | 32 866 989 | 164 |
| exercisable at the end of the period | - | - |

In order to determine the fair value of the share based compensation the Bank used Black-Scholes-Merton model with the following key parameters of risk-free rate of 2.25%, Volatility 25%. At the year end of 2016 the estimate of the spot price is based on the transaction price related to the sale of the Bank’s shares between MSZVK Magyar Szanálási Vagyonkezelő Zrt. and the new shareholders,, at the end of 2017 the basis was an independent expert evaluation, which estimate the market price of 100% issued shares of MKB Bank. As the Bank’s shares are not listed, the volatility is estimated based on historical volatility of share prices of the similar exchange listed banks in Hungary.

At 31 December 2017 vesting conditions of ESOP/MRP are foreseen probable to be met by the management (1. three years of prudential operation according to efficient and effective risk management prescribed by law or 2. admission of MKB shares to a regulated capital market and 3. employment during the vesting period) and HUF 1,259 million expense recognised within operating expenses.

# 43 IFRS 9 "Financial Instruments"

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 Group currently plans to apply IFRS 9 initially on 1 January 2018. The implementation of IFRS 9 has significant impact on the consolidation financial statements, therefore the Bank discloses the estimated impact of the implementation of IFRS 9 based on the currently available information.

**Classification – Financial assets**

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost (AC), fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL/FVPL). 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 Group 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. 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 or when it is close to the maturity.

**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.

**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 Group'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.

Data in HUF million except stated otherwise

43.1

| | 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** | **78 017** | **-** | **-** | **78 017** |
| **Loans and advances to customers** | **858 592** | **(15 037)** | **(253)** | **843 302** |
| Opening balance under IAS 39 | 858 592 | | | |
| Addition: to mandatory FVPL (IFRS 9) | | (15 037) | | |
| Remeasurement: ECL allowance | | | (253) | |
| Closing balance under IFRS 9 | | | | 843 302 |
| **Investment securities - Held to maturity** | **559 319** | **(308 723)** | **(354)** | **250 242** |
| Opening balance under IAS 39 | 559 319 | | | |
| Addition: to FVOCI - debt instruments | | (308 723) | | |
| Remeasurement: ECL allowance | | | (354) | |
| Closing balance under IFRS 9 | | | | 250 242 |
| **Total financial assets measured at amortised cost** | **1 527 527** | **(323 760)** | **(607)** | **1 203 160** |
| ***Fair value through profit or loss (FVTPL)*** | | | | |
| **Trading assets** | **52 562** | **20 585** | | **73 147** |
| Opening balance under IAS 39 | 52 562 | | | |
| Addition: from FVOCI - debt instruments | | 20 585 | | |
| Closing balance under IFRS 9 | | | | 73 147 |
| **Loans and advances to customers** | **-** | **15 037** | **247** | **15 284** |
| Opening balance under IAS 39 | - | | | |
| Addition: from amortised cost (IAS 39) | | 15 037 | | |
| Remeasurement: from amortised cost to FV | | | 247 | |
| Closing balance under IFRS 9 | | | | 15 284 |
| **Investment securities - FVPL (mandatory)** | **19 757** | **-** | **-** | **19 757** |
| **Total financial assets measured at FVPL** | **72 319** | **35 622** | **247** | **108 188** |
| ***Fair value through other comprehensive income (FVOCI)*** | | | | |
| **Investment securities - FVOCI (debt instruments)** | **342 915** | **288 138** | **6 742** | **637 795** |
| Opening balance under IAS 39 | 342 915 | | | |
| Addition: from amortised cost (IAS 39) | | 288 138 | | |
| Remeasurement: from amortised cost to FV | | | 6 742 | |
| Closing balance under IFRS 9 | | | | 637 795 |
| **Investment securities - FVOCI (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 FVOCI** | **343 393** | **288 138** | **6 741** | **638 272** |

The Group 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.

Those Loans and government bonds, which are measured at amortised cost and failed the SPPI test or their business model changed being reclassified from ’Loans and advances to customers’ and ’Investment securities - Held to maturity’ to Fair Value through profit and loss from Fair Value through other comprehensive income.

The discounted government bonds have been reclassified to Fair Value through profit or loss from Fair Value through other comprehensive income.

Data in HUF million except stated otherwise

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

### Impairment – Financial assets and contract assets

43.2

| 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 | 93 741 | - | 19 141 | 112 882 |
| **Total** | **93 760** | **-** | **19 144** | **112 904** |
| **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 FVOCI (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** |

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 FVOCI, 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.

During the financial year 2017 the Group proceeded with the development of business and risk concepts addressing the changes in accounting and methodological framework. As part of this effort numerous impact studies were performed and are planned to continue in 2018. Besides the impact simulation rounds data availability and data quality assurance program was launched in order to identify data sourcing logic and other IT impacts.

