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Consolidated Interim Financial Statements

Prepared under
International Financial Reporting Standards
as adopted by the EU

Budapest, 27 September, 2018

June 30, 2018

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Data in HUF million except stated otherwise

MKB Bank Zrt.
Consolidated Statement of Financial Position as at June 30, 2018

	Note	30.06.2018	31.12.2017
Assets			
Cash reserves		36 603	31 599
Loans and advances to banks	6	58 722	78 017
Derivative financial assets	7	29 526	19 757
Securities	8	864 221	955 274
Loans and advances to customers	9	952 822	858 592
Non-current assets held for sale and discontinued operations	31	3 916	21 648
Other assets	10	29 798	27 306
Current income tax assets		-	163
Deferred tax assets	24	4 377	3 312
Investments in jointly controlled entities and associates	11	3 295	2 643
Intangibles, property and equipment	12	48 118	46 676
Total assets		**2 031 398**	**2 044 987**
Liabilities			
Amounts due to other banks	13	373 666	239 312
Deposits and current accounts	14	1 381 766	1 539 140
Derivate financial liabilities	15	34 498	43 366
Other liabilities and provisions	17	58 313	49 837
Current income tax liabilities		877	16
Deferred tax liabilities		-	5
Issued debt securities	18	8 067	10 624
Subordinated debt	19	27 990	22 307
Total liabilities		**1 885 177**	**1 904 607**
Equity			
Share capital	20	100 000	100 000
Treasury Shares		(5 550)	(5 550)
Reserves	21	46 221	40 381
Total equity attributable to equity holders of the Bank		**140 671**	**134 831**
Non-controlling interests	22	5 550	5 549
Total equity		**146 221**	**140 380**
Total liabilities and equity		**2 031 398**	**2 044 987**

Budapest, 27 September, 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 period ended June 30, 2018

	Note	30.06.2018	30.06.2017
Statement of profit or loss			
Interest income		29 775	28 430
Interest expense		8 813	8 627
Net interest income		**20 962**	**19 803**
Net income from commissions and fees		14 035	14 621
Other operating income / (expense), net		15 451	6 306
Impairments and provisions for losses	**23**	(1 595)	(539)
Operating expenses		33 716	20 813
Share of jointly controlled and associated companies' profit / (loss)		760	-
Profit / (Loss) before taxation		**19 087**	**20 456**
Income tax expense / (credit)	**24**	1 084	983
PROFIT/ (LOSS) FOR THE YEAR		**18 003**	**19 473**
Other comprehensive income:			
Items that may be reclassified subsequently to profit or loss:			
Revaluation on financial assets measured at FVTOCI		(11 792)	(5 842)
IFRS 9 impact on remeasurement of financial assets measured at FVTOCI		(6 859)	-
Other comprehensive income for the year net of tax		**(18 651)**	**(5 842)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**(648)**	**13 631**
Profit / (Loss) attributable to:			
Shareholders of the bank		**18 003**	**19 474**
Non-controlling interests		**-**	**(1)**
Total comprehensive income attributable to:			
Shareholders of the bank		**(648)**	**13 632**
Non-controlling interests		**-**	**(1)**
Net income available to ordinary shareholders		18 003	19 474
Average number of ordinary shares outstanding *(thousands)*		85 000	85 000
Earnings per Ordinary Share *(in HUF)*	**25**		
Basic		212	229
Diluted		205	229

Budapest, 27 September, 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 period ended June 30, 2018

	Note	Share capital	Treasury shares	Share premium	Share-based payments	Retained earnings	Revaluation on financial assets measured at FVTOCI	Non-controlling interests	Total equity
At 1 January 2017		**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**
Affect on IFRS 9 implementation		-	-	-	-	(511)	6 859	-	**6 348**
Profit/(loss) for the year		-	-	-	-	18 003	-	-	**18 003**
Other comprehensive income for the year		-	-	-	-		(18 651)	-	**(18 651)**
Change in non-controlling interests		-	-	-	-		-	1	**1**
Share-based payments		-	-	-	140		-	-	**140**
At 30 June 2018		**100 000**	**(5 550)**	**21 729**	**194**	**33 736**	**(9 438)**	**5 550**	**146 221**

Budapest, 27 September, 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 period ended June 30, 2018

	Note	2018	2017
Cash flows from operating activities			
Profit/ (Loss) before taxation		**19 087**	**20 738**
Adjustments for:			
Depreciation, amortisation and impairment	12	2 057	4 546
Impairment on other assets	10	436	58
Provisions for off-BS items and settlement for customers	17	(2 194)	(915)
Impairment on financial assets (loans and advaces)	6, 9	11 448	8 802
Impairment on jointly controlled entities and associates	11	104	
Impairment on securities	8	64	*
Change in post acquisition reserve of jointly controlled entities and		-	-
Deferred tax movement		(1 070)	7
Net Interest income		(20 758)	(43 930)
Dividends on securities		(12)	(17)
Revaluation of issued securities	18	291	(376)
Revaluation and other result on securities measured at FVTOCI	8	3 823	(46 913)
Foreign Exchange movement	6, 9, 10, 17 Change in Equity	(318)	(335)
Cash flows from operating activities		12 958	(58 335)
Change in loans and advances to banks	6	19 311	(10 978)
Change in loans and advances to customers	9	(117 120)	(8 936)
Change in non-current assets held for sale and discontinued		17 732	(21 339)
Change in derivative assets	7	(9 769)	2 891
Change in securities	8	(296 162)	*
Change in other assets	10	(3 201)	554
Change in amounts due to banks (short term)	13	12 203	(153 969)
Change in current and deposit accounts	14	(157 374)	19 271
Change in other liabilities and provisions (without provision charge of the year)	17	7 143	13 490
Change in derivative liabilities	15	(8 868)	13 383
Interest received		29 558	48 362
Interest paid		(8 800)	(4 432)
Dividends received		12	17
Income tax		(1 084)	(1 537)
		(516 419)	(103 223)
Net cash (used in)/generated by operating activities		**(503 461)**	**(161 558)**
Cash flow from investing activities			
Investment in group companies		(756)	(992)
Disposals of group companies		-	(54)
Purchase of property and equipment	12	(921)	(2 726)
Disposals of property and equipment	12	168	3 174
Purchase of intangible assets	12	(2 750)	(6 403)
Disposals of intangible assets	12	985	617
Purchase of securities measured at FVTOCI	8	(255 590)	(1 393 806)
Disposals of securities measured at FVTOCI	8	436 373	1 654 456
Change in AC securities (without impairment)	8	205 923	(196 557)
Net cash (used in)/ generated by investing activities		**383 432**	**57 709**
Cash flow from financing activities			
Change in issued securities	18	(2 557)	(1 892)
Change in subordinated liabilities	19	5 683	22 307
Change in amounts due to banks (Borrowings)	13	122 151	17 019
Net cash (used in)/ generated by financing activites		**125 277**	**37 434**
Net increase of cash and cash equivalents		5 248	(66 415)
Cash reserves at 1 January		**31 599**	**97 914**
FX change on cash reserve		(244)	100
Cash reserves at the end of period		**36 603**	**31 599**

* Modification of the structure of the Financial Statement

Budapest, 27 September, 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

Notes to the Financial Statements

(from page 8 to page 80)

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 interim non-audited consolidated financial statements of the Bank as at and for the half year ended 30 June 2018 comprises 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.

[1] For further information on consolidated subsidiaries please see Note 4
[2] BRRD

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

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

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

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

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 interim 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. The financial statements are authorised for issue on the 27 September 2018 by the Board of Directors.

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

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

3 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.

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.

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 potential 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 the 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 the identifiable assets, liabilities and contingent liabilities of the business acquired, the difference is recognised immediately in the statement of comprehensive income.

Funds 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.

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.

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.

A list of the Group's significant jointly controlled and associated companies is set out in Note 4.

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 Group's share of the identifiable assets, liabilities and contingent liabilities acquired. If Group's interest in the fair value of the 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 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 costs and subsequently carried at costs less any accumulated amortisation and any accumulated impairment losses. Intangible assets are amortised over their estimated useful lives not exceeding 15 years from the date when the asset is available for use, applying the straight-line method.

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

Expenditure on internally developed intangible asset (software) is recognised as an asset when the 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.

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 „Operating expenses" line in statement of comprehensive income.

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

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

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 losses.

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

Investment property

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

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

Cash reserve

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

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

Determination of fair value

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

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

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

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

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

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

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

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

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

Initial recognition and measurement of Financial Instruments

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

Through initial measurement, all financial instruments - except for accounts receivables - that were not measured at fair value, are recognized at a modified fair value by the Group. The modified fair value includes all transaction costs which are directly attributable to the issuance and acquisition of financial instruments.
Financial instruments measured at fair value through profit or loss are recognized at their fair value by the Bank. All related transaction costs incurred at their inception, issuance, and/or purchase accounted as expense through Profit or Loss. If accounts payables do not contain significant financing component, they are recognized at transaction price by the Group.