Data in HUF million except stated otherwise

43.3

| | Stage 1 | Stage 2 | Stage 3 | POCI | |
|---|---|---|---|---|---|
| **Assets to be measured at Amortised cost** | **12-month ECL** | **Lifetime ECL** | **Lifetime ECL** | **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 | 150 511 | 20 612 | 4 944 | - | **176 067** |
| 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 | 75 336 | 22 475 | 17 042 | - | **114 853** |
| Securities and shares for investment purpose | 264 122 | 190 | - | - | **264 312** |
| Other financial assets | 32 636 | - | 69 | - | **32 705** |
| Other receivables | 42 443 | 94 | 3 347 | 302 | **46 186** |
| Placements with, and loans to, other banks | 78 027 | - | - | - | **78 027** |
| Credit cards | 2 424 | 157 | 194 | - | **2 775** |
| **Total gross carrying value** | **1 103 182** | **67 317** | **96 841** | **48 936** | **1 316 276** |
| ***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 | 780 | 2 343 | 4 131 | - | **7 254** |
| Loans for current assets to customers | 726 | 264 | 13 542 | - | **14 532** |
| Overdrafts | 301 | 178 | 4 762 | - | **5 241** |
| Other loans to customers | 753 | 670 | 23 792 | - | **25 215** |
| Securities and shares for investment purpose | 207 | 5 | - | - | **212** |
| Other financial assets | 137 | - | 64 | - | **201** |
| Other receivables | 611 | 2 | 2 729 | 133 | **3 475** |
| Placements with, and loans to, other banks | 22 | - | - | - | **22** |
| Credit cards | 201 | 46 | 181 | - | **428** |
| **Total loss allowance under IFRS 9** | **5 477** | **4 096** | **81 959** | **21 584** | **113 116** |

## 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.

# 44 Events after the end of the reporting period

On 28-29 December 2017, Blue Robin Investments S.C.A. and Pantherinae Pénzügyi Zrt. bought 10 million ordinary shares at 1,000 HUF face value from Pannónia Pension Fund. During the transaction Pantherinae Pénzügyi Zrt. acquired 3.1 % share in the Bank, interest of Blue Robin Investments S.C.A. increased from 26%, to 32.9%, the ownership of Pantherinae Pénzügyi Zrt. was ceased. The fact of the purchase was entered in the Shareholder Register on 4 January 2018. (New Owners' structure refers to Note 1.)

On 31 December 2017, a large loan-portfolio was reclassified to non-current assets held for sale in net amount of HUF 21 648 million. According to the contract transferring of the loan-portfolio must be performed in two parts in 2018. The first package was transferred at the beginning of February 2018. (Details in Note 40.)

After the end of the reporting period there were changes in the Composition of the Governing bodies of MKB Bank Zrt. From 14 February 2018 the mandate of Rakesh Kumar Aggarwal as a member of the Board of Directors was ceased. Drabik Zsolt's membership of the Board of Directors took effect on the same day. On 2 March 2018 Szemerey Tamás Béla became a member of the Supervisory Board, the membership entered into force. New members were designated by Blue Robin Investments S.C.A. the preference shareholder, for the period up to 5 years from the assignment; the appointment was supported by Nomination Committee of MKB Bank Zrt., and authorised by the National Bank of Hungary. The new members signed the Declaration of Acceptance.

MKB Bank Zrt. established a new mortgage bank in 2016, with 99 % participation and purchased back 1% of the shares held by Gránit Bank Zrt. in 2017. MKB Jelzálogbank Zrt. (hereinafter: Jelzálogbank) initiated the relevant procedures to obtain the operating authorisation in 2016, this process has been delayed and was in progress during 2017.

After strategic discussion the Board of Directors of MKB Bank Zrt. decided - maintaining the possibility of establishing a mortgage bank later on – to conclude the project about the establishment of a mortgage bank and to withdraw the application for operating authorisation. On 21 February 2018 the National Bank of Hungary issued its order and terminated the proceedings at the request of the Bank, the resolution on repeal the establishment is expected to be issued. The winding up can be feasible after the cancellation.

Compliance with the law HUF 4 million capital reduction was required in Euro-Immat Kft., from HUF 4 758,48 million to HUF 1 758,48 million. Consequently the own equity/registered capital ratio was recovered. The Court of Registration registered the transaction on 5 March 2018.

On 9 March 2018 there was a private placements of subordinated bond in nominal amount of EUR 15 million with maturity of 14 June 2024.

# BUSINESS REPORT
## to the consolidated 2017 financial statements of
## MKB Bank Zrt. (Prepared under IFRS)

In 2017, the scope of activities of MKB Bank Zrt's subsidiaries and jointly controlled companies comprised the following sectors

- **banking services**
- **finance and operating leases**
- **financial and investment services**
- **valuation and sales tasks related to work-out activities**
- **maintenance of buildings and fixed asset investments**
- **property investment**
- **other loans (motor, car and other vehicle loans)**
- **renting vehicles, trade and repair**
- **management of investment funds**

The activities of subsidiary companies and jointly controlled entities were tightly fit to the core credit institutional feature and, moreover, to MKB Bank Zrt's own business strategy and business policies.

In line with group-wide business policy targets elaborated early 2001, finance and operating lease activities were concentrated in MKB-Euroleasing Group.

MKB Group's profit after taxation for 2017 under IFRS amounted to HUF 19,201 million gain.

Consolidated shareholders' equity was HUF 140,380 million at 2017 year-end.

As at 31 December 2017, MKB Group held repurchased own shares of HUF 5,550 million in its portfolio (2016: HUF 5,550 million).

Budapest, 4 April 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

**Annex**

## Governing bodies of MKB Bank Zrt. as at 31 December 2017

| Supervisory Board: | Board of Directors: | Executive Committee : |
| --- | --- | --- |
| Chairman | Chairman | Chairman |
| Dr Mihály Barcza | János Jaksa | dr. Ádám Balog |
| Members | Members | Members |
| Albert Godena | Rakesh Kumar Aggarwal | András Bakonyi |
| Tibor Lados | Dr Ádám Balog | Zoltán Bánfi |
| Dr Ádám Lovászi-Tóth | Balázs Benczédi | dr. András Csapó |
| Ferenc Müller | Dr András Csapó | Csaba Gábor Fenyvesi |
| János Nyemcsok | Márk Hetényi | Ildikó Ginzer |
| | Imre Kardos | 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 2017. 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 2017 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.

## OPERATING ENVIRONMENT

### International macroeconomic environment

With regard to global developments, 2017 was characterised by gradually improving macroeconomic environment, low volatility, persistently low inflation expectations and the related monetary policy dilemmas.

The Fed raised interest rates three times, respectively in March, June and December and, in October 2017, began to gradually reduce its approximately USD 4,500 billion balance sheet, effectively stepping on the path of quantitative tightening. In the last month of the year, market sentiment was shaped mainly by the expectations of the American tax overhaul.

At the same time, the ECB and the Japanese central bank decided to extend its scheme of asset purchases in 2018, which further increased the global liquidity surplus. In the Eurozone, business climate indices hit six-year records during the year, while the modest inflation expectations confirmed the continuation of the loose monetary policy. In the first half of the year, the European political risks dropped significantly, however, in the last month, the stalling negotiations in reorganizing the Catalan and German government cast a shadow on the overall picture. The Brexit talks entered into a new phase at the end of 2017, focusing on the issues of transition and the system of relations that will follow the UK exit.

In January 2018, the International Monetary Fund revised up its forecast for the global economic growth in 2018-2019' projecting 3.9% global growth for both 2018 and 2019, which is 0.2 percentage points higher than the prognosis published in October 2017. According to the IMF, the risks of global growth, driven mostly by the economic performance of the developing countries are balanced in the short term, but in the medium term the geo-political tensions, political uncertainties and the surfacing protectionist tendencies of certain countries pose downward risks.

### Hungarian macroeconomic environment

In 2017, the average GDP growth was 4.0% in Hungary with the expansion fuelled by accelerating capital investments and the favourable external business climate. Due to the major sports events held in the summer, tourism and services grew dynamically, while the construction industry benefitted from the increase in EU projects and housing and office construction projects. Consumer prices rose on average by 2.3% in 2017. The volume of savings also grew owing to the wage contribution cuts and minimum wage increase: the financial assets held by residents expanded by 7.7% on an annual basis in Q3 2017. Household spending was also up in 2017. The unemployment rate stabilised at a low level and the shortage of labour still remained the characteristic of certain sectors in the second half of 2017.

In 2017, the National Bank of Hungary gradually reduced the three-month deposit stock (from HUF 900 billion at the beginning of the year to HUF 75 billion by December) without changing the reference rate. A number of new components were added to the unconventional monetary toolset. In the first half of the year, the central bank introduced 6 and 12-month FX swap tenders which could contribute to maintain an abundant liquidity for an extended period in the inter-bank market. As a result of the step, the Hungarian short-term inter-bank rates fell into the negative territory. In November 2017, decisions were taken to introduce two new unconventional tools aimed at maintaining the loose monetary policy.

In 2017, the EUR/HUF exchange rate fluctuated around the 309 level with moderate volatility (on average 309.24).

**Overview of the banking sector**[3]

The favourable profitability trends of the Hungarian credit institution sector continued in 2017: Credit institutions reported HUF 694.0 billion profit before tax in 2017, which was up by 38% over the already record-high profit before taxation booked in the same period of the previous year. However, such a high profit level was partly the result of one-off, non-repetitive one-off items and impacts or structural effects, such as reversed impairment or the effect of reduced banking tax following the stabilisation of the budget. Due to the favourable macro-economic environment, portfolio cleaning and the significantly better quality of extended new loans, impairments and provision were released, which increased the profit. In the credit institutions sector, the ratio of loans overdue for more than 90 days sank to 7.6% in the household segment and dropped to 3.3% in the non-financial corporate segment.

In 2017, the capital requirements for banks were raised: apart from the increase in the capital maintenance buffer, a capital buffer was also introduced for other systemically significant institutions and a systemic risk capital buffer was required for non-performing project loans. Beside these measures, the capital position of the banking system still remains stable; at the end of 2017 the capital adequacy ratio was at 20.5%, while the historically high profits can further increase the capital buffer of the sector.

At the end of 2017, the total assets of the credit institutions were close to HUF 36.4 thousand billion. The net loan portfolios of domestic non-financial companies and households expanded by 12.7% and 4.6%, respectively. The lending practises of the corporate segment were supported by the favourable macroeconomic trends, low interest rates and the support of the continued Market-based Lending Scheme (MLS). While in the retail business the increasing consumption, improving labour market trends, a growth in real-wages due to the low inflationary environment and the dynamic housing market, gave momentum to both housing and personal loans.

MKB expects the banking system to further reinforce its position: the favourable tendencies in lending business will continue, while demand for the investment and consumption will drive up lending volume growth in the retail and corporate segments. In terms of profitability, an increase in lending mitigates the effect of low interest rates.