Classification and subsequent measurement of Financial Instruments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Classification and measurement of financial liabilities subsequent to initial recognition

The Group classify its financial liabilities into the following categories:

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

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

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

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

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

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

Fair Value Option (FVO)

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

Determination and recognition of the Expected Credit Loss

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

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

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

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

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

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

- changes in the clients’ rating after the issuance,
- PD change in the master scale compared to the initial value,
- default in payment,

- the amount of the client's exposure classified as Stage 2 exceeds a certain proportion of its gross exposure.

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

Financial assets whose default risk has increased to such an extent after initial recognition that there is objective evidence of impairment have to be assigned to Stage 3 and a loan loss provision has to be recognised by calculating the Lifetime-EL.

The Group defines materiality threshold, exposure that are below that threshold should be considered as a small amount (below the limit). The impairment of those assets which are above the threshold should be estimated individually.

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

The impairment and provision of assessed as class of clients calculated on monthly basis, automatically.

Factors taken into account when determining expected credit loss:
- remaining lifetime in years,
- exposure at default (EaD),
- lifetime expected credit loss (LtEL),
- loss given default (LGD),
- probability of default (PD),
- credit conversion-factor (CCF),
- loss rate of the non-default and default transaction,
- discount rate calculated on the remaining lifetime.

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

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

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

The applied risk parameters are determined on the basis of statistical models for homogeneous groups and transaction groups. The models are validated at least once a year, and if necessary it will be revised.

For transactions that are recognised at fair value, the fair value calculation the credit risk component of the discount factor is calculated based on the principles related to determination of ECL as mentioned above.

The Group calculates the expected credit loss for the remaining lifetime, excepting the following financial instruments for which the loss is calculated for 12 months:
- debt securities with low credit risk at the reporting date,
- financial instruments excepting lease receivables and account receivables, which credit risk do not significantly increased compared to initial recognition.

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

The expected credit loss represents the expected credit losses of a financial asset until maturity in terms of a probability weighted average. These are evaluated based on the followings:

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

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

If the credit risk of the financial instrument has increased significantly since its initial recognition until the reporting date, the Group recognises the loss on the asset at the same amount as the expected lifetime credit loss. If the credit risk of the financial instrument has not significantly increased since the initial recognition until the reporting date, the Group recognizes loss on the asset at the same amount of the 12-month expected credit loss. The impairment/expected credit loss calculated for 12 months is the part of the lifetime expected loss results from potential default events within 12 months of the reporting date.

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

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

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

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

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

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

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

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

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

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

The Group present recognized loss for the expected credit loss on the following financial instruments measured not at fair value through profit or loss:

- debt instruments,
- lease receivables,
- trade receivables,
- financial guarantees and,
- lending commitments.

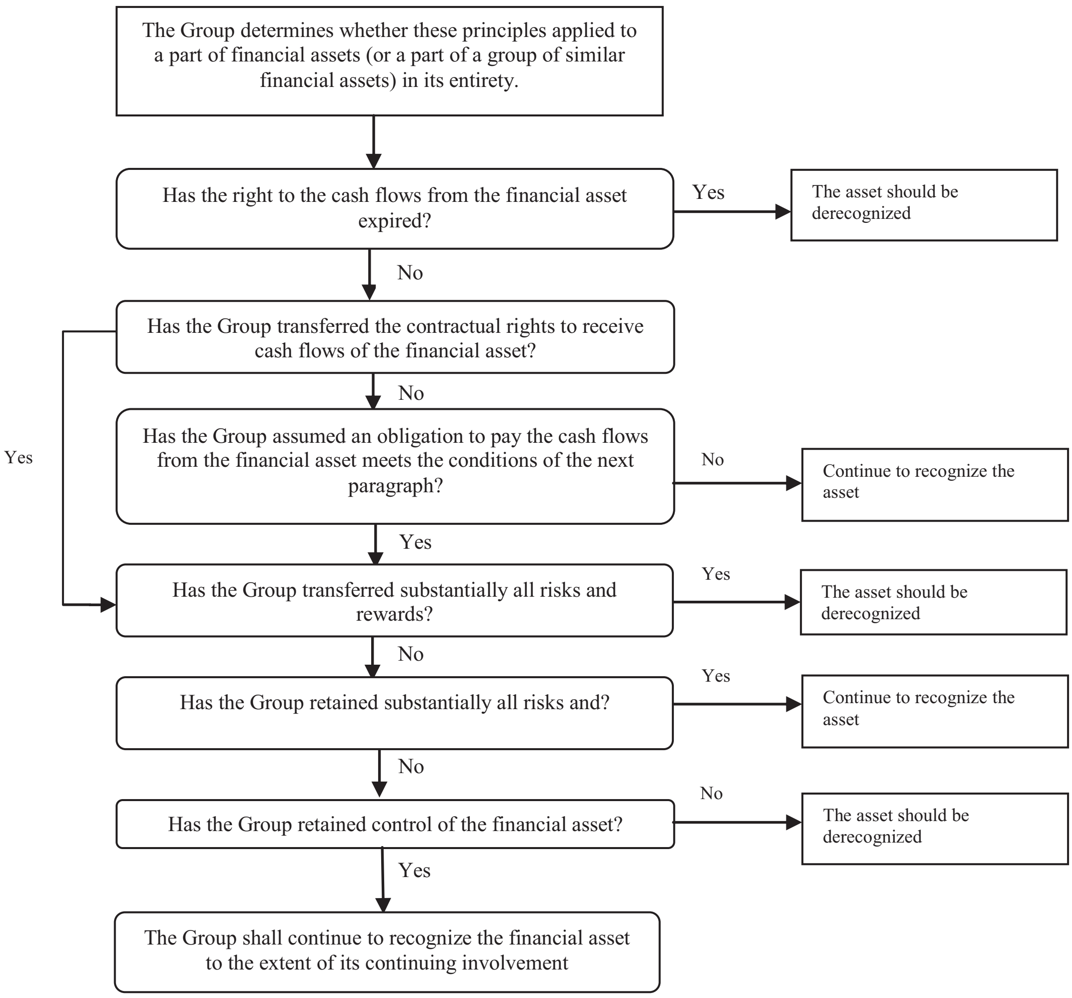
The expected credit loss can be recognized by the Group as the following:

- in case of financial assets measured at amortised cost as the deducted amount from the gross book value (impairment),
- in case of financial guarantees and lending commitments as provision,
- if the financial instruments include both a loan and an undrawn commitment component and the Group is unable to distinguish the expected credit loss calculated for the loan and the undrawn commitment component, the Group will therefore determine the impairment loss on the two components together. The aggregate impairment reduces the gross book value of the undrawn commitment. If the impairment thus determined exceeds the gross book value of the loan component, the difference is recognized as a provision.
- in case of financial assets measured at fair value through other comprehensive income (OCI), the impairment loss is not recognized in the balance sheet as their book value is the fair value and the recognized impairment modifies the cumulative other comprehensive income.

During the valuation of the financial instruments measured at fair value through profit or loss, the Group recognises in a separate statement whether there were any changes in the client’s credit risk.

Derecognition of Financial Assets

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



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

Transfers that qualify for derecognition of financial assets

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

- The Group has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.
- The Group is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.
- The Group has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the Group is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to

the eventual recipients, and interest earned on such investments is passed to the eventual recipients.

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

The Group examines the following before derecognition:

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

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

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

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

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

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

Derecognition due to significant changes in contractual cash flows

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

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

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

Financial assets under legal proceeding

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

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

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

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

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

Derecognition of financial liabilities

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

An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.
Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

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

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

Measurement at amortised cost

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

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

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

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

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

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

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

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

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

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

Simplified approach for trade receivables, contract assets and lease receivables

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

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

Financial assets measured at Fair Value

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

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

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

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

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

Financial guarantees

The Group does not recognise the financial guarantees as contingent items in the Financial Statement because this could cause recognition such income or expense which may not being realisable.
In case when the realisation of income or expense is substantially sure, the asset does not considered as contingent item and it should be recognised in the Financial Statement.

The contingent items assessed permanently in order to the Group post the changes up the Financial Statement in time.
Insofar the occurrence of economic benefits inflow or outflow being substantially sure, the relating income or expense should be accounted in that period wherein the probability of the occurrence changed.

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

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

Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Group which are classified as Fair Value Through Profit or Loss or Amortised cost. Loans and advances are recognised when cash is advanced to borrowers (settlement date). They are derecognised when either borrower repay their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. If they are measured at amortised cost they are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost, otherwise they are measured at fair value. Where loans and advances are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

Assets held for sale

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

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

To meet the criteria for classification as held for sale:

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

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

A disposal group classified as held for sale may qualify for the definition of the discontinued operations.
Discontinued operations are a part of the Group that has been disposed of or classified as held for sale and embody a distinct, major industry or geographical area of activity and are part of a coordinated plan for disposing a separate business or geographical area of activity.

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

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

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

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

Financial assets and liabilities held for trading

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

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

Long-term deposit

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

Structured Bonds

MKB issues structured bonds for its retail and institutional clients since 2008. The 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 at fair value to profit or loss in their entirety and as a consequence the embedded derivatives are not separated.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when the 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). Measurement is initially at fair value, with transaction costs taken directly to the statement of comprehensive income. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in “Interest income”.

Investments in securities

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

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

Derivatives

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

Derivatives may be embedded in other financial instruments. Embedded derivatives are treated as separate derivatives according to the IFRS 9 standard.
Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

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.

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 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 on the statement of financial position.

Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in “Other operating income” and “Operating expenses”, respectively.

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 method, except for the items which at initial recognition are designated by the Group to 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.

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.

Contingent liabilities, which include certain guarantees, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the 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 in the additional notes.

Income tax

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

The Group applies the coporate income tax as income tax.

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

Deferred tax is provided using the financial position method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the end of the reporting period.

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

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

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

Interest income and expense

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

The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently. When calculating the effective interest rate, the 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 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.

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).

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.

Dividends

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

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 30.

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 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.

Financial guarantees

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

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

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.

Treasury shares

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

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 25.

MKB Bank Zrt. Data in HUF million except stated otherwise

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

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

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

	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
Cash and balances with central banks	31 599	-	-	31 599
Loans and advances to banks	78 017		(9)	78 008
Loans and advances to customers	858 592	(15 037)	(1 054)	842 501
Investment securities - Held to maturity	559 319	(308 723)	(159)	250 437
Total financial assets measured at amortised cost	**1 527 527**	**(323 760)**	**(1 222)**	**1 202 545**
Trading assets	72 319	20 586		92 905
Loans and advances to customers	-	15 037	251	15 288
Total financial assets measured at FVPL	**72 319**	**35 623**	**251**	**108 193**
Investment securities - FVOCI (debt instruments)	342 691	288 137	6 744	637 572
Investment securities - FVOCI (equity instruments)	702			702
Total financial assets measured at FVOCI	**343 393**	**288 137**	**6 744**	**638 274**

The Group typically holds its financial assets in HTC business model, except certain securities, that are held in HTCS business model.

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 which carrying amount at the year-end was HUF 20 586 million. The government bonds have been reclassified to Fair Value through other comprehensive income amounted to HUF 308 723 million. The remeasurements on financial assets measured at Fair Value through other comprehensive was HUF 6 743 million.

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. Those loans which did not passed the SPPI test's criteria have been reclassified to Fair Value through profit or loss at HUF 15 037 million amount and the Group recognise HUF 250 million as remeasurment.

Impairment on loans and debt instruments measured at amortised cost have been increased with HUF 1 218 million because of the IFRS 9 implementation. Furthermore the provision on the off-balance sheet items has been decreased with HUF 566 million.

The Group's equity increased with HUF 6 347 million as a result of implementation of IFRS 9 standard.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- **IFRS 14 "Regulatory Deferral Accounts"** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- **IFRS 17 "Insurance Contracts"** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),
- **Amendments to IAS 19 "Employee Benefits"** - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IAS 28 "Investments in Associates and Joint Ventures"** - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to various standards due to "Improvements to IFRSs (cycle 2015 - 2017)"** resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after 1 January 2019),
- **IFRIC 23 "Uncertainty over Income Tax Treatments"** (effective for annual periods beginning on or after 1 January 2019).
- **Amendments to References to the Conceptual Framework in IFRS Standards** (effective for annual periods beginning on or after 1 January 2020)

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

4 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,
- 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,

Data in HUF million except stated otherwise

- 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:

4.1

2018

Company	Percentage of equity owned	Percentage of voting rights	Country of incorporation	Brief description of activities
Euro - Immat Üzemeltetési Kft.	100,00%	100,00%	Hungary	Intangible assets, license maintenance
Exter-Adósságkezelő Kft.	100,00%	100,00%	Hungary	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

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

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. 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 as joint venture. The company was renamed MKB-Pannónia Alapkezelő Zrt. Az MKB Befektetési 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 has not obtained during 2017. In January 2018, the Bank decided to terminate the project relating to the establishment and repeal the proceedings. The voluntary liquidation process has started at 30 June 2018.

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. 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 2018, the Bank did not sell or deconsolidated any entities, hence the consolidation group has not changed during the year.

g) Non-consolidated entities

The percentage of equity owned by the Group of the below listed companies is not material and therefore exempted from the group of consolidation:

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

5 Risk management

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. 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

Data in HUF million except stated otherwise

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

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

5.1 Capital adequacy ratio

	2018Q2 Basel III IFRS	2017 Basel III IFRS
Share capital	100 000	100 000
Nominal value of repurchased own shares		
Issued, but unpaid		
Outstanding share capital	*100 000*	*100 000*
Reserves	21 939	37 124
Intangible assets	(15 029)	(12 567)
AVA - additional valuation adjustments	-585	-464
Additional Tier 1	**-**	**-**
Tier 1: Net core capital	**106 325**	**124 093**
Subordinated debt	27 990	22 307
Tier 2: Supplementary capital	**27 990**	**22 307**
Regulatory capital	**134 315**	**146 400**
Risk-weighted assets (RWA)	814 873	750 832
Large loan limit	0	0
Operational risk (OR)	173 370	173 370
Market risk positions (MR)	22 909	6 549
Total risk weighted assets	**1 011 152**	**930 751**
Regulatory capital / Total assets	6,62%	6,97%
Tier1 ratio	**10,52%**	**13,33%**
Capital adequacy ratio	**13,28%**	**15,73%**

The table above contains the MKB Bank's consolidated capital adequacy ratio. Unconsolidated capital adequacy ratio is 14.94%.

At June 30, 2018, as an actual figure of regulatory capital the Group was HUF 134.3 billion based on Basel III IFRS under Supervisory Regulation. The decrease of regulatory capital - by HUF 12.1 billion – is derived from the decrease of revaluation reserve (HUF -11.8 billion), decrease of revenue reserve (HUF -0.6 billion) and increase of deduction of ESOP program (HUF -2.8 billion) and increase of deduction of intangible assets (HUF -2.5 billion), which was compensated by the increase of subordinated loan (HUF 5.7 billion).

Data in HUF million except stated otherwise

Risk-weighted assets including operational and market risk increased by 8.64% from HUF 930.8 billion in 2017 to HUF 1,011.2 besides approximately 5.95% weakening of domestic currency. The main part of the increase derived from the increase of market risk and increasing of business volumes in MKB Bank and Euroleasing Group.

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.

Encumbered assets

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

5.2 Encumbered assets

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets of the reporting institution				
Loans on demand	370	370	431	431
Debt securities	136 240	136 090	145 639	148 237
Loans and advances other than loans on	43 316	43 316	53 901	53 901
Total encumbered assets	**179 926**	**179 776**	**199 971**	**202 569**

5.3 Collateral received and own debt securities issued

		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
30 June 2018			
Collateral received by the reporting			
Loans on demand	-	3 808	-
Other collateral received	-	-	326 501
Collateral received and own debt securities issued	**-**	**3 808**	**326 501**
31 December 2017			
Collateral received by the reporting			
Loans on demand	-	1 842	-
Other collateral received	-	-	375 218
Collateral received and own debt securities issued	**-**	**1 842**	**375 218**

Data in HUF million except stated otherwise

5.4 Sources of encumbrance

	2018		2017	
	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	*110 573*	*179 926*	*153 613*	*199 971*
Derivatives	7 184	70 215	35 155	95 298
Deposits	103 389	109 711	118 458	104 673
Repurchase agreements	-	-	489	514
Collateralised deposits other than repurchase	103 389	109 711	117 969	104 159
Total Sources of encumbrance	**110 573**	**179 926**	**153 613**	**199 971**

As of 30 June 2018 the total size of encumbered assets was 8.34 % 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 active repo transactions, secured refinancing, collateralized derivative transactions as well as encumbrance due to collateral requirement of used clearing systems and central counterparties. MKB did not have covered bond issues or securitization.