Numerous innovations have been made in 2017 and are on-going in the banking sector for which customers are the direct beneficiaries: the digital shift, including the further introduction of an instant payment system, means faster, more efficient and cheaper products and services for customers, while the Certified Consumer Friendly Housing Loan created by the National Bank of Hungary strengthens the banking system competition and increases the transparency of the loan products and their comparability as well.

[3] Source of data: MNB, preliminary data

## PERFORMANCE OF THE MKB BANK GROUP IN 2017

**MKB Group's (consolidated) total assets under IFRS** was HUF 2,045.0 billion at the end of 2017, representing a 2.7% decrease. The portfolio of customer loans stagnated at HUF 858.6 billion, while the customer deposit portfolio grew slightly to HUF 1,539.1 billion by the end of 2017. MKB Group's profitability improved significantly in 2017: it reported HUF 20.7 billion pre-tax profit, in contrast to the HUF 7.8 billion in 2016. The Group'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[4]

### Retail segment

The aim is to place the retail business to a robust growth trajectory via increasing new customers, at the early phase of customer acquisition, relying partly on corporate affiliation and strategic co-operations of MKB, and with due time build upon the on-going digital developments and Fintech incubation programmes. This objective is supported by the improved processes, intensive product development and steps towards enhancing the digital customer experience, which enables the bank to provide retail customers more complex offers and a more complete product and service range. MKB is constantly developing its digital services in order to enable its customers to manage their finances faster and more effectively 24 hours a day.

Thanks to successfully implemented strategy, the number of customers has risen: the number of acquired new customers is almost 40% higher compared to previous year, while the number of customers leaving the bank dropped by two-thirds.

More than 21 thousand customers have joined the loyalty scheme of the MKB Pláza established at the end of 2016, benefiting from the preferential terms and conditions offered by 157 companies.

In 2017, there was a rapid rise in the new loans extended by the Bank to retail customers: the disbursed mortgage loan portfolio grew almost by 140%, while the disbursement of new personal loans increased by nearly 120%. The majority of the retail loans are secured: 91% of the portfolio is made up of mortgage loans for home purchases and all-purpose mortgage loans. The Bank’s External Sales Partners also made valuable contributions to an increase in the loan portfolio.

The household assets[5] managed by the Bank exceeded HUF 740 billion by the end of the year. The transformation of the structure of savings continued to follow the specificities of the low interest rate environment: while the share of term deposits and bonds was gradually decreasing, the assets in investment funds and government securities were rising.

[4] Source of market share data: NBH, MKB own calculation
[5] deposits + bonds + investment funds + government bonds

**Branch network and alternative sales channels/Digitisation**

In addition to its national network of 69 branches (24 branches in Budapest and the surrounding metropolitan area and 45 branches in the countryside), the Bank uses external sales channels to provide its products. In 2016, it re-introduced sales through loan intermediaries, as a result of which MKB became a dominant player in the market of mortgage loans and small corporate products.

It is MKB's ultimate strategic goal to become Hungary's leading digital bank. Further significant steps were taken in 2017 to achieve this goal: the Bank was first to introduce a number of developments in the market. The number of customers banking digitally has been constantly rising and by the end of the year, two-thirds of customers were using digital channels.

In April 2017, MKB was one of the first in Hungary to introduce the mobile wallet service called MKB Pay. In Hungary, mobile wallet payment is considered to be in its infancy, but it is developing robustly and may soon become a general payment method. The use of MKB Pay also reflects the same tendency: more than 10% of the customers banking through their mobile phones already use the application.

The introduction of online account opening was one of the greatest novelties in 2017. MKB beat its competitors and was among the first to launch this new service. Following a videochat identification not only can a bank account be opened but customers can also immediately start using the bank cards attached to their accounts with the help of the MKB Pay application. MKB Bank was the only bank offering instant bank card virtualisation to its customers in 2017.

The number of mobile bank application users more than doubled in 2017, which means that 25% of digitally banking customers use their smartphones for banking. A number of new functions were added to the application in two phases, in the spring and in the autumn: with a unique option, customers can login through a push message and approve transactions in Netbankár (internet based finance-management), while MKB was the first bank in Europe to introduce facial recognition based identification, significantly enhancing security in mobile banking.

MKB was also the first bank among the Hungarian credit institutions to introduce online requests for mortgage loan offers for its retail customers, significantly shortening and simplifying the administration.

Our website was also revised during the year for easier orientation and more effective information, as a result of which the number of new visitors doubled.

The other part of the development concerns the areas of operation which are less visible for customers. The change in the core operational system (Flexcube) of the bank and the optimization of business processes all contributed to a large extent to the implementation of a customer-oriented approach. These developments being tailored to the needs of customers support a safe, rapid and simple process of customer administration, while enhancing customer experience.

**Corporate and institutional customers**

The strategic aim of MKB Bank, building upon on its traditional values, is to maintain a strong corporate business line focusing on local knowledge, responsible and professional servicing, advisory-based sales and orientation for innovative solutions. In 2017, MKB focused, increasingly on small and medium-sized enterprises, beside the traditional large corporate segment. All corporate customers irrespective of size are served within one business line helps to expand the Bank's small corporate business. This structure secures that MKB can provide its customers with uniformly consistent, high quality and effective services, following their development. MKB achieved outstanding success in the small corporate segment in 2017. Following a successful public procurement procedure, in the summer of 2017 MKB signed an intermediary agreement with Hungarian Development Bank (Magyar Fejlesztési Bank, MFB) for the establishment of 35 MFB Points in MKB branches, for the intermediation of MFB products and in order to enable customer access to refundable and non-refundable financing under favourable conditions. More than 200 trained colleagues manage customer requests at MFB Points opened by MKB. By the end of the year, the processing of transactions of more than HUF 8.5 billion began and the first disbursements were also made.