The secured refinancing facilities were granted in the course of the „Funding for Growth Scheme" refinancing loan program of the National Bank of Hungary. The majority of collateralized derivative transactions were concluded to hedge on balance sheet FX position. A significant amount of securities was encumbered as collateral for a liquidity facility provided by the National Bank of Hungary which supported the active liquidity management of the bank.

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:

- 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.

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.

Data in HUF million except stated otherwise

5.5 Forborn assets

	2018	2017
Corporate Banking		
Forbearence loans and advances based on actual restructured status	16 495	17 688
Provision	(15 509)	(12 708)
Carrying amount	**986**	**4 980**
Retail and Private Banking		
Forbearence loans and advances based on actual restructured status	26 402	36 816
Provision	(13 120)	(17 366)
Carrying amount	**13 282**	**19 450**
Total carrying amount	**14 268**	**24 430**

Credit Risk

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

5.6 The Group's maximum exposure classifies as credit risk

2018	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Gross amount of exposures	**36 603**	**58 733**	**1 044 025**	**864 285**	**29 526**	**520 464**
Performing exposures	**36 603**	**58 733**	**925 720**	**864 285**	**29 526**	**514 439**
Not past due or Past due <= 30 days	36 603	58 733	922 523	864 285	29 526	-
Past due > 30 days <= 90 days	-	-	3 197	-	-	-
Non-performing exposures	**-**	**-**	**118 305**	**-**	**-**	**6 025**
Unlikely to pay - that are not past-due or past-due <= 90 days	-	-	58 248	-	-	-
Past due > 90 days <= 180 days	-	-	2 082	-	-	-
Past due > 180 days <= 5 year	-	-	34 279	-	-	-
Past due > 5 year	-	-	23 696	-	-	-
Of which defaulted	**-**	**-**	**117 176**	**-**	**-**	**6 025**
Of which credit impaired	**-**	**-**	**111 769**	**-**	**-**	**-**
Loss allowance for impairment	**-**	**(11)**	**(91 203)**	**(64)**	**-**	**(2 244)**
Performing exposures	-	(11)	(10 375)	(64)	-	(1 871)
Non-performing exposures	-	-	(80 828)	-	-	(373)
Unlikely to pay - that are not past-due or past-due <= 90 days	-	-	(37 044)	-	-	-
Past due > 90 days <= 180 days	-	-	(919)	-	-	-
Past due > 180 days <= 5 year	-	-	(24 455)	-	-	-
Past due > 5 year	-	-	(18 410)	-	-	-
Of which: allowances for collectively assessed financial assets	**-**	**-**	**(44 770)**	**-**	**-**	**-**
Of which: allowances for individually assessed financial assets	**-**	**-**	**(46 434)**	**-**	**-**	**-**
Total gross amount	**36 603**	**58 733**	**1 044 025**	**864 285**	**29 526**	**520 464**
Total allowance for impairment	**-**	**(11)**	**(91 203)**	**(64)**	**-**	**(2 244)**
Total carrying amount	**36 603**	**58 722**	**952 822**	**864 221**	**29 526**	**518 220**

Data in HUF million except stated otherwise

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 (incl. shares and other non fixed income securities)

6 Loans and advances to banks

6.1 Loans and advances to banks

	2018
Current and clearing accounts	4 058
Money market placements	48 776
Loans and advances	5 899
Allowances for impairment	(11)
Loans and advances to banks	**58 722**
Balance at 1 January	**(8)**
Impairment loss for the year:	
Increases due to origination and acquisition	(6)
Changes due to change in credit risk (net)	3
Allowance for impairment at the end of period	**(11)**

Data in HUF million except stated otherwise

	2017
Current and clearing accounts	13 212
Money market placements	53 901
Loans and advances	10 912
Less collective allowances for impairment	(8)
Loans and advances to banks	**78 017**
Balance at 1 January	**(7)**
Impairment loss for the year:	
Charge for the year	(4)
Reversal	3
At the end of period	**(8)**

7 Derivative financial assets

7.1 Derivative financial assets

	2018			2017		
	Cost	Unrealised result	Book value	Cost	Unrealised result	Book value
Derivative instruments by type						
FX-based derivatives instruments	-	10 928	10 928	-	2 555	2 555
Index-based derivative instruments	-	4	4	-	1	1
Interest-based derivative instruments	-	16 460	16 460	-	16 746	16 746
Options	589	2 134	2 134	-	455	455
Total derivative instruments	**589**	**29 526**	**29 526**	**-**	**19 757**	**19 757**

Data in HUF million except stated otherwise

8 Investments in securities

8.1 Investments in securities

	2018
Investment securities measured at FVOCI	
Hungarian Government bonds	399 605
Hungarian corporate sector bonds	37 830
Foreign Government bonds	1 406
Foreign equities	889
Less allowance for impairment	(116)
Investment securities measured at amortised cost	
Hungarian Government bonds	314 957
Hungarian corporate sector bonds	38 439
Less allowance for impairment	(64)
Investment securities measured at FVTPL	
Government Treasury bills	55 900
Government bonds	14 657
Hungarian corporate sector bonds	549
Hungarian equities	53
Securities	**864 221**
Allowances for impairment	
Balance at 1 January	(219)
Impairment loss for the year:	
Increases due to origination and acquisition	(4 963)
Decreases due to derecognition	8 908
Changes due to change in credit risk (net)	(3 790)
At the end of period	**(64)**

Data in HUF million except stated otherwise

	2017
Available-for-sale	
Hungarian Government bonds	324 880
Hungarian corporate sector bonds	17 811
Hungarian equities	33
Foreign equities	702
Less specific allowances for impairment	(33)
Held-to-maturity	
Hungarian Government bonds	484 676
Hungarian corporate sector bonds	74 643
Less specific allowances for impairment	-
Investment in securities	**902 712**
Specific allowances for impairment	
Balance at 1 January	(33)
Impairment loss for the year	-
Balance at 31 December	**(33)**

	2017		
	Cost	Unrealised result	Book value
Debt and equity instruments			
Government Treasury bills	49 893	998	50 891
Government bonds	1 451	8	1 459
Hungarian corporate sector bonds	210	2	212
Total debt and equity instruments	**51 554**	**1 008**	**52 562**

At 30 June 2018, HUF 136,240 million (2017: HUF 279,972 million) from the total amount of Investments in securities were pledged as collateral for stock exchange, for NBH related to Funding for Growth Scheme and credit card transactions in the ordinary course of business.

The total revaluation effect excluding deferred taxes in equity comprises HUF 10,383 million gain (2017: HUF 2,466 million gain), 945 million deferred tax income (2017: HUF 112 million deferred tax expense).

In 2018 HUF 3,423 million gain (2017: HUF 17,148 million gain) was recognized in the profit or loss relating to securities measured at FVTOCI, which is a reclassification from other comprehensive income into profit or loss.

Data in HUF million except stated otherwise

Related to the Held-to-maturity investments HUF 4,207 million interest income (2017: HUF 2,892 million) was recognized in the Statement of profit or loss during the first six months of the year.

9 Loans and advances to customers

9.1 Loans and advances to customers at amortised cost

2018	Gross amount	Allowance for impairment	Carrying amount
Core business			
Wholesale			
Refinanced loan	68 106	(2 429)	65 677
Funding for Growth Scheme	76 059	(2 683)	73 376
Factoring	14 344	(519)	13 825
Overdraft	117 170	(3 661)	113 509
Széchenyi Loans	30 704	(1 667)	29 037
Other	386 744	(27 706)	359 038
Total Wholesale	***693 127***	***(38 665)***	***654 462***
Retail			
Residental mortgage			
HUF	*233 197*	*(25 104)*	*208 093*
Foreign currency	*3 132*	*(1 381)*	*1 751*
Credit card	2 200	(178)	2 022
Overdraft	1 868	(642)	1 226
Personal loan	7 156	(810)	6 346
Car finance	23 014	(3 682)	19 332
Other	41 810	(5 700)	36 110
Total Retail	***312 377***	***(37 497)***	***274 880***
Total Core business	**1 005 504**	**(76 162)**	**929 342**
Non-core business			
Commercial Real Estate (CRE)	***38 522***	***(15 042)***	***23 480***
Total	**1 044 026**	**(91 204)**	**952 822**

Data in HUF million except stated otherwise

2017	Gross amount	Specific allowances for impairment	Collective allowances for impairment	Carrying amount
Core business				
Wholesale				
Refinanced loan	49 959	(877)	(691)	48 391
Funding for Growth Scheme	71 981	(547)	(991)	70 443
Factoring	16 125	(328)	(144)	15 653
Overdraft	58 362	(2 031)	(456)	55 875
Széchenyi Loans	22 061	(455)	(217)	21 389
Other	367 779	(31 556)	(2 197)	334 026
Total Wholesale	***586 267***	***(35 794)***	***(4 696)***	***545 777***
Retail				
Residental mortgage				
HUF	*246 664*	*(38 890)*	*(2 202)*	*205 572*
Foreign currency	*4 436*	*(1 900)*	*(44)*	*2 492*
Credit card	2 530	(142)	(64)	2 324
Overdraft	2 102	(589)	(50)	1 463
Personal loan	1 279	(59)	(49)	1 171
Car finance	20 820	(4 083)	(167)	16 570
Other	68 726	(4 064)	(187)	64 475
Total Retail	***346 557***	***(49 727)***	***(2 763)***	***294 067***
Total Core business	**932 824**	**(85 521)**	**(7 459)**	**839 844**
Non-core business				
SCU	***56 240***	***(12 967)***	***(738)***	***42 535***
Total	**989 064**	**(98 488)**	**(8 197)**	**882 379**

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

CRE (previously SCU) remaining portfolio

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

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

Data in HUF million except stated otherwise

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.