MKB continued its successful involvement in phase 3 of the Funding for Growth Scheme (FGS) of the National Bank of Hungary in the first quarter of the year, made further commitments in phase 2 of the Market-Based Lending Scheme (MLS) and considerably exceeded its overall MLS commitment in 2017. In addition, it also lended significant volumes in the framework of Eximbank's Export Promoting Credit Programme (Hungarian abbreviation: EHP). Financing products include card, working capital and investment loan facilities offered within the Széchenyi Programme. MKB Bank has played an outstanding role in the success of the Széchenyi Card Programme from the very beginning. By raising the maximum amount of loans to HUF 100 million, it now offers a flexible, even larger credit, facility which, combined with other MKB Bank products, creates a sound financial basis for micro, small and medium-sized enterprises. On the basis of the financing provided via the programme in 2017, the Bank had 20.3% market share, which secures the Bank a stable second position in the market. The Agricultural Széchenyi card instrument launched in 2016 must also be highlighted hence the Bank has already loaned approximately HUF 31.5 billion within this framework in 2017.

In the second half of 2017, the Bank founded the MKB Agricultural Competence Centre with the aim of providing the agricultural sector professional services such as key programmes, special financial products designed for the sector and expert advice. To promote the expert advisory services and to support the sector not only financially but also professionally, the bank entered into a strategic agreement with the Hungarian Chamber of Agriculture (NAK) and the National Association of Agricultural Machine and Equipment Distributors (MEGFOSZ).

In the large corporate segment, the Bank has maintained its strong market positions in lending and, among the large and medium-sized corporate customers, places great emphasis on offering effective financing instruments structured to suit individual requirements.

**Investment services**

MKB Group offers a wide ranges of investment banking services such as Private Banking, Asset Management, Consulting, Advisory in Capital Market and M&A, FintechLab, Venture Capital Fund management, MFB Points and Treasury. The aim is to exploit more intensively all means of cooperation within the group.

Apart from its own funds with a wide range of investment options, MKB-Pannónia Investment Fund Manager offers the products of five foreign and three Hungarian partners, available in the various customer segments. The sale of structured bonds and certificates was also added to the traded investment funds, thus expanding the spectrum of investment products.

MKB is a primary and contracted dealer of institutional and retail government securities. Within the framework of a distribution agreement, the Bank also sold the bonds of Diákhitelközpont, Hungarian Development Bank and FHB Mortgage Bank.

In the futures FX section of Budapest Stock Exchange, MKB became the stock exchange member with the second largest turnover in 2017.

MKB became a NOMAD (Nominated Advisor) in the recently founded SME market (Xtend) of the Budapest Stock Exchange at the end of the year. It started regular analyses in relation to Alteo and Masterplast shares and in 2018, the Bank regularly quotes bid and offer prices for the two securities for investors.

In 2017, the capital market and transaction advisory unit of MKB managed all, precisely four public purchase offers in the Hungarian capital market.

At the end of 2017, the National Bank of Hungary approved MKB's public issuance programme up to HUF 100 billion.

MKB Private Banking further strengthened its market positions in 2017. The business line managed more than HUF 420 billion assets of almost 2 thousand customers, which corresponds to a HUF 80 billion increase versus 2016. With that performance, the Private Banking business line made it into the top three players in the market. The average size of HUF 236 million assets managed for one customer stands out significantly from the market average. The opportunities involved in the cooperation between MKB Private Banking and MKB-Pannónia Investment Fund Manager may bring further important developments in investment banking, while the development incubated in MKB Fintechlab will also grant access to innovative services.

Premium investment services include customised sample portfolio-based investment consultancy and a broad array of products, customised products and personal liaising with highly qualified experts. The customer assets managed in the service launched in 2016 reached HUF 100 billion by the end of 2017.

**Service quality and customer satisfaction**

Customer satisfaction is a determining factor in our operations. The Bank is engaged in constant dialogue with its customers and regularly monitors their satisfaction. MKB Dialóg - an online Q&A query community platform for MKB customers - was launched in 2017 with an aim to represent customer voice within the organization and to ensure that customer opinion is taken into account and integrated into the operations of MKB, be it a new product launch or the approval of the of the new website.

The entire chain of MKB's actions is centred around customer experience. According to the results of the complex customer satisfaction survey conducted in the autumn of 2017 involving a number of business lines/segments via questioning thousands of customers, it seems the bank's efforts gaining ground since the conducted research indicates that a large number of customers would recommend MKB.

## SUBSIDIARIES/STRATEGIC PARTNERS

In addition to our own banking products and services, our full product range includes the services offered by our subsidiaries and partners. Our aim is to reinforce the market position of our strategic subsidiaries, to enhance intra-group cooperation and to improve the auxaliry financial services.