Effects of the Act on Consumer Loan Contracts of Financial Institutions

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 May 1st, 2004 and before July 26th 2014 and have not been terminated before July 26th, 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 July 26th, 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.

Allowances for impairment

9.2 Allowances for impairment

	Stage 1	Stage 2	Stage 3	2018
Allowances for impairment on loans and advances to customers				
Balance at 1 January	**(5 721)**	**(4 202)**	**(102 300)**	**(112 223)**
Impairment loss for the year:				
Increases due to origination and acquisition	(1 569)	(123)	(1 496)	(3 188)
Decreases due to derecognition	4 415	192	32 550	37 157
Changes due to change in credit risk (net)	(7 502)	(33 773)	41 330	55
Changes due to modifications without derecognition (net)	49	(30)	719	738
Decrease in allowance account due to write-offs	42	-	1 207	1 249
Other adjustments	(87)	(27)	(14 878)	(14 992)
At the end of period	**(10 373)**	**(37 963)**	**(42 868)**	**(91 204)**

Data in HUF million except stated otherwise

	2017
Specific allowances for impairment on loans and advances to customers	
Balance at 1 January	100 086
Impairment loss for the year:	
Charge for the year	25 785
Reversal	(12 118)
Utilisation	(7 938)
Effect of foreign currency movements	(296)
Unwinding of discount	(1 080)
Reclassification	(11)
Disposal of Non-current assets held for sale and discontinued operations	(32 438)
At the end of period	**71 990**
Collective allowances for impairment on loans and advances to customers	
Balance at 1 January	11 645
Impairment loss for the year:	
Charge for the year	5 390
Reversal	(9 282)
Utilisation	(12)
Effect of foreign currency movements	(22)
Unwinding of discount	106
Reclassification	(56)
At the end of period	**7 769**

At 30 June 2018 there were no loans designated as hedged item in a fair value hedge relationship.

Data in HUF million except stated otherwise

10 Other assets

10.1 Other assets

	2018
Prepayments and other debtors (other financial assets)	25 490
Inventory	555
Collaterals held in possession	67
Other taxes refundable	4 292
Allowances for impairment	(606)
Other assets	**29 798**
Allowances for impairment	
Balance at 1 January	(657)
Impairment loss for the year:	
Increases due to origination and acquisition	(1)
Decreases due to derecognition	13
Changes due to change in credit risk (net)	39
At the end of period	**(606)**

	2017
Prepayments and other debtors	26 036
Inventory	571
Collaterals held in possession	86
Corporate income tax refundable	163
Other taxes refundable	783
Specific allowances for impairment	(170)
Other assets	**27 469**
Specific allowances for impairment	
Balance at 1 January	(169)
Impairment loss for the year:	
Charge for the year	(61)
Reversal	3
Utilization	57
At the end of period	**(170)**

Data in HUF million except stated otherwise

11 Investments in jointly controlled entities and associates

11.1 Investments in jointly controlled entities and associates

	2018	2017
Cost	3 295	2 643
Investments in jointly controlled entities and associates	**3 295**	**2 643**

12 Intangibles, property and equipment

12.1 Intangibles, property and equipment

2018	Intangible assets	Freehold property	Equipment	Total
Cost				
Balance at 1 January	**56 311**	**40 703**	**24 775**	**121 789**
Additions – including internally developed	3 709	160	761	4 630
Other additions	(959)	-	-	(959)
Disposals	(985)	(145)	(769)	(1 899)
Balance at 30 June	**58 076**	**40 718**	**24 767**	**123 561**
Depreciation and impairment losses				
Balance at 1 January	**43 743**	**12 794**	**18 576**	**75 113**
Depreciation for the year	785	510	760	2 055
Impairment loss	-	-	2	2
Disposals	8	(146)	(606)	(744)
Other additions	(989)	6	-	(983)
Balance at 30 June	**43 547**	**13 164**	**18 732**	**75 443**
Carrying amounts				
At 1 January	12 568	27 909	6 199	46 676
Balance at 30 June	**14 529**	**27 554**	**6 035**	**48 118**

Data in HUF million except stated otherwise

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**
Depreciation and impairment losses				
Balance at 1 January	**42 484**	**13 954**	**19 383**	**75 821**
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**

Depreciation and amortization is presented among the Operating expenses.

During the first six months of 2018, the most significant component of these 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.

13 Amounts due to other banks

13.1 Amounts due to other banks

	2018	2017
Due on demand	4 088	5 485
Money market deposits	19 600	6 000
Borrowings	349 978	227 827
Amounts due to other banks	**373 666**	**239 312**

Data in HUF million except stated otherwise

14 Deposits and current accounts

14.1 Deposits and current accounts

	2018	2017
From corporate clients	1 063 937	1 235 242
From retail clients	317 829	303 898
Current and deposit accounts	**1 381 766**	**1 539 140**

15 Derivative financial liabilities

15.1 Derivative financial liabilities

	2018			2017		
	Cost	Unrealised result	Book value	Cost	Unrealised result	Book value
Derivative instruments by type						
FX-based derivatives instruments	-	9 100	9 100	-	4 265	4 265
Index-based derivative instruments	-	2	2	-	-	-
Interest-based derivative instruments	-	23 995	23 995	-	38 846	38 846
Options	327	1 401	1 401	179	76	255
Total derivative instruments	**327**	**34 498**	**34 498**	**179**	**43 187**	**43 366**
Derivative financial liabilities	**327**	**34 498**	**34 498**	**179**	**43 187**	**43 366**

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

16 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.

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.

Data in HUF million except stated otherwise

17 Other liabilities and provision

17.1 Other liabilities and provision

	2018	2017
Accruals and other creditors	52 022	41 593
Corporate income tax payable	877	16
Other taxes payable	2 369	2 128
Provision for contingencies and commitments	3 922	6 116
Other liabilities and provisions	**59 190**	**49 853**

Provision for contingencies and commitments

17.2 Provision for contingencies and commitments

	2018
Balance at 1 January	**6 682**
Increases due to origination and acquisition	192
Decreases due to derecognition	(958)
Changes due to change in credit risk (net)	(856)
Other adjustments	(1 138)
At the end of period	**3 922**

	2017
Balance at 1 January	**7 120**
Provisions made during the year	2 364
Provisions used during the year	(6)
Provisions reversed during the year	(3 279)
Effect of foreign currency movements	(83)
At the end of period	**6 116**

Provisions recognized for different type of products are disclosed in Note 23.

18 Issued debt securities

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

18.1 Issued debt securities

Interest	Balance at openning period	Issued debt securities	Repurchased debt securities	Repaid debt securities	Revaluation result	Balance at the end of period
30 June 2018						
Fixed rate	1 276	-	300	(1 717)	141	-
Structured	9 315	-	(16)	(1 416)	150	8 033
Accrued interest	33	-	-	-	-	34
Total	**10 624**	**-**	**284**	**(3 133)**	**291**	**8 067**
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**

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. At 30 June 2018 the carrying amount of FVTPL own issued bonds amounted to HUF 8,033 million (2017: HUF 9,332 million).

19 Subordinated debt

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.

19.1 Subordinated debt

2018	Interest	Due date	Amount in original currency	Original currency	Carrying amount in million HUF
Subordinated debt	Fixed rate	26.05.2017	70 000 000	EUR	23 051
Subordinated debt	Fixed rate	19.03.2018	15 000 000	EUR	4 939
Total			**85 000 000**	**EUR**	**27 990**

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

20 Share capital

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

21 Reserves

Share premium

Share premium comprises of premiums on share capital issuances.

Retained Earnings

Retained earnings comprise the accumulated profit after taxes earned in the course of the operating life of an entity of the 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 2018 MKB did not recognize any general reserve (2017: HUF 0 million).

Revaluation reserves

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

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

22 Non-controlling interest

For 30 June 2018 and for the year ended December 31, 2017 there are no material non-controlling interests related to non-wholly owned subsidiaries of the Group.

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

Data in HUF million except stated otherwise

23 Impairments and provisions for losses

23.1 Impairments and provisions for losses

	Note	2018	2017
Impairment loss, net of reversals on			
Loans and advances to banks and customers	**6, 9**	617	(1 443)
Other assets	**10**	2	69
Realised gain (-) or loss (+) on dereconition		(998)	370
Provision on			
Guarantees and contingencies	**17**	(1 216)	465
Impairments and provisions for losses		**(1 595)**	**(539)**

24 Income tax

Income tax expense recognized in the Statement of Comprehensive Income

24.1 Income tax

	2018	2017
Current tax expense	*1 097*	*1 121*
Hungarian corporation tax charge – on current year profit	1 097	1 121
Deferred tax expense/(income)	*(13)*	*(138)*
Origination (reversal) of temporary differences	(13)	(138)
Income tax (credit) / expenses	**1 084**	**983**

In the reporting period 9% current income tax rate applied in Hungary. Due to this calculation method 9% current income tax rate applied in the Hungarian market as current income tax rate.

25 Earnings per share

The calculation of basic earnings per share on 30 June 2018 based on the net income attributable to ordinary shareholders of HUF 18,003 million (2017: HUF 19,474 million) and a weighted average number of ordinary shares outstanding of 85,000 thousands (2017: 85,000 thousands).

Basic value

30 June 2018

$$\text{Earnings per Ordinary Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding (thousands)}} = \frac{\text{HUF 18,003 million}}{\text{85,000 thousands}} = \text{HUF 212}$$

31 December 2017

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

30 June 2017

$$\text{Earnings per Ordinary Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding (thousands)}} = \frac{\text{HUF 19,474 million}}{\text{85,000 thousands}} = \text{HUF 229}$$

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. On June 30 2017, there were no dilution factor that might cause an adjustment in the weighted average number of ordinary shares, therefore basic and diluted EPS were equivalent. From the end of 2017 there was a dilution effect because the vesting conditions are valid; HUF 2,626 thousands (31 December 2018 2,501 thousands) number of shares were equity-settled as share-based compensation.

Diluted value

30 June 2018

$$\text{Diluted Earnings per Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding taking into account the dilution factors (thousands)}} = \frac{\text{HUF 18,003 million}}{\text{87,626 thousands}} = \text{HUF 205}$$

31 December 2017

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

30 June 2017

$$\text{Diluted Earnings per Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding taking into account the dilution factors (thousands)}} = \frac{\text{HUF 19,474 million}}{\text{85,000 thousands}} = \text{HUF 229}$$

Data in HUF million except stated otherwise

26 Contingencies and commitments

26.1 Contingencies and commitments

2018	Gross	Provision				Net
		Stage 1	Stage 2	Stage 3	IAS 37	
Contingencies						
Guarantees and similar obligations	150 457	(119)	(99)	(181)	-	150 058
Obligations from letters of credit and other short	13 814	(15)	(1)	-	-	13 798
Other contingent liablities (including litigation)	95 231	(1 276)	(3)	-	(1 264)	92 688
Total contingencies	**259 502**	**(1 410)**	**(103)**	**(181)**	**(1 264)**	**256 544**
Commitments						
Undrawn commitments to extend credit	273 914	(319)	(41)	(192)	-	273 362
Total commitments	**273 914**	**(319)**	**(41)**	**(192)**	**-**	**273 362**

2017	Gross	Provision	Net
Contingencies			
Guarantees and similar obligations	135 990	1 507	134 483
Obligations from letters of credit and other short term trade related items	14 788	17	14 771
Other contingent liablities (including litigation)	99 155	3 979	95 176
Total contingencies	**249 933**	**5 503**	**244 430**
Commitments			
Undrawn commitments to extend credit	285 619	1 076	284 543
Total commitments	**285 619**	**1 076**	**284 543**

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

27 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 5).

Key sources of estimation uncertainty

Allowances for credit losses

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

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

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

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

Determining fair values

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

Critical accounting judgements in applying the 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 3.

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:

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.

Data in HUF million except stated otherwise

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

27.1 Valuation type classification of financial instruments

	Note	Quoted market prices in active markets	Valuation techniques - observable inputs	Valuation techniques - significant unobservable inputs	Total
30 June 2018					
Derivative financial assets	**7**	-	29 526	-	29 526
Loans and advances to customers	**9**	-	-	7 287	7 287
Securities	**8**	291 381	219 757	-	511 138
Derivative financial liabilities	**15**	-	34 498	-	34 498
Issued debt securities	**18**	-	8 067	-	8 067
Total		**291 381**	**291 848**	**7 287**	**590 516**
31 December 2017					
Financial assets measured at FVTPL	**7**	242	72 077	-	72 319
Investments in securities	**8**	112 615	230 778	-	343 393
Deposit and current accounts	**14**	-	1 658	-	1 658
Financial liabilities measured at FVTPL	**15**	-	43 366	-	43 366
Issued debt securities	**18**	-	9 332	-	9 332
Total		**112 857**	**357 211**	**-**	**470 068**

The determination of fair value level and the transfers between levels are in line with accounting policy (see Note 3). There were no transfers between fair value levels in the reporting period ended on June 30, 2018.

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

As part of its trading activities the 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.

Data in HUF million except stated otherwise

27.2 Risk type classification of financial instruments

	Note	Interest	Foreign exchange rate	Other
30 June 2018				
Derivative financial assets	**7**	13 117	16 474	35
Loans and advances to customers	**9**	7 287	355	-
Securities	**8**	503 930	55 647	225
Derivative financial liabilities	**15**	23 995	9 100	1 403
Issued debt securities	**18**	8 067	3 227	8 067
Total		**556 396**	**84 803**	**9 730**
31 December 2017				
Financial assets measured at FVTPL	**7**	69 480	3 450	71
Investments in securities	**8**	342 692	58 190	702
Deposit and current accounts	**14**	1 658	-	1 658
Financial liabilities measured at FVTPL	**15**	39 003	4 517	4
Issued debt securities	**18**	9 332	3 050	9 332
Total		**462 165**	**69 207**	**11 767**

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.

28 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 3 g, and Note 27), which are significantly affected by the assumptions used on the amount and timing of the estimated future cash flows and discount rates. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured.

Data in HUF million except stated otherwise

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

28.1 Accounting classifications and fair values

2018	Note	Fair value through profit or loss	Amortised cost	Fair value through other comprehensive income	Total carrying amount	Fair value
Financial assets						
Cash reserves		-	36 603	-	36 603	36 603
Loans and advances to banks	**6**	-	58 722	-	58 722	59 117
Derivative financial assets	**7**	29 526	-	-	29 526	29 526
Securities	**8**	71 159	353 332	439 730	864 221	873 188
Loans and advances to customers	**9**	7 287	945 535	-	952 822	954 686
Total		**107 972**	**1 394 192**	**439 730**	**1 941 894**	**1 953 120**
Financial liabilities						
Amounts due to other banks	**13**	-	373 666	-	373 666	373 666
Deposits and current accounts	**14**	-	1 381 766	-	1 381 766	1 381 766
Derivative financial liabilities	**15**	34 498	-	-	34 498	34 498
Issued debt securities	**18**	8 067	-	-	8 067	8 067
Subordinated debt	**19**	-	27 990	-	27 990	27 990
Total		**42 565**	**1 783 422**	**-**	**1 825 987**	**1 825 987**

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		-	-	-	-	31 599	31 599	31 599
Loans and advances to banks	**6**	-	78 017	-	-	-	78 017	81 875
Measured at amortised cost		-	*78 017*	-	-	-	*78 017*	*81 875*
Financial assets measured at FVTPL	**7**	72 319	-	-	-	-	72 319	72 319
Investments in securities	**8**	-	-	343 393	559 319	-	902 712	907 715
Loans and advances to customers	**9**	-	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	**13**	-	-	-	-	239 312	239 312	251 877
Deposits and current accounts	**14**	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	**15**	43 366	-	-	-	-	43 366	43 366
Issued debt securities	**18**	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	**19**	-	-	-	-	22 307	22 307	29 297
Total		**54 356**	**-**	**-**	**-**	**1 800 393**	**1 854 749**	**1 879 688**

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

Cash reserves

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

Financial assets measured at FVTPL

Fair values of Financial assets measured at FVTPL and Negative fair values of derivative financial instruments and Micro 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.