## MKB FINANCIAL GROUP

### MKB Euroleasing group[6]

Based on new financing volumes which surpassed by almost 25% the 2017 Plan, MKB-Euroleasing solidly maintained its position and continued to be one of the top three market-leading leasing companies; it became the market leader in the agricultural machine financing segment in Q1 2017 and maintained its second position in retail vehicle financing, and at the same time, it also managed to become one of the largest market players in financing of large commercial vehicles. With solid basis for building diversified portfolio, the Group has an optimistic outlook for 2018, expecting an increase in the volume of its new loans and a further strengthening of its market position.

At MKB-Euroleasing group, the processes are developed with the Kaizen methodology, integrated deeply into the operation of the organisation. The continuous, gradual development taken in small steps is one of the fundamental principles of the methodology. 2017 was declared the year of Kaizen, and therefore almost 500 proposals were collected during the year, most of which were actually implemented. Simultaneously with process development, major product development activities also took place, as a result of which, the operational lease products became available in the general machine financing segment and the bank is the first to be able to offer open-ended financial lease products to retail customers in the market. The complex vehicle-financing instrument launched in the autumn of 2017 allows both companies and private individuals to use the servicing options integrated into the financing. With the dissemination of that product in the market, more and more customers can have access to a more economical and flexible option of the complex vehicle fleet management combined with a long-term operating lease.

MKB-Euroleasing is also seen as one of the best workplace, since in 2017 it received the AON Best Workplace award. Where people love to work, customers can count on the highest possible service level.

### MKB Consulting

Just two years after its foundation at the end of 2017, MKB Consulting had become a major player in the tender and financial consultancy market. Concerning the tendering business line, the company helped 260 customers within its small corporate portfolio to gain access to approximately HUF 1.5 billion assistance during the year, while the key corporate customers of the company were granted HUF 11 billion assistance through successful applications dedicated mainly to research-development and innovation.

MKB Consulting provides advisory services in fund raising for various institutional entities, such as city of county rank, Budapest Stock Exchange (BÉT) and key equity fund managers. Within the

[6]Source: Hungarian Leasing Association

framework of fund raising through the equity market, the company worked for almost eighteen months to re-start the National Exchange Development Fund with HUF 20 billion share capital, which, according to the plans, can finance at least four new companies a year in making their way to the Budapest Stock Exchange. Besides this flagship project, the advisory activities of MKB Consulting also contributed to the implementation of the BÉT training and stock exchange preparation projects from 2018.

**MKB Inkubátor Kft./MKB Fintechlab**

We believe that large companies and start-ups complement each other. MKB, therefore, as the first Hungarian bank opened up to the world of start-up technology and innovation (and now with Fintechlab, i.e., its innovation laboratory and start-up incubator), MKB Fintechlab has become the dominant actor not only in the Hungarian, but in the regional market as well.

Fintechlab supports the strategy of the Financial Group through three pillars: it builds up a community leading in innovation around the Financial Group, supports start-ups within the framework of its incubation programme and seeks out and builds up valuable partnerships for MKB. In 2017, two partnerships were established: FintechBlocks developed the Bank’s new innovation platform and FaceKom developed the unique video-bank-assisted account opening.

Each year Fintechlab selects 6-10 Hungarian and regional start-up companies that are developing global standard fintech solutions and provides a unique incubation environment (accelerated development path and validation, product development and market-entry) and financial support for them. In 2017, six Hungarian fintech start-ups took part in the incubation programme, and some of them won Hungarian and international awards. Fintechlab also began to raise its activities to international level: start-ups from 11 countries applied for the second incubation programme.

**MKB SZÉP Card**

The popularity of MKB SZÉP Cards speaks for itself. It rapidly became one of the most frequently selected extra-wage benefits. It allows for advanced, versatile and comfortable utilization for SZÉP Card holders at more than 23 thousand MKB acceptance sites in Hungary.

By the end of 2017, in total 216 thousand employees benefitted from the options available with the MKB SZÉP Cards to enjoy recreation and relaxation offered in the form of preferentially taxed employer benefits, which translated into 16% increase in the number of users of MKB SZÉP Cards. In 2017, cardholders received almost 13% more benefits, which corresponds to HUF 15.3 billion. The consumption ratio is an excellent indicator of the efficiency of the Card hence HUF 14.2 billion of the granted amounts, was turned back into the economy over one year.

**MKB-Pannónia Investment Fund Manager**

A new phase opened in the history of the MKB Financial Group with the merger of the asset and fund management companies that had previously operated as separate business associations: MKB Investment Fund Manager, MKB Bank’s portfolio and asset management division and Pannónia CIG Fund Manager were incorporated into one entity. As a result of the transaction, the combined portfolio and fund management company named as 'MKB-Pannónia Investment Fund Manager' in terms of assets, became one of the five largest players in the Hungarian market. The objective is to develop the most effective professional cooperation between the Bank and the recently founded MKB-Pannónia Investment Fund Manager.

## STRATEGIC COOPERATIONS

### MKB Pension Fund

The voluntary segment of MKB Pension Fund had more than 84 thousand members and held almost HUF 133 billion assets at the end of 2017 which corresponds to almost 10% market share and ranked as 5th largest pension fund. The portfolio grew significantly, by almost 4.5% versus previous year. The terms and conditions offered by the Fund are among the most favourable available of the leading funds; its 22-year history, stable and prudent operation, professional background and results provide a guarantee for the savings of its members for retirement. The spectacular 14% increase in individual members' contributions was an outstanding result in 2017, clearly reflecting the increasing and deliberate intention of the members to save more for their retirement.