Investments in securities

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

Loans and advances to banks and to customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by coupon rates. In general, contractual cash flows are discounted using a rate which is sum of the available interest rate which would have been offered if the customer applied for loan at the end of the reporting period plus the counterparty marge. The used interest rates are available in published Terms and Conditions as of 30 June, 2018 and the counterparty marge is available in the Bank's systems. The rediscounted cash flows are decreased using by the same impairment percentage as it was used for impairment purpose, and it is considered as fair value of the loan portfolio. Non-performing loans which are assessed for impairment individually are discounted with discount factors which are calculated as in case of performing loans, but that estimated cash flows of these loans are used for calculation, which was also used for impairment purpose. In the case of work-out loans where the bank expects cash flows only from sale of collaterals and therefore they are impaired to the net present value of this amount, the fair value is equal with the carrying amount.

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

Amounts due to other banks and Current and deposit accounts

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

Issued debt securities and Subordinated debt

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

Data in HUF million except stated otherwise

29 Related parties

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:

29.1 Transactions with related parties

	Parent company and its group		Non-consolidated subsidiaries		Associates		Key Management Personnel	
	2018	2017	2018	2017	2018	2017	2018	2017
Assets								
Loans and advances to customers	-	-	1 203	1 380	335	265	373	348
Liabilities								
Current and deposit accounts	26	50	400	509	86	200	284	219
Income statement								
Interest income	-	-	9	8	4	3	5	-
Interest expense	-	-	1	1	-	-	-	-
Other net income / (expense)	-	-	13	5	150	1	(714)	(374)
Contingencies and commitments								
Undrawn commitments to extend credit	-	-	973	980	-	106	-	-
Provision	-	-	6	10	4	5	-	-

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

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

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

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

Data in HUF million except stated otherwise

29.2 Compensation of key management personnel

	2018	2017
Short-term employee benefits	323	374
Share-based payment transactions	391	-
Total	**714**	**374**

The short-term employee benefits in above table included one-time compensation, which related to closing of the resolution process.

30 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 30 June 2018, 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: 69 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.

30.1 Segment information

2018	Note	Corporate Banking	Institutional Banking	Retail and Private Banking	Other	Total
Assets						
Cash reserves		-	36 603	-	-	36 603
Loans and advances to banks	**6**	-	58 722	-	-	58 722
Derivative financial assets	**7**	-	29 526	-	-	29 526
Securities	**8**	827 406	36 815	-	-	864 221
Loans and advances to customers	**9**	676 721	1 221	274 880	-	952 822
Non-current assets held for sale and discontinued operations	**31**	-	-	3 916	-	3 916
Other assets	**10**	-	-	-	29 798	29 798
Deferred tax assets		-	-	-	4 377	4 377
Investments in jointly controlled entities and associates	**11**	3 295	-	-	-	3 295
Intangibles, property and equipment	**12**	-	-	-	48 118	48 118
Total		**1 507 422**	**162 887**	**278 796**	**82 293**	**2 031 398**
Liabilities						
Amounts due to other banks	**13**	-	373 666	-	-	373 666
Deposits and current accounts	**14**	1 063 301	636	310 189	7 640	1 381 766
Derivate financial liabilities	**15**	-	34 498	-	-	34 498
Other liabilities and provisions	**17**	274	991	2 039	55 009	58 313
Current income tax liabilities		-	-	-	877	877
Issued debt securities	**18**	218	1 165	6 684	-	8 067
Subordinated debt	**19**	-	27 990	-	-	27 990
Shareholders' equity	**20, 21,22**	-	-	-	146 221	146 221
Total		**1 063 793**	**438 946**	**318 912**	**209 747**	**2 031 398**
Income statement						
Gross revenue - external customers		17 889	37 420	10 437	90	65 836
Gross revenue - inter-segment		(227)	1 296	(1 069)	-	-
Interest and commission expenditure		(649)	(11 284)	(265)	-	(12 198)
Impairment and provisions for losses	**23**	(154)	(1)	(1 430)	(10)	(1 595)
Operating costs		(8 842)	(7 274)	(10 735)	(4 672)	(31 523)
Expenses related to bank levies		-	-	-	(2 193)	(2 193)
Share of jointly controlled and associated companies' profit / (loss)		760	-	-	-	760
Profit / (Loss) before taxation		**8 777**	**20 157**	**(3 062)**	**(6 785)**	**19 087**
Segment result		**8 777**	**20 157**	**(3 062)**	**(6 785)**	**19 087**
Other information						
Capital expenditure		-	-	-	4 630	4 630
Depreciation and amortisation		1 581	1	461	12	2 055
Other non-cash expenses		308	254	374	163	1 099

Data in HUF million except stated otherwise

2017	Note	Corporate Banking	Institutional Banking	Retail and Private Banking	Other	Total
Assets						
Cash reserves		-	33 952	-	15 440	49 392
Loans and advances to banks	**6**	-	63 175	-	-	63 175
Financial assets measured at FVTPL	**7**	-	109 864	-	-	109 864
Investments in securities	**8**	916 293	16 143	-	-	932 436
Loans and advances to customers	**9**	587 048	1 264	294 067	-	882 379
Non-current assets held for sale and discontinued operations	**31**	-	-	-	152	152
Other assets	**10**	-	-	-	32 721	32 721
Deferred tax assets		-	-	-	3 623	3 623
Investments in jointly controlled entities and associates	**11**	2 091	-	-	-	2 091
Intangibles, property and equipment	**12**	-	-	-	45 843	45 843
Total		**1 505 432**	**224 398**	**294 067**	**97 779**	**2 121 676**
Liabilities						
Amounts due to other banks	**13**	-	256 682	-	-	256 682
Deposits and current accounts	**14**	1 317 557	-	297 630	-	1 615 187
Negative fair values of derivative financial instruments	**15**	-	33 525	-	-	33 525
Other liabilities and provisions	**17**	2 875	1 452	111	39 198	43 636
Deferred tax liabilities		-	-	-	18	18
Issued debt securities	**18**	356	596	10 919	-	11 871
Subordinated debt	**19**	-	21 718	-	-	21 718
Shareholders' equity	**20, 21,22**	(55 425)	-	-	194 464	139 039
Total		**1 265 363**	**313 973**	**308 660**	**233 680**	**2 121 676**
Income statement						
Gross revenue - external customers		16 429	25 358	16 000	309	58 096
Gross revenue - inter-segment		(195)	2 156	(1 961)	-	-
Interest and commission expenditure		(5 405)	(5 671)	(2 133)	-	(13 209)
Impairment and provisions for losses	**23**	1 390	-	(840)	(11)	539
Operating costs		(9 055)	(1 532)	(9 761)	(465)	(20 813)
Expenses related to bank levies		-	-	-	(4 157)	(4 157)
Share of jointly controlled and associated companies' profit / (loss)		-	-	-	-	-
Profit / (Loss) before taxation		3 164	20 311	1 305	(4 324)	20 456
Segment result		**3 164**	**20 311**	**1 305**	**(4 324)**	**20 456**
Other information						
Capital expenditure		-	-	-	5 818	5 818
Depreciation and amortisation		4 059	-	894	23	4 976
Other non-cash expenses		313	53	337	16	719

During 2014 MKB Group ceased its foreign operations, in the first six months of 2017 and in 2016 conducted financial services only in Hungary. 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.

31 Non-current assets held for sale and discontinued operations

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

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

On June 30, 2018, the net amount of the loan portfolio was HUF 3 916 million, the gross amount was HUF 8,226 million and the related impairment was HUF 4 310 million.

The result of the sale of the first part of the loan portfolio in 2018 is a profit of HUF 1,916 million.

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

31.1 Non-current assets held for sale

	2018	2017
Assets		
Loans and advances to customers	3 916	21 648
Total assets	**3 916**	**21 648**

32 Government grants

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

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

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

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

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

MKB Bank participated in all phases of the Scheme, and lent loans to SME's since the beginning of the program, with an interest rate of 2.5%.

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 and to Other liabilities, 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.

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.

33 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:

2018	Number of shares	Weighted average exercise price (HUF/share)
outstanding at the beginning of the period	14 334 839	370
modificated outstanding due to capital reduction at the beginning of the period	-	-
forfeited at the beginning of the period	665 161	370
granted during the period	665 161	370
forfeited during the period	-	370
exercised during the period	-	-
expired during the period	-	-
outstanding at the end of the period	15 000 000	337
exercisable at the end of the period	-	337

* Those shares which are not valid being redistributed.

2017	Number of shares	Weighted average exercise price (HUF/share)
outstanding at the beginning of the period	32 866 989	164
modificated outstanding 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
exercised during the period	-	-
expired during the period	-	-
outstanding at the end of the period	14 334 839	370
exercisable at the end of the period	665 161	370

* Those shares which are not valid consist of shares held for employees or chief officers until the termination of the legal relationship.

On 19 April 2018 the shareholders approved the existence of the vesting conditions and the advanced fulfilment at the General Meeting.

Based on the decision the ESOP expires and 78% of those who will be settled at cash (82.5% of the total program) has declared, and to the others the deadline of the decision was 31 August 2018. The Group expects that everybody will quit and ask for payment. 17.5% of the total program being completed in shares. Neither the cash, nor the share-based payments has not been completed until the reporting date, but the related costs amounted to HUF 3,121 million has been accounted, of which HUF 2,980 million thought profit or loss and HUF 141 million against the equity.

The first part took place in July 2018, and ESOP Organisation contracted with one shareholder on share-based payments at market price. The entitled cash-based payments have not been paid yet.

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.

In 2018, the payment of the deferred expenses relating to fulfilment in 2017 as the first year of deferred for 5 years was completed in 2018. Until the reporting date the proportional part of the estimated expenses relating to 2018 have been deferred (Note 29.2).

The basis of the performance-based remuneration are share options and bonds, which amount depend on the performance of the Group. Similarly to the previous year, an agreement on the purchase right and issuance of bonds between MKB Bank Zrt and the MRP organization was concluded.

34 Events after the end of the reporting period

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

Two shareholders of MKB Bank Zrt, i.e. RKOFIN Befektetési és Vagyonkezelő Korlátolt Felelősségű Társaság (RKOFIN Investment and Asset Management Ltd., hereinafter: "RKOFIN Ltd.") and MKB Bank Munkavállalói Résztulajdonosi Program Szervezet (MKB Bank Employee Stock Ownership Plan Organisation, hereinafter "ESOP Organisation) concluded a share purchase agreement on July 17, 2018 on the transfer of a part of the share package issued by MKB Bank Zrt and held by the ESOP Organisation, altogether 9.620.597 pieces of series "A" dematerialised ordinary shares with a face value of HUF 1000 each. The Board of Directors of MKB Bank Zrt decided on the registration of this change into the Share Registry on August 30, 2018 subject to the condition that – inter alia – the resolution of Magyar Nemzeti Bank (National Bank of Hungary) authorizing the acquisition of influencing shareholding shall be available. Following the closing of the transaction on the transfer of shares, the previous 4% stake of RKOFIN Ltd. in the Bank will increase to 13.620597%, while the former 15% ownership stake of the ESOP Organisation will decrease to 5.379403%.

The Bank sold one of its 100% owned subsidiaries, MKB Befektetési Alapkezelő Zrt. The share purchase agreement was signed on 23 July 2018, the closing date of this transaction is 28 September 2018.

MKB Bank has completed its entire digital transformation, including a full replacement of its core banking system, between 29 June and 5 July 2018 in accordance with plans. The services relating to the new digital core system will be implemented gradually in daily operational functioning of the credit institution.

Enclosure 1

STATEMENT

on the consolidated semi-annual financial statements of 2018
and on the Report of the Management
Pursuant to Ministry of Finance Decree no. 24/2008 (VIII.15.)

MKB Bank Zrt. (hereinafter: Bank) declares concerning its consolidated semi-annual financial statements the following statement:

The Bank declares that the consolidated semi-annual financial statements have been compiled in accordance with the applicable accounting rules. The consolidated semi-annual financial statements compiled based on the best knowledge of the Bank's competent experts and decision making managers present a realistic and reliable picture on the assets, liabilities, financial position, as well as profits and losses of the Bank as an issuer of securities and of the consolidated enterprises.

No independent audit report was made concerning the consolidated semi-annual financial statements.

The Bank declares furthermore that the consolidated Report of the Management (Management's discussion & analysis) provides a reliable picture of the position, situation, development and performance of the Bank as an issuer of securities and of the consolidated enterprises, and describes the key risks and uncertainty factors concerning the remaining six months of the financial year.

Budapest, 27 September, 2018

MKB Bank Zrt.

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

CONSOLIDATED MANAGEMENT REPORT

OPEARTING ENVIRONMENT

Macroeconomic environment

At the beginning of 2018 higher volatility appeared in the world's financial and capital markets than it was experienced in the previous years due to globally rising inflation expectations. Confidence in the US economic recovery caused the appreciation of the dollar from April; meanwhile the US 10-year government bond yields stabilized around 3% after the seven-year peak levels seen in May. In the first half of 2018 the Fed increased interest rates twice, and according to the Central Bank's forecast, the interest rate cycle - launched in 2015 – may end in 2019. The ECB maintained its loose monetary policy during the first half of the year, but in June they reported that this year they would finish their quantitative easing (QE) programme; and the first rate hike may come in the second half of 2019.

The Hungarian economy expanded by average 4.6% on a yearly basis in the first half of 2018, due to the outstanding performance of the service sector. Consumption growth was boosted by employment and wage growth, as well as higher consumer confidence. In the previous years, the rise in the minimum wage and the guaranteed wage minimum resulted in dynamic wage growth in the domestic economy: gross wages increased by an average of 11.9% in the first six months of 2018. Because of the economic recovery after the global financial crisis and the reform measures affecting the labour market the unemployment rate sank to 3.7% - the level not seen since the 2008 global financial crisis.

Industrial production rose by 3.5% between January and June, furthermore business confidence indices in the sector have increased significantly since the beginning of 2018. In addition, the economic dynamics also improved as a result of the previously installed new capacities. The construction industry's output grew by 19% on a yearly basis over the first six months of 2018. In the first half of 2018 the number of building permissions amounted to 18 thousand, 9% below the value of the same period of the previous year. Additionally, the number of built flats increased by 30% to about 6.5 thousand.

Due to rising fuel prices and the previous low basis, the inflation rate rose in Hungary in the second quarter of the year (average for the first quarter: 2%, average for the second quarter: 2.7%). The exchange rate of the Forint against the major foreign currencies showed a higher excursion in the second quarter compared to the first quarter, but this has only a moderate impact on inflation. Monetary conditions remained unchanged in the National Bank of Hungary's interest rate decision in June. The Central Bank has repeatedly emphasized in its communication that the primary aim of the Central Bank is to reach the inflation target.

Banking sector

The outstanding performance of the banking sector in 2017 was caused by unsustainable items in the long run. In line with expectations, in 2018, the profitability of the domestic credit institutions sector has declined compared to the previous year's record-level profits. While the gross operating income of credit institutions increased - the trading income had the strongest profit increasing effect as a result of one-off items - the post-tax profit of the sector declined due to rising costs and decreasing write-downs (which are running out of portfolios for reversal). Nevertheless, the capital structure of the banking sector remains stable and its liquidity position is strong. In addition, in 2018, the portfolio quality of the banks continued to improve.

The sector aims to maintain profitability through the growth of lending activity – besides a long-lasting sustained growth in corporate lending households lending has also been steadily growing – and through providing digital solutions and increasing operational efficiency.

OVERVIEW OF MKB GROUP PERFORMACE IN H1 2018[3]

In the first half of 2018, the Group reached HUF 19.1 billion pre-tax profit. Interest income was HUF 21.0 billion and commission income reached HUF 14.0 billion. Partly due to changing money and capital market conditions, increased volatility and the rise in bond yields on the global and regional markets originated revaluation surplus, HUF 15.5 billion other income was realized by MKB Group. The Group's financial results was further improved by the release of impairments and provisions for losses of HUF 1.6 billion due to the successful problematic portfolio downsizing and the booming economic environment. As a result of rising labour costs and widening administrative burdens, operating expenses (including banking levy and transaction tax) were HUF 33.7 billion at the end of the period.

The Group reported HUF 2,031.4 billion total assets at the end of the first half of 2018. Customer deposits were HUF 1,381.8 billion, net customer loan volume reached HUF 952.8 billion.

The consolidated Basel III. capital adequacy ratio was 13.3% at the end of June, 2018.

The subsidiaries – MKB Euroleasing, MKB Consulting, MKB-Pannónia Fund Manager, MKB Fintechlab – and the Bank's strategic partners – MKB Pension Fund and MKB Pannónia Health and Mutual Fund – also contributed to the stable, predictable results of the MKB Group.

Budapest, 27 September, 2018

dr Ádám Balog
Chief Executive Officer

Csaba Gábor Fenyvesi
Chief Financial Officer

[3] The comparison between the first half of 2018 with the end of 2017 and the first half of 2017 is difficult, because MKB Group applies the IFRS 9 standard from January 1, 2018, but the comparative period figures are in accordance with IAS 39. Therefore, the calculations of the changes compared to the base periods are not included in this analysis.