The private pension pillar of MKB Pension Fund had approximately 4 thousand members and HUF 19.5 billion assets in 2017. The main objective of the Fund is to offer services that fully satisfy customer needs with new innovative solutions. The Fund is committed to the continuous development of online services and therefore made electronic administration for its customers and employers available in 2017. With the Personal hosting and Electronic administration service, members can view their data stored in the system simply and rapidly, monitor the increase in savings and the annual account history, as well as check their current portfolio. As an electronic administration interface, the Employer portal offers administration advantages to employer partners.

### MKB-Pannónia Health and Mutual Fund

MKB-Pannónia Health and Mutual Fund has been consistently one of the leading and largest funds for twenty years. The Health and Mutual Fund operates via an advanced online administration system offering a wide range of services. At the end of 2017, it had more than 186 thousand members and its assets under management reached HUF 12.3 billion.

Following a successful tender, Dimenzió Voluntary Health and Mutual Fund merged with MKB-Pannónia Health and Mutual Fund on 1 January 2018, which strengthened its market presence and allowed the fund to become the second largest player among the health funds in the Hungarian market with members counting 210 thousand, and with the largest assets. In a unique manner, it will also have an own health centre.

In 2017, individual contributions grew by a remarkable 27% compared to the previous year and, for the first time ever, were higher than the employer contributions.

Members are able to spend their savings on themselves and on their family members at approximately 15 thousand service providers across the country, out of which 8,700 also accept MKB Health Fund cards. Customer satisfaction of the fund members illustrates the success of the self-assistance services, which have undergone dynamic growth since introduction in 2016.

The primary objective of the fund is to enhance customer satisfaction thus placing a strong emphasis on introducing new services within the legal framework. As a novelty, on 1 April 2017 it made the ‘Care Health Insurance’ available to all members on a solidarity basis, through which the fund members became automatically insured and gained eligibility for a wide range of high-quality health services.

## FINANCIAL PERFORMANCE

In 2017, the structure of MKB Group changed compared to previous year-end as follows.

MKB Bank acquired 100% ownership and voting rights in MKB Jelzálogbank Zrt. established in 2016. The main role of this specialized credit institution is to refinance mortgage loans granted by commercial banks through financing obtained by issuing mortgage bonds.

On 14 November 2017 MKB Bank established and registered another MRP organization to fulfill the objectives of remuneration policy on allowance of top management outside the organization.

On 1 December 2017 MKB Bank acquired 49% minority interest in MKB Pannónia Alapkezelő Zrt.

**Statement of Financial Position**

Total assets of the Group decreased by 2.69%, compared to the end of 2016, and amounted to HUF 2,044,987 million as at 31 December 2017.

Cash reserves decreased by HUF 66,315 million compared to the end of 2016: the balance of the account held at NBH declined by HUF 67,921 million, while cash on hand grew by HUF 1,606 million.

Loans and advances to banks rose by 16.38%, i.e. HUF 10,978 million compared to the end of 2016, mainly because of the higher volume of money market balances with other commercial banks while the maturity structure changed. The balance of short-term lending decreased by HUF 50,417 million, while other loan balance increased by HUF 61,395 million.

Financial assets measured at fair value through profit or loss showed a decrease of 3.84%, i.e. HUF 2,891 million, caused by the lower volume of securities by HUF 8,275 million which was accompanied by the growth of derivatives with positive fair values in the amount of HUF 5,384 million. Among securities, mainly government bonds decreased by HUF 13,495 million, while interest-bearing treasury bills grew by HUF 6,382 million in. Within derivative transactions, the growth was mainly driven by HUF 6,517 million higher balances of interest-related instruments, while currency-related instruments were about 20% lower.

Investments in securities slightly decreased by 2.32%, i.e. HUF 21,425 million compared to prior year end. The decline was mainly caused by the HUF 245 619 million lower balances of bonds, which was mainly offset by the HUF 208 572 million increase in held-to-maturity securities. The elements of the portfolio significantly changed: the volume of bonds issued by other corporate entities grew by HUF 19,058 million and interest-bearing T-bills by HUF 12,431 million, while the balances of Hungarian government bonds showed a decrease of HUF 52,871 million as compared to 2016 year-end.

In 2017, the balance of Loans and advances to customers slightly increased by 0.06% compared to the end of 2016, and amounted to HUF 858,592 million as at 31 December 2017.

The amount of Non-current assets held for sale and discontinued operations grew by HUF 21,339 million compared to 2016 year-end, since the management obliged to dispose a loan portfolio therefore items in net amount of HUF 21,648 million were reclassified to assets recognised held for sale on 31 December 2017.

Other asset balances showed a decline of HUF 612 million from 31 December 2016 to 31 December 2017 due to one-off items including primarily lower amount of interest rate adjustment related accruals in connection with the Funding for Growth Scheme.

During the reporting period Amounts due to other banks reflected a decrease of 36.40%, or HUF 136,950 million. The decline resulted mainly from the HUF 144,184 million lower amount of deposits placed by NBH.

Deposits and current accounts owed to customers grew by 1.27%, i.e. HUF 19,272 million in comparison with the volume as at 2016 year-end, induced mainly by HUF 389,238 million rise in balances of current accounts and growth in other items combined with HUF 387,166 million lower short- and long-term deposits.

Among liabilities, Negative fair values of derivative financial instruments increased by 44.64%, i.e. by HUF 13,383 million, primarily due to the interest- and currency-related derivative transactions.

Other liabilities and provisions increased by HUF 12,656 million or 34.02%, from 2016 year-end, mainly caused by one-off items. The amount of payable banking tax rose by HUF 4,844 million and other liabilities also showed a growth of HUF 9,690 million, which were mitigated by HUF 1,878 million reversal of accrued fair value adjustments in connection with the refinancing of Funding for Growth Scheme loans.

For the end of the financial year 2017, the volume of issued bonds dropped by 17.59%, i.e. HUF 2,268 million compared to the end of 2016 driven by interest rate change of foreign currency denominated bonds and the maturing volumes of HUF denominated bonds in the total amount of HUF 1,944 million.

On 26 May 2017, MKB Bank Zrt. issued subordinated debt in the amount of EUR 70 million (HUF 21,710 million) bearing interest at a fixed rate. The final maturity is 14 June 2024. The bonds were sold to private stakeholders.

**Statement of Profit or Loss and Other Comprehensive Income**

In 2017, Net interest income showed a HUF 908 million growth compared to the previous year. From the total change in net interest income, there was a decrease by HUF 2,723 million in interest income due to the lower cash reserves and investments in securities including the balance of the account held at NBH. Net interest expenses paid to banks decreased by HUF 2,063 million in line with lower Amounts due to other banks as written above. Net interest income from customers grew by HUF 4,008 compared to 2016 as a result of lower interest expenses relating to deposits placed by customers as the decreased market interest rates induced decline volume of deposits. The cost of debt financing dropped by HUF 797 million compared to the previous year, caused by the shrinking volumes of bonds due to the repayments at maturity dates. In addition, net interest income derived from interest-related derivative transactions in hedge accounting fell by HUF 3,327 million during the year.

Net income from commissions and fees increased by 0.63%, i.e. HUF 182 million compared to the previous year, due to the change of pricing policies, product conditions, and the expansion of specific business volumes. The movement in total Net income from commissions and fees was positively affected by the growth in commission income: net HUF 984 million relating to bank account services and net HUF 179 million on bank card transactions. The increase was considerably offset by the decline of brokerage fees in the amount of HUF 968 million in connection with securities trading.

Data in HUF million except stated otherwise

The net balance of other operating income and expense showed an increase of HUF 16,505 million, and amounted to HUF 10,219 million net income as at 31 December 2017. The development was a result of different effects: the fair value revaluation of financial instruments measured through profit and loss was higher by HUF 2,981 million which was decreased by the HUF 2,050 million loss accounted for on hedging transactions in the same period of 2016. Meanwhile, as increasing effects, the net gain realised on sale of liquidity securities rose by HUF 7,767 million and the amount of banking tax declined by HUF 4,157 million, the latter due to changes in the respective legislation. Simultaneously, other net expenses decreased by HUF 450 million during 2017.

Impairments and provisions dropped by HUF 5,625 million compared to prior year end, and amounted to HUF 9,611 million in 2017.

Operating costs grew substantially by 27.17% or HUF 10,402 million, mainly due to higher personnel related expenses and HUF 1,654 million growth in legal and advisory services together with the increase of IT costs in the amount of HUF 544 million.

Expenses for Legal and advisory services contain the following other audit service fees for 2017:

| 2017 | Amount in HUF |
|---|---|
| ***Reviews to ensure trouble-free execution***** Reviews relating to offering of mortgage loan as coverage | 6 278 000 + VAT |
| ***Report on IFRS preparedness*** Compliance reviews provided to the Bank on the IFRS model implementation under prudential regulation according to requirements of Act C of 2000 on accounting | 1 000 000 + VAT |
| ***Review on dividend payment*** Assurance reviews in connection with prohibition against paying dividends by the Bank to comply with commitment made towards the European Union | 1 000 000 + VAT |
| **Other audit service fees*** | **8 278 000 + VAT** |

* Fix fee per each service
** Several services are completed during the year. Total amount represents fees accounted for all completed audit services during 2017.

Based on above factors, MKB Group's profit after taxation for 2017 amounted to HUF 19,201 million.

For the end of 2017, total other comprehensive income decreased by HUF 12,134 million compared to the previous year resulted from HUF 12,132 million lower revaluation on available-for-sale securities.

## CAPITAL MANAGEMENT

The Capital situation of MKB Group was sufficient at the end of 2017.
As a result of the 2017YE 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.

At 31 December 2017, as an actual figure of regulatory capital the Group was HUF 146.4 billion based on Basel III IFRS under Supervisory Regulation. The increase of regulatory capital - by HUF 33.6 billion – is derived from the increase of profit and subordinated debt, which was compensated by the increase of deduction of intangible assets, decrease of revaluation.

Risk-weighted assets including operational and market risk decreased by 0.65% from HUF 936.8 billion in 2016 to HUF 930.8 besides approximately 0.28% strengthening of domestic currency. The main part of the decrease derived from the decreasing market risk capital requirement and decrease of business volumes in work out and CRE segment 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

Budapest, 4 April 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer