MANAGEMENT'S DISCUSSION & ANALYSIS

(International Financial Reporting Standards, IFRS)

The following section of the Annual Report provides a discussion and analysis of the Bank's financial condition and results of operations so as to help the reader to assess any changes in the financial condition and profits for 2006. The forthcoming analyses are based on figures reported in MKB Bank's unconsolidated financial statements prepared under International Financial Reporting Standards ("IFRS") as at, and for the financial year ended, December 31, 2006 and audited by KPMG Hungária Ltd. chartered accountants. On this basis, the discussion focuses on the Bank's own performance as a separate entity. The unconsolidated financial statements prepared under IFRS are presented separately.

OVERVIEW

In 2006, MKB Bank's principal long-term financial priorities aiming at growing and diversified revenues, focused cost discipline, high credit quality and effective balance sheet and capital management were again manifested in strong business developments and financial performance.

During 2006, MKB Bank successfully continued to execute its major strategic and business policy targets and strengthened further its market presence. Subsequent to the sound 2005 performance, MKB Bank's income-generating capacity resulted in outstanding business achievements in 2006. Total assets increased 12.2% to HUF 1,843.3 billion from HUF 1,643.1 billion in 2005. The pace of organic volume growth was 9.1% higher than in previous year (2005: HUF 183.5 billion, 2006: HUF 200.1 billion). Persistently increasing business volumes and turnovers as well as more intense cross-selling resulted in a gross operating income of HUF 74.9 billion which surpassed even the remarkable 2005 achievement of HUF 60.9 billion by 23.1% and a HUF 23.1 billion profit before taxation 15.9% in excess of the previous year's figure. Meanwhile, business volumes both on the asset and deposit sides produced good rates of growth, despite the fact that the business environment turned more unfavourable in the second half of 2006. In the overall increase of asset volumes, the pace of growth in customer loans and advances (with a total nominal rise of HUF 140.2 billion) was again high in 2006 while the credit quality of the portfolio as a whole continued to be strong.

FINANCIAL PERFORMANCE

In 2006, MKB seized business opportunities and reacted effectively to developments in the financial and capital markets, thus accounted for significantly increased interest, commission and fee revenues from customer services. The Bank's total operating income - net interest income plus non-interest income - continued to grow in 2006 with a year-over-year rise at 23.1% to HUF 74,913 million (2005: HUF 60,867 million). The main factor of this expansion was the expansion of interest bearing items. Net interest income's share showed practically the same value as at the end of 2005 (2005: 62.2%, 2006: 62.0%). The share of net commission and fee income increased slightly from the 25.3% figure of 2005 to 25.5% in 2006, while in total it grew by 23.7% to HUF 19,068 million. The increasing share can be explained by the fact that income derived from commissions and fees on lending business, payment transactions, current account keeping, card services and brokerage fees grew more dynamically than those earnings resulted from the expansion of interest-earning items. The rate of growth in net commission and fee income was 23.7% while net interest income rose 22.6% over year 2005. Additionally, the dynamic increase in net interest income, realised on the expanding business volumes, was accompanied by a significant (24.1%) rise of other operating income from HUF 7.6 billion in 2005 to HUF 9.4 billion in 2006, mainly due to high unrealised gains on foreign exchange transactions. Meanwhile, pre-provision net operating profit after deducting costs was HUF 34,796 million in 2006, up 36.4% from HUF 25,519 million in 2005.

Profit before taxation of HUF 23,092 million for 2006 was 15.9% in excess of the 2005 profit of HUF 19,916 million, as the sound growth in gross operating income was only partially counterbalanced by higher net provision charges and the increase in operating costs. The pre-tax return on average equity ratio (ROAE) was 15.2% (the calculation method of the average shareholder's equity was based on prior year end and current year end) for 2006 (2005: 16.7%) including the effect of capital rises while the pre-tax return on average assets ratio (ROAA) was 1.3% in 2006 (2005: 1.3%). The lower value of pre-tax ROAE can be explained by the fact that equity were expanded significantly during 2006 in order to be able to finance the acquisition of Unionbank and Romexterra. Excluding this effect, ROAE for year 2006 represented 17.3% which meant an increase on a comparable basis. MKB Bank's sustained high operating profitability is reflected by the ratios of the relevant key income items to average total assets. Gross operating margin (gross operating income to average assets) of 4.3% for 2006 increased compared to the 3.9% figure of 2005, whereas relative operating costs represented 2.3% in 2006 (2005: 2.3%). Meanwhile, the relative net provision charge was at 0.7% for 2006, which grew compared to the 0.4% figure of 2005, providing a strong coverage to non-performing loans.

Tax charges decreased to HUF 4,758 million (2005: HUF 5,134 million), of which HUF 3,195 million paid taxes represented cash outflow.

On the grounds of profit after taxation of HUF 18,334 million for 2006, the Board of Directors proposes HUF 16,035 million dividend payment, equivalent to 122.1% dividend on each ordinary share.

Net interest income

The largest component of revenue, net interest income, amounted to HUF 46,442 million, 22.6% in excess of HUF 37,873 million in 2005. The growth in net interest income over the previous year resulted primarily from the business expansion and increasing interest rate level, manifested in a 15.0% increase in average interest-earning assets in which domestic commercial loans denominated in foreign currencies and dynamically growing retail lending was the most significant factors. As far as retail lending is concerned, private housing loans denominated in foreign currencies had a dominant share in the total growth of volume. Meanwhile, market competition still remained intense in 2006.

During 2006, the growth in interest-earning assets to an average of HUF 1,703.9 billion from HUF 1,481.3 billion in 2005 was primarily attributable to the rise in domestic customer loan balances. The nominal growth in average volumes was stronger in foreign currency denominated customer loans that increased by 23.1% while loans in domestic currency at an average were also up 5.7% over 2005. The average securities portfolio decreased by HUF 43.5 billion mainly due to the liquidation of MKB Bank's held-to-maturity portfolio. Meanwhile, average central bank balances also increased as a result of holding liquid assets to provide lending growth with readily available funds. The increase in loans and securities in domestic currency was covered by the growth of customer deposits denominated in domestic currency. The increase in foreign currency denominated loans was primarily financed by foreign exchange loans from the banking sector.

Due principally to the significant increase in HUF and a more moderate rise in foreign exchange average interest rates, the growing trend in both the average nominal yield on average interest-earning assets and the cost of funds was characteristic to 2006. Net interest margin, which is the difference between interest income and interest expense expressed as a percentage of average earning assets and average interest-bearing liabilities, was 2.6% in 2006 (2005: 2.3%). The higher interest margin in 2006 has been the net outcome of the growing nominal interest rate environment in the domestic currency that resulted in higher margins on customer accounts.

Non-interest income

For 2006, total non-interest income increased 23.8% over its previous year level and amounted to HUF 28,471 million (2005: HUF 22,994 million), representing 38.0% of gross operating income compared to 37.8% in 2005. The rise in the nominal amount of such income was the net result of different factors as discussed below.

Total net commission and fee income of HUF 19,068 million, the largest component in non-interest income, was up 23.7% from HUF 15,419 million in 2005, reflecting the continued expansion of the Bank's fee-generating activities. All fee-income elements grew compared to 2005, with strong growth rates in card services (60.4%), credit related fees (22.8%) and income from securities and brokerage fees (34.8%). Meanwhile, fees from payment services for 2006 also increased by 14.8% over their 2005 level to HUF 5,199 million. On this basis, the share of credit and card services related fees made up 25.6% and 9.5% of the total (2005: 25.5% and 7.3%, respectively) while the proportion of fees in connection with brokerage and other securities businesses was 8.2% (2005: 7.5%). Fee expenses also increased by 17.0% over their 2005 level, due mainly to a more significant nominal rise in such expenses of card services, deposit protection fees and brokerage fees.

Other operating income of HUF 9,403 million for 2006 was 24.1% over the total amount of HUF 7,575 million for 2005. The extensive growth was mainly due to dynamic increase in realised gains from trading securities that increased from 2005 year-end figure of HUF 763 million to HUF 2,600 million for year 2006. Meanwhile, the Bank accounted for a total net gain of HUF 1,892 million (2005: HUF 946 million) from trading and revaluation gains on the Bank's securities portfolio, deriving primarily from the liquidation of held-to-maturity portfolio.

An important factor in other operating income was that the net amount of foreign exchange gains and derivative revaluations significantly increased mainly because of revaluation losses, which can be related to derivative transactions, realized as a consequence of HUF depreciation during 1H. The unrealised foreign exchange gains on derivative transactions grew from HUF 1,625 million to HUF 8,855 representing an increase of 28.2% in 2006. At the same time the realised net gains on foreign exchange significantly decreased (by HUF 5,900 million) which reflects the valuation effect of the Bank's BS positions. Summarized valuation effect on balance end derivatives items comprised HUF 6,412 million gains which means 25.4% increase over the previous year's level (HUF 5,113).

Dividend income from investments and affiliates amounted to HUF 1,810 million, that remained slightly below the HUF 1,971 million in 2005.

Operating costs

Cost discipline remained to be a priority also in 2006, although the Bank continued to invest in revenue growth initiatives. During 2006, operating costs totalled HUF 40,117 million, 13.5% higher than HUF 35,348 million a year earlier. The nominal growth in operating expenses was driven by the extra expenses of running the Bank's extended sales capacities, the additional costs of newly launched strategic projects. Meanwhile, the significant IT projects, aiming at the implementation of more advanced systems all across the MKB Bank to promote customer services, also continued in 2006.

General and administrative costs decreased 17.9% over 2005 in nominal terms, reflecting lower consultant utilisation in connection with the strategic projects beginning in 2005. Personnel costs, comprising 45.8% (2005: 43.8%) of total expenses, were up 18.8%. The increase in staff expenses can be explained by the growth in the total number of full-time equivalent staff (from 1,624 by 11.6% to 1,812 persons in 2006), which is a consequence of MKB Bank's organic growth manifested in the opening of 16 new branches during 2006. The significant nominal increase of 30.1% in marketing and public relation costs reflected the intensive support of sales initiatives and the promotion of newly opened delivery units.

Due primarily to the costs of the enlarged branch network as well as the move into a new office building resulted in a growth in gas, electricity and property rental expenditures. As a consequence of the above mentioned factors, occupancy and rental costs increased at 26.1% from HUF 4,566 million in 2005 to HUF 5,757 million in 2006. Simultaneously, communication and data processing expenses grew 8.5%, as the Bank continued to invest in information technologies to leverage alternative, lower-cost electronic delivery channels in order to improve customer service and introduce new products. Moreover, creating the high standard information and technology background of 16 new branches opened in 2006 also contributed to the increase in communication and data processing expenses. Expenses were incurred in building the Bank's data mining and customer relationship management capacities to enlarge sales capabilities as well as in supporting some functional tasks. Meanwhile, irrecoverable VAT and other tax expenses increased 2.6% over 2005.

The accepted benchmark to measure efficiency in the banking industry, the cost-to-income ratio for the year was 53.6%, 4.5 percentage points below the 58.1% figure of 2005. The progress compared to last year's figure reflects the cost discipline to manage the costs-leveraging effects of enlarged sales capacities, revenue growth initiatives and the fact that gross operating income grew more dynamically than operating expenses in 2006.

BALANCE SHEET MANAGEMENT

In 2006, with the execution of its primary business policy objectives the Bank continued to expand its customer base, with asset and deposit growth in most of the strategic business lines. At the end of 2006, MKB Bank's total assets were up 12.2% from HUF 1,643.1 billion at previous year-end to HUF 1,843.3 billion at 31st December, 2006, with sustaining the high share of customer asset balances of over 72% in the total. In 2006, average interest-earning assets amounted to HUF 1,703.9 billion, 97.7% of total average assets, up from HUF 1,481.3 billion, 95.4% of total average assets, in 2005.

In 2006, growth in total assets was primarily driven by customer lending whose net volume was up 11.6% from HUF 1,204.2 billion in 2005 to HUF 1,344.5 billion. Customer loan portfolio was the largest component in the balance sheet. Its share of 72.9% in total assets remained practically unchanged from 73.2% in 2005. The bulk of the nominal growth came from three main sources. Expansion of long-term, foreign exchange denominated loans to domestic large enterprises played a major role in the growth of the portfolio. Besides large corporate exposures, lending to SMEs and loans to the retail clientele increased to a meaningful extent on the annual basis. In the growth of retail financing, foreign exchange denominated housing loans, MKB Bank's traditionally strong products, real estate (project finance) and trading industrial loans were key drivers. As regards dynamics, net loans to retail and SME enterprises altogether showed a relative rise of 27.1% to HUF 541.9 billion at 2006 year-end (2005: HUF 426.4 billion).

The Bank's business policy continued placing strong emphasis on retaining and expanding the customer deposit base in order to fund constantly growing credit volumes. Total volume of current and deposit accounts held at MKB Bank by corporate and private customers have grown, altogether by 14.1% to HUF 960.3 billion (2005: HUF 841.9 billion). In the overall volume growth, HUF denominated deposits were dominant. At period-end, current accounts stood at HUF 329.6 billion, representing 10.3% growth in the recent 12 months, while deposit accounts accounted for HUF 630.7 billion, up 16.1% over 2005. Current and deposit accounts of Hungarian corporate customers grew the most dynamically: 20.9% and 34.6%, respectively. Private individuals' balances in both of the above mentioned categories increased moderately: 1% and 4%, respectively. In addition, the Bank's certificates of deposits attracted HUF 2.4 billion (2005: HUF 6.6 billion) funding at the end of the year. During 2006, MKB Bank renewed both its domestic bond issuance program of HUF 100 billion and the similar foreign program (European Medium-Term Note, EMTN) of EUR 1,000 million. Under these programs, altogether HUF 11 billion and EUR 50 million nominal value of *MKB III. Bonds, MKB FIX 2013 and 2016 Bonds* and *Eurobonds* were issued in several tranches. On this basis, funding from issued securities altogether increased 21.8% in a year and totalled to HUF 190.9 billion at December 31, 2006 (2005: HUF 156.8 billion). Simultaneously, inter-bank financing remained a strong contributor, despite that it missed last year's figure by 6.8%. The share of customer balances in total financing was slightly up to 52.1% in 2006 from 51.2% in 2005 while inter-bank liabilities decreased and represented 19.6% (2005: 23.5%) share in total funding. In the meantime, issued securities made up 10.4% of total funds, up from 9.5% in 2005.

Overall inter-bank assets (MNB and other commercial bank placements and loans) in nominal terms have increased HUF 16.1 billion, or 7.4% over 2005. The rise was the net outcome of the 27.0% increase from HUF 102.6 billion to HUF 130.3 billion in placements with the central bank, while commercial inter-bank balances decreased by 10.2% from HUF 114.3 billion to HUF 102.6 billion in 2006. The principal reason for the increase in overall inter-bank balances was the Bank's prime initiative to flexibly support lending growth from readily available assets while maintaining an appropriate level in liquidity.

Securities portfolio decreased altogether 21.4% to HUF 97.0 billion, due to the liquidation of held-to-maturity portfolio.

Meanwhile, equity investments in participations increased by HUF 49.4 billion up from their 2005 year-end level through the net outcome of additional capital raises in the Bank's subsidiary companies on the one hand, and the acquisition of two foreign banking subsidiaries (Romexterra, Unionbank), on the other.

Inter-bank financing amounted to HUF 360.4 billion, 6.8% down during the last 12 months (2005: HUF 386.8 billion) which was caused mainly by the HUF 55.4 billion repayment of a part of MKB's borrowings from other banks.

Borrowed funds and issued debt securities increased 13.5% and amounted to HUF 269.3 billion at 2006 year-end (2005: HUF 237.2 billion). The net growth in such balances resulted from the securities issues under the renewed domestic and foreign bond programs, and the EUR 120 million growth in subordinated debt. Included in other borrowed funds were altogether HUF 65.6 billion (2005: HUF 35.4 billion) debts that represent direct, unsecured and unconditional obligations of the Bank and are subordinate to the claims of the Bank's depositors and other creditors. In 2006, through the issuance of debt securities under the EMTN program, an additional subordinated loan of EUR 120 million was borrowed from the major shareholders. Besides this latter transaction, the difference in the HUF-equivalent amounts reflected only the effects of changing foreign exchange rates.

Shareholders' equity increased 41.5% and amounted to HUF 178.8 billion (2005: HUF 125.2 billion). The growth in equity reflected the effect of the execution of three capital increases in 2006 (two of them occurred to cover the acquisition of Romexterra and Unionbank).

At the end of 2006, the Bank had a practically closed currency position in the balance sheet that represented a practically unchanged overall net position from 2005 year-end. The slight increase in fccy net currency position was due to uncovered revaluation gain of securities. In the course of the whole year, MKB Bank was running a currency position which was always well within legal limits.

CAPITAL MANAGEMENT

MKB Bank's strong capital base contributes to its safety, promotes customer confidence, supports its high credit rating and enables it to take advantage of growth opportunities. MKB Bank's policy is to remain well capitalised in order to provide adequate business flexibility and support risks associated with its activities. As capital is a critical resource, it is actively managed by the Bank. The capital management processes take into account the changes in balance sheet and risk-adjusted assets, the capital structure and the costs and availability of various types of capital, investment plans and shareholder returns, while satisfying the requirements of regulators, rating agencies, financial markets and depositors. It requires active management of both risk-weighted assets and the capital base.

Domestic and international guidelines require the Bank to maintain certain minimum capital-to-asset ratios. These risk-based ratios are determined by allocating assets and specified off-balance sheet instruments into four weighted categories, with higher levels of capital being required for categories perceived as representing greater risk. Regulatory capital is divided into Tier 1 Capital and Tier 2 Capital. In addition to retained earnings, the Bank may raise regulatory capital by issuing several types of financial instrument to the public. These financial instruments are then classified as either Tier 1 or Tier 2, depending on the types of conditions or covenants they place upon the issuer.

In June 2004, the Basel Committee on Banking Supervision released its report entitled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II). The new framework is designed to more closely align regulatory capital requirements with underlying risks by introducing substantive changes in the treatment of credit risk. Moreover, an explicit new capital charge for operational risk has been also been introduced, as well as increased supervisory review and extended public disclosure needs. MKB Bank is committed to completing the necessary tasks and has launched a comprehensive project aimed at being in a position to implement and meet the new regulatory requirements until 1st January, 2008.

Tier 1 Capital includes securities with no fixed maturity date, such as ordinary shares. At December 31, 2006, MKB Bank had HUF 113.6 million (2005: HUF 104.9 billion) Tier 1 Capital. In 2006, three new share issuances with share premiums contributed to the growth in this capital element. Besides the growth in equity elements, the increase in the total amounts invested in financial institutions (2006: HUF 49.8 billion, 2005: HUF 9.2 billion) resulted in the decrease in the Bank's Tier 1 Capital. Meanwhile, the growth of intangible assets was visible which reduced Tier 1 capital by HUF 8.3 billion (2005: HUF 3,977 million). This increase related to the implementation of new Core System.

Tier 2 Capital may include subordinated long-term debt and similar instruments and qualified loan loss reserves. The amount of subordinated long-term debt may not exceed 50% of the issuer's Tier 1 Capital and, in addition, the capital treatment accorded subordinated debt is reduced as it approaches maturity. Qualified general loan loss reserves may be included in Tier 2 Capital up to 1.25% of risk-weighted assets. Total Tier 2 Capital is limited to 100% of Tier 1 Capital.

In 2006, Tier 2 capital element increased to HUF 72,806 million (2005: HUF 43,672 million), principally due to the additionally borrowed subordinated debt of EUR 120 million. Another significant part of Tier 2 Capital is the general risk reserve amounting to HUF 6,743 million (2005: HUF 7,157 million), net of deferred tax, which is allowed to be set aside for anticipated, yet not identified losses inherent in the asset portfolio and calculated in accordance with Hungarian banking regulations and amounts up to 1.25% of the Bank's risk weighted assets. In 2006, general risk reserve declined HUF 414 million through utilisations for loan losses.

Risk-weighted assets increased 11.4% over 2005 and amounted to HUF 1,582.7 billion (2005: HUF 1,421.1 billion). Market risk positions contributed HUF 73.3 billion to the amount of risk-weighted assets (2005: HUF 28.9 billion). Growth can be related to general interest risk position due to increase in trading and AFS securities portfolio instead of HTM portfolio. Total amount of collaterals eligible for risk-asset calculations decreased 9.9% over 2005 in which central bank and government guarantees represented the largest proportion.

At 2006 year-end, MKB Bank's level of capital remained strong, with capital ratios in excess of regulatory minimum requirements. The Bank's regulatory capital base increased 25.5% from HUF 148.6 billion in 2005 to HUF 186.4 billion in 2006 while total risk-weighted assets and the market risk charge altogether grew 14.2%. As capital was put into more effective use, the capital adequacy ratio of 10.3% at 2005 year-end has increased to 11.3% at December 31, 2006. However, the Bank's capital adequacy ratio safely exceeded the minimum legal and BIS requirements, and represented the level MKB Bank thinks essential for a bank operating in the CEE region.

At the end of 2006, the Bank's authorised, issued, called up and fully paid share capital comprised 13,132,671 (2005: 11,520,786) ordinary shares of HUF 1,000 (2005: HUF 1,000) each. All shares rank pari passu in the event of a winding up. The Bank's principal shareholder was BayernLB who owned 89.62% in MKB Bank's share capital, while P.S.K. Beteiligungsverwaltung

GmbH. held 10.38%. The remaining meagre number of shares was in the possession of a number of domestic corporations and private individuals. There were no repurchased shares held in the Bank's own portfolio at 2006 year-end (2005: Nil).

Based on the resolution of the Board of Directors in December 2005, MKB Bank's registered share capital was increased by a nominal amount of HUF 406 million at a price of HUF 30,800 on ordinary shares of HUF 1,000 each during January 2006. The capital increase has been fully subscribed and paid in by shareholders existed at the balance sheet date. On January 25, 2006, the Board of Directors made a resolution to raise MKB Bank's registered share capital by an additional HUF 523.885 million at a price of HUF 30,800 on ordinary shares of HUF 1,000 each. The subscription period was open between February 6 and 21, 2006. Based on the resolution of the Board of Directors in June 2006, MKB Bank's registered share capital was increased by a nominal amount of HUF 682 million at a price of HUF 30,800 on ordinary shares of HUF 1,000 each during July, 2006. On December 1, 2006, the Board of Directors made a resolution to raise MKB Bank's registered share capital by an additional HUF 435.230 million at a price of 30,800 on ordinary shares of HUF 1,000 each. The subscription period was open between January 2 and 18, 2007.

RISK MANAGEMENT

OVERVIEW

As its businesses expose MKB Bank Nyrt. to risks, risk management is an integral part of the Bank's operations and a crucial component of its overall financial performance. MKB Bank's risk management framework has been designed to capture and manage all relevant risks and is supported by the strong commitment to a prudent risk management culture both on the executive and business line levels. The main principles and priorities of the Bank's risk management function include the ultimate oversight by the Board of Directors, the importance of independent review of all risk-taking activities separately from business lines, and the proper evaluation, diversification, monitoring and reporting of all risks. The effective communication on risk and risk appetite, the on-going initiatives to better identify, measure, monitor and manage risks, the improvement of efficiency, user-friendliness and awareness of key risk processes and practices, and the employment of highly-skilled staff are major aspects in running an effective risk management function in the Bank.

The foundation of effective risk management is a strong risk management culture, run mutually by risk management professionals, business areas and functional units. The common work is aimed at business, risk and resource issues in order to identify risks, which are to be measured, monitored and managed. Numerous analytical techniques are employed to define and optimise the risk-reward profile. Policies and limits are in place to ensure that risks are well diversified, while processes are tailored to ensure a proper risk assessment at the transaction, customer and portfolio levels.

The top level of the organizational perspective of risk management is the *Board of Directors*. Its main responsibilities include shaping, influencing and communicating the Bank's risk culture by defining the organizational structure and by determining the direction and the limits of the Bank's risk-taking willingness with respect to different activities. It reviews and approves policies for controlling risks, monitors major risks and ensures sufficient and appropriate risk management resources. Key risk strategies, policies and limits are always subject to Board of Directors review and approval.

The middle level of the risk management organization comprises the *Board of Management* and various *risk committees*, including Credit Committee and Asset and Liability Management Committee (ALCO), comprising senior executives. At this level, primary responsibilities are the implementation and maintenance of an integrated group-wide risk measurement, management and reporting framework and the establishment of a comprehensive risk assessment and approval process, including policies and practices, guidelines and risk limits that ensure appropriate risk diversification and risk-returns both on a portfolio and transactional basis.

The bottom line of the risk management structure comprises individual *customer relationship managers* and *risk managers* whose main responsibilities are managing, monitoring and controlling risks within the established guidelines, policies and limits. All activities that expose the Bank to risks are subject to independent reviews separate from business units that initiate the transaction. Risk profiles of individual transactions, customers and portfolios are subject to on-going reviews and are reported to executives and to higher organizational levels of risk management.

The Bank applies comprehensive risk management tools and policies to mitigate the main risks it is exposed to, namely credit, market, liquidity and operational risk. They are discussed in more details in the following sections.

CREDIT RISK

Credit risk is the possibility of financial loss from the default of a borrower or counterparty to fully perform under the terms of a credit-related contract and includes loan loss risk, pre-settlement risk and settlement risk, and replacement risk. Credit risk arises primarily from the Bank's lending activities, as well as from guarantees, commitments to extend credit, securities and derivative financial instruments. It also includes transfer risk, which is the repayment risk that is incurred with transactions subject to potential restrictions on the cross-border movement of funds. Overall, the Bank’s credit risk exposures amounted to HUF 2,184.2 billion at 2006 year-end (2005: HUF 1,971.4 billion).

The Bank’s approach to credit risk management is based on the independence and integrity of risk evaluation while also being integrated into business management processes. Strategies, policies, procedures and limits are to steer the daily management of credit risk as a vital part of MKB Bank’s strong credit culture.

The Credit Committee regularly reviews the policies, standards and limits that control risks and recommends to the Board of Directors any amendments that may be required from time to time. All major credit decisions are referred to the Credit Committee for approval, while larger credits need Board of Directors authorisation as well.

Risk Office (RO) is supervised by the Chief Risk Officer, and is independently responsible for controlling the Bank's overall credit exposure, and for establishing credit approval policies, standards, limits and guidelines that define, quantify, and monitor credit risk. It also reviews compliance with established credit limits and assesses industry, geographic region or country, product, and individual borrower or counterparty exposure, together with loans under problematic treatment or intensive care. Together with Business Units, it monitors significant developments in the creditworthiness of its portfolio, the majority of which is risk relevant, therefore subject to joint decision by the Business Units and RO. The criteria for risk relevant business are established within the Credit Policy and other subordinated regulations of MKB Bank. In 2006 the Bank further strengthened the involvement of RO in the credit processes. It means earlier and wider ranged involvement in prepare and making decision. Maintaining the efficiency the overall credit processes have been revamped.

Managing credit risk within the guidelines established by RO and approved by the Board of Directors is the responsibility of all relationship managers, involved in extending credits to customers, and the dedicated risk managers. The primary focus of managing credit risk is to evaluate the likelihood that a borrower or counterparty will repay a loan from expected cash flows and to follow up with appropriate action should any signs of deterioration occur. Where collateralised transactions are involved, RO is also involved in ensuring the appropriateness and validity of such security.

Provisioning of exposures is performed quarterly in strict conformity with the relevant internal rules. All exposures are reviewed quarterly by the Credit Committee, with exposures above a certain limit (currently HUF 50 million) being reviewed on a case by case basis. Credit Committee is in charge to recommend the provision while the approval is the authority of the Board of Management.

The Bank continuously develops those analytical tools it uses to analyse and manage credit risk. This comprises the elaboration and employment of certain models and management information systems.

Internal risk ratings

All corporations, financial institutions and any other borrowers are assigned an internal risk rating based on a detailed examination of the relevant borrower. This examination considers, amongst others, financial strength, market position and competitiveness, industry sector trends, overall company strategy, future outlooks, management record and skills, and any other important risk factors the borrower and the Bank face. The Bank's internal rating system is currently based on a 6-grade scale but is in the process of being further developed in order to be Basel II compliant. The Bank's internal rating system has currently a 6-grade scale but preparing for the IRB-F method, which is challenged by BayernLB's LB-Rating on the one hand and also is under investigation for further development in order to be both Basel II and LB-Rating compliant.

As a result of the TRM project the standardised retail risk model was added to the business model – transparent, simplified decision-making competencies, standardised risk assumption (introduction of override), dominance of non Risk Office relevant decisions, are evaluated by credit scoring models and supported by credit origination solution. The models are on-going reviews in order to enhance their predictive power. The reviews cover portfolio analysis and analytical scorecard buildings are based on statistical bases which are supported by increasingly reliable database.

The internal risk ratings and credit scores are assessed and updated on a regular basis by RO.

Internal limits and diversification

Concentration risk exists if a number of customers are engaged in comparable activities, are operating in the same geographic region or have similar economic characteristics or are under joint ownership such that their ability to meet contractual obligations are affected by changes in economic, political and other conditions in the same way. Portfolio diversification is one of the Bank's paramount principles. The Credit Policy, the overall Credit Risk Strategy and the sector specific credit risk strategies, together with the client/group/sector limits are set to ensure the necessary diversification across different industries and types of credit risks and to guarantee that MKB Bank is not overexposed to any given client, industry sector or geographic area. The Bank will introduce a separate credit risk concentration policy in 2007 based on the approval of the BoD.
As a response to the restrictive government policy the Bank's Credit Risk Strategy for 2007 define different growth possibility in different sectors. Sectors are differentiated according to the expected extent of the negative impact of the "Gyurcsány package". Sectors with the most intensive impact are expected to have declining share from the whole portfolio.

To avoid excessive losses if any particular counterparty is unable to honour its financial or contractual obligations, the Bank establishes limits for individual borrowers that are set according to internal risk assumption procedures. In addition, limits are in place to manage exposure to any particular country. Each country is assigned a risk preference that considers factors common to all entities in a given country yet outside the control of individual entity. Limits are determined on the basis of risk ratings, historical loss experiences and the Bank's overall strategy and specific approach to that risk factor.

The Bank has a well-diversified commercial loan portfolio. In 2006, the largest nominal growth occurred in loans to the real estate, trade and services, metals and mining and technology sectors whose net volumes were up by HUF 73.3 billion, HUF 43.5 billion, HUF 13.0 billion and HUF 9.5 billion over 2005, respectively. The breakdown reflects a relatively even industry-wide distribution without excessive exposures to any single sector with the largest concentration in real estate, food and beverages, and financial services that represented 27.1%, 9.8%, 9.2% respectively (2005: 24.2%, 12.1%, 11.1% respectively), in the total corporate portfolio. Despite its significant share in the entire loan portfolio of the Bank, the real estate portfolio is well diversified across its segments. The significant increase was in private portfolio (by HUF 51.2 billon) which reflects dynamic expansion of residential mortgage and personal loans during the business year. The above mentioned sectors were determined according to the RIBS code, used by the BayernLB Group.

The composition of the loan portfolio as a percentage of shareholders' equity shows that the share of loans above 10% of shareholders' equity in the total has decreased to 7.2% in 2006 from 12.4% at 2005 year-end. The cause of the setback is that shareholder's equity increased by 41.5% from 2005 to 2006 year-end. Simultaneously, the share of loans in the 1-10% category has fallen to 38.4% in 2006 from 40.3% in 2005, while customer numbers in the class also decreased. While the share altogether slightly decreased at the top end, the number of clients in the two lower brackets significantly increased and their share in the total portfolio was up by 7.1 percentage points. This development reflects the successful execution of MKB Bank's two-pronged medium-term strategy aimed at the acquisition of better quality, small- and medium-sized enterprises.

At December 31, 2006, MKB Bank's total cross-border net exposures (including Banks) amounted to HUF 200.6 billion, down from HUF 203.8 billion in 2005 but represented more than 10% of total exposures. Exposures toward large corporates, banks and the Bank's subsidiaries (in Romania and Bulgaria) in CEE countries have increased. In the meantime, the Bank has decreased its exposures to EU member-states by HUF 13 billion. While the share of other foreign outstandings outside Europe and Former Soviet Union in the total remained immaterial, less than 2%. These shifts were part of the strategy to expand exposures to regional countries as a result of their EU accession, the Bank's market experience and the consequently improving risk profile of these markets. At these levels of risk, the Bank is committed to these markets.

Collaterals

MKB Bank's lending practice is based upon the principle that loans should be repaid primarily from the operating cash flow of the debtor. Therefore, the assessment and monitoring of the clients' financial health is considered highly important. Pledged collateral, however, can mitigate credit risk and secure repayment in case of financial difficulties, therefore MKB Bank obviously prefers security that can be easily realised. Generally, the credit portfolio of MKB Bank is well collateralised. Among collaterals, mortgages on property and equipment, government guarantees and cash deposits represented the most significant part in 2006.

Total collaterals for on-balance sheet and off-balance sheet items increased by 30.6% over 2005 year-end and amounted to HUF 926.2 billion, at a conservatively estimated realisable value, representing an overall collateral coverage of 43.3% (2005: 38.3%). Both in 2005 and 2006, the largest component was collaterals pledged for customer loans totalling HUF 565.4 billion and HUF 665.7 billion, respectively, representing a 71.9% (2005: 79.7%) share in the total. On this basis, 49.5% (2005: 46.8%) of gross outstanding customer loans were covered by collaterals, in which mortgages on buildings and other fixed assets represented a 70.1% (2005: 69.9%) proportion. Cash equivalent collaterals amounted to HUF 20.3 billion, down from HUF 24.4 billion in 2005, taking up a 2.2% (2005: 3.4%) share in the total.

MARKET RISK

Market risk is the potential of loss from adverse changes in market rates and prices, such as interest rates (interest rate risk), foreign currency exchange rates (foreign exchange risk), commodity prices (commodity risk), prices of equity securities (equity risk) and fixed income securities risk (spread risk), the correlations among them, and their levels of volatility. Financial products that expose the Bank to market risk include loans, securities, deposits, debt, and derivative financial instruments.

As part of the annual plan, the Board of Directors sets the maximum amount and scope of market risks incurable by the Bank, ensured by a comprehensive limit structure broken down by relevant portfolios. The Bank's Asset and Liability Management Committee (ALCO) has the overall responsibility for establishing and managing market risk policies for the Bank, within the framework of internal policy documents, covering risk management, assessment of risk and related limits, competence and decision-making mechanism, and regulation for breaches of limits, approved by the Board of Directors. The members of the ALCO are senior executives who have principal decision-making responsibilities for businesses throughout the whole Bank. At the operational level, market risks are managed by the Money and Capital Markets Directorate on a group-wide basis.

RO supports the activity of ALCO, performs regulatory tasks and is responsible for market risk controlling. It ensures compliance with regulations and decrees in the area of market and portfolio risk management, establishes general market risk management policies for market and portfolio risk, monitors the limit system, including volume, potential loss amounts (PLA) and value-at-risk (VaR) limits. RO is also responsible for operating and developing risk management systems to measure interest rate, foreign exchange, equity risk and, on a daily basis, analysing and identifying stress situations, to quantify the effects of potential negative market events due to e.g. unusual price movements, and illiquidity. RO provides reports to the ALCO and the Board of Management on the risk position of the Bank and the Group.

The MKB Bank group's market risk management activities are divided into two main types: trading and non-trading. *Trading activities* include transactions with debt and equity securities, foreign currencies, and derivative financial instruments. The Bank and group companies manage exposure to market risk by establishing and monitoring various limits on trading activities. These limits include product volume, gross and net positions, VaR and PLA limits. Product volume limits define maximum aggregate amounts of trading products and contracts that the Bank may hold at any time. Position limits restrict the gross and net amounts of positions that can be held in the trading and investment books. VaR measures the potential loss in future earnings due to market rate movements within the trading portfolio using proprietary models that are based on statistical probability. VaR is calculated on the basis of 1-day holding period at 99% confidence level. PLA limits define maximum amount of loss that the Bank is willing to assume.

The Bank's *non-trading activities* encompass all activities other than accounted for as trading transactions, including lending, investing in securities (although the latter has been ceased in January 2006 with all securities falling under trading book activity), accepting deposits, and issuing debt.

Besides VaR calculations, the Bank runs stress-tests to simulate the potential effects of extreme market developments on its positions and income on a daily basis.

The pricing of daily trading transactions for the Bank's own account are controlled and monitored continuously through the market conformity method. Market positions are re-valued daily on the basis of market prices and market rates.

Interest rate risk

The management of interest rate risk is aimed at minimising the adverse effects of changing market interest rates on the Bank's interest margin, net interest income and the market value of fixed income portfolios. Non-trading interest rate risk is monitored both at a strategic and at an operational level. The ALCO sets and monitors limits on allowable risk, reviews and approves the underlying products and model assumptions. It generally monitors gap mismatches, and interest sensitivity. Gap mismatches result from timing differences in the maturities or re-pricing of assets, liabilities and off-balance sheet instruments. Sensitivity analyses are based on potential interest rate scenarios (200 bp up/down) on the Bank's actual re-pricing profile and a combination of assumptions of market conditions and business developments. At the operational level, the Money and Capital Markets Directorate conducts interest rate risk management.

The Bank employs interest rate swaps, investment portfolio purchases or sales, and other derivative interest rate contracts as primary risk management techniques to keep interest rate risk within the approved limits.

At the end of 2006, the Bank's trading and liquidity portfolio of bonds, primarily Hungarian government bonds, incurred a regulatory capital charge of HUF 3,260 million (2005: HUF 1,401 million).

From profitability point of view, a 200 bp abrupt upward movement in market interest rates through the full spectrum of re-pricing periods would have resulted in a HUF 1,137 million (2005: HUF 1,716 million) loss, while a 200 bp downward movement in such rates would have meant a HUF 1,153 million (2005: HUF 1,847 million) gain in the Bank's net interest income at year-end. Based on the above shock-scenarios, the full impact of the simulated change in market terms was less than 1% of the regulatory capital even in the unfavourable case.

Foreign exchange risk

The Bank is exposed to foreign exchange risk through its holdings of financial instruments denominated in foreign currencies. Exchange risk management aims to reduce the adverse impact of potential changes in the market value of foreign currency financial instruments induced by exchange rate fluctuations.

The operational management of the Bank's foreign currency position through setting and monitoring various limits, including net open positions, stop-loss limits, and through the use of derivative financial instruments is the responsibility of the Money and Capital Markets Directorate.

At 2006 year-end, the Bank had a practically closed net foreign exchange position of HUF 1171 million (2005: HUF 295 million), in its trading portfolio incurring VaR of HUF 9.1 million (2005: HUF 3.3 million).

MKB Bank had two acquisitions in 2006: MKB Unionbank in Bulgaria and Romexterra Bank in Romania. The long BGN foreign exchange position coming from MKB Unionbank acquisition is hedged with subordinated loan capital of EUR. Because of the fact, that BGN is fixed to EUR, this position is hedged from market risk point of view. The only risk that the Bulgarian Currency Board may devaluate BGN against EUR is monitored regularly by MKB Unionbank. Long RON foreign exchange position is hedged with short RON/HUF foreign exchange forward position. Hungarian banking regulation does not allow netting between two different currencies, therefore the BGN hedging requires HUF 1.638 million regulatory capital charge (2005: no regulatory capital charge).

Equity risk

According to the current policy the Bank do not hold equity in its security portfolio.

LIQUIDITY RISK

Liquidity risk is the possibility that the Bank's cash flows may not be adequate to fund operations and meet commitments on a timely and cost-effective basis. While capital is held to absorb potential losses over time, liquidity is managed to provide the Bank with the ability to generate or obtain sufficient cash or its equivalents in order to meet its known and unanticipated cash funding needs as they fall due. It is essential in protecting MKB Bank’s capital, sustaining market confidence and expanding into profitable business opportunities.

Within the above framework, MKB Bank continues to preserve its large core client deposits, ensuring the on-going access to different sources of wholesale funding and maintaining a dedicated pool of assets that provide ready access to cash needed for operations, to meet payment demands on borrowings and to make new loans and investments as opportunities arise. The Bank manages its liquidity on a daily basis, taking into account the various limitations, to maintain cost efficiency.

Liquidity risk exposure is limited by the regulations approved by the Board of Directors that approves the Bank’s overall liquidity management and funding policies and sets liquidity ratios and obligatory core liquid asset holdings. The Board of Directors delegates the responsibility for liquidity risk management to senior executives through the ALCO. The ALCO meets weekly to analyse the Bank’s liquidity profile and discuss strategic and operative issues. The ALCO seeks to balance the Bank's sources and uses of funds while minimising market exposure through establishing and monitoring various liquidity risk limits, maximum cumulative outflow (MCO), risk control mechanism, and product participation limitations. At the operational level, the Money and Capital Markets Directorate manages liquidity risk.

The Bank's management of liquidity risk comprises structural, tactical and contingent perspectives. *Structural liquidity risk management* assesses and analyses liquidity exposures inherent in current balance sheet compositions due to mismatches in maturities of assets and liabilities. These exposures are measured and monitored through stress testing. *Tactical liquidity risk management* handles normal day-to-day funding issues by setting limits on net fund outflows for specified periods, especially for crucial short-term time horizons. Scenario analyses are performed periodically on the assumed behaviour of cash flows under varying conditions to assess funding requirements and, as required, to update assumptions and limits. Although MKB Bank can routinely access liquidity in the public markets, contingency plans exist that could be implemented on a timely basis to minimise liquidity risks. *Contingent liquidity risk management* identifies comprehensive strategies and procedures in cash flow shortfalls due to general market disruptions or adverse economic developments that may put pressure on the Bank's ability to honour its commitments and highlights potential liquidity exposures based on different market scenarios. These plans are updated annually.

The Bank relies on a wide range of funding sources, primarily capital, retail and commercial deposits, and money and capital market funding. Liquidity management provides for the appropriate mix of core and non-core deposits. Stable funds fully cover the Bank's equity holdings, loans and invested assets.

MKB Bank holds marketable securities and other short-term investment that can be readily converted to cash to support its operations. These liquid assets can be sold or pledged in the sort run to meet the Bank's obligations. Cash, short-term deposits with the central bank and readily marketable government securities (liquid assets) amounted to HUF 231.3 billion at 2006 year-end, up from HUF 180.5 billion in 2005, and represented 12.6% (2005: 11.0%) of total assets.

MKB Bank's liquidity position was stable and well-balanced throughout 2006. Grundsatz II. ratio, calculated and employed according to the German regulatory requirements, is used as a primary measure of group-wide operational liquidity. The ratio expresses the requirement that liabilities falling due within one month should be covered by liquid assets, i.e. those maturing within the same time band or readily convertible to known amount of cash, and should meet a minimum level of 1. During 2006, the ratio was at an average of 1.03 (2005: 1.11), showing that the Bank could manage its liquidity at a continuously safe level and at more reasonable costs.

Compared to 2005, the Bank's maturity position widened as at year-end long-term assets exceeded long-term liabilities plus shareholders' equity by HUF 270.5 billion, up from HUF 213.1 billion at 2005 year-end. In relative terms, the maturity gap to total assets ratio also increased from 13.0% as at December 31, 2005 to 14.7% in 2006.

The HUF 124 billion overall increase in short-term assets was partly driven by the growth of HUF 77 billion in short-term loans and advances, reflecting the growth of financing business. Meanwhile, short-term bank balances were almost at the same level. The growth was HUF 9.5 billion which is related to Hungarian National Bank balances. Simultaneously, the volume of trading assets and securities in this maturity bracket slightly increased by HUF 8.9 billion which is related to the increase of revaluation of derivatives transactions, comparing to the previous year. Medium- and long-term assets increased only HUF 73.4 billion, primarily as an outcome of the Bank's higher volume of project financing activities.

Short-term liabilities increased HUF 181.4 billion partly as a result of the HUF 45.4 billion growth in inter-bank funds as these borrowings, which were raised on international markets 3 to 5 years ago, approach to their due dates in 2007. The rise in funding from commercial banking markets was accompanied by the significant increase of HUF 78.4 billion in short-term customer account and deposit balances. Simultaneously, the Bank borrowed additional medium- and long-term funds in the form inter-bank financing, subordinated debt and securities issues, altogether increasing by HUF 16.1 billion. The significant decrease was visible among inter-bank liabilities (HUF 78.1 billion) which caused a significant lag compared to the increase of long-term assets.

The current amount of maturity transformation is properly supported by the well-diversified, highly stable customer account and deposit base that are also regularly tested through statistical methodologies.

OPERATIONAL RISK

Operational risk is the risk that unexpected losses will be incurred due to human error, system failure, fraud, inadequate internal controls and procedures, or external events. Operational risk is inherent in each of the Bank's business and internal supporting activities. Mitigating operational risk are standards, systems and procedures to monitor transactions and positions, segregation of duties, documentation of transactions, regulatory compliance review, insurance coverage, and periodic specific and comprehensive reviews of the design and operation of internal control systems, the reliability and integrity of data processing operations by internal auditors. The Bank also employs dedicated professionals within the RO who are proactive in developing and implementing new methodologies for the identification, assessment, monitoring and management of operational risk working in close co-operation with the Operational Risk Control unit of BayernLB. This ensures a better understanding of operational losses and improved risk mitigation strategies. In addition, the Bank maintains contingency and recovery plans for supporting its operations in the event of natural and other disasters.

Parallel with other Basel II initiatives, the Bank has also started to implement best-practice quantification methodologies and key risk indicators on operational risk.

The Bank set up a Complaint Management Quality Assurance Group in order to enable early reaction upon operational risks identified from the customer complaints. The Group monitors all complaints that are registered in the Complaint Management System, prepares management reports and statistics to identify trends and provide early warnings on relevant issues.

CREDIT QUALITY

In 2006, MKB Bank's credit portfolio performed well in a less favourable market environment and credit quality remained in good condition. Customer-focused as well as up-to-date credit approval procedures and portfolio management practices, that completely meet modern risk management principles and standards, ensure consistently high credit quality and early recognition of any problem loans.

Provisions for loan losses are considered as reserves for estimated credit losses and other credit-related charges. Such provisions are charged against income and are based on regular assessment of risk factors, including, but not necessarily limited to, estimated losses from loan arrangements, general macro-economic and political conditions, deterioration in credit concentrations or pledged collateral, international lending risk, historical loss experience and trends in portfolio volume, maturity, composition, delinquencies and overdue payment obligations, and management's judgments relating to current and future conditions. In strict conformity with relevant internal rules, the management maintains provisions for losses at such levels it believes are sufficient to absorb any probable losses in the loan and off-balance sheet portfolios.

The main principles of provisioning and classifying procedures have not changed during 2006. Industry-specific risk provisions, which are of general nature and charged for the currently performing loans of those customers who might carry potential, though as yet unidentifiable, future risks, have been brought forward into 2006 as well. Such provisions, where appropriate, amount to 2% of gross exposures (net of suretyships or guarantees of the Hungarian State) to these sectors. In 2006, such provisions increased by HUF 56 million and they amounted to HUF 138 million (2005: HUF 82 million) at year-end.

In classifying its exposures, the Bank has prudently taken full account of all recognisable and estimated risks and all provision requirements for assets and off-balance sheet items has been covered.

During 2006, the Bank charged a total net provisions of HUF 11,704 million that was more than HUF 5,603 million set aside in 2005. The additional specific risk provisions set aside for inter-bank and customer loan losses amounted to HUF 10,997 million while specific provisions of HUF 325 million were released on guarantees and contingencies. Provisions on MKB Bank's investment securities and participations portfolio decreased by HUF 5 million. Meanwhile, no provisions were charged or released on other assets. The other components of overall net provisions are collectively assessed provisions which increased by HUF149 million in 2006. This reflects the effect of application of incurred loss model which means HUF 221 million additional provision.

On the above grounds, the additional net provision charge to average total assets ratio for 2006 was 0.7%, up from 0.4% in 2005.

The total amount of provisions for customer loan losses at the end of 2006 was HUF 23,947 million, 17.9% higher than HUF 20,319 million in 2005, and represented 1.8% of outstanding customer loans (2005: 1.7%).

As higher provision charges for the period have not been fully off-set by the rise in customer asset balances, the net provision charge to the net change in customer loans ratio for 2006 increased from its 2005 level of 0.9% to 1.3% in 2006.

As part of portfolio management, the Bank has written off loans classified as 'bad' in the value of HUF 353 million and sold a portfolio of HUF 9,732 million. The ratio of substandard, doubtful and bad loans (defined as classified loans) was at 2.3% in 2006, up from 2.1% in 2005. Within that amount, the share of de facto non-performing loans (which are in payment arrears) has increased from 1.0% in 2005 to 1.1% in 2006.

Loan Classification

In 2006, the total amount of provisions charged for customer loans has increased that reflected MKB Bank's prudent approach to cover any potential loss of the expanding credit portfolio with respect to the more effective execution of its key business strategy aiming at significantly broadening the Bank's SME and retail customer base. On the basis of MKB Bank's conservative management of credit risks, provisions are set aside wherever it is assumed that some loss to the Bank might arise in the future, even when the loan is currently performing.

Classification of Investments and Securities

In the case of investments, loss provisions are defined according to the projected losses or any impairment in value, while trading and available-for-sale securities are carried at fair value. During 2006, a net specific provision of HUF 5 million was released on the Bank's securities portfolio and participations.

Classification of Off-Balance Sheet Items

In the ordinary course of business, MKB Bank enters into various types of transactions that involve off-balance sheet financial instruments. These include credit-related as well as derivative financial instruments. Credit-related items are typically customer-driven and comprise commitments to extend credit, guarantees, standby letters of credit and commercial letters of credit as part of the Bank's lending operations with a wide range of customers. MKB Bank uses derivative financial instruments in both its trading and asset and liability management activities. Interest rate, foreign exchange and equity derivative financial instruments include swaps, futures, forwards and option contracts, all of which derive their value from underlying interest rates, foreign exchange rates, credit-related contracts or equity instruments. Certain transactions involve standardised contracts executed on organised exchanges, while others are negotiated over-the-counter, with the terms tailored to meet the needs of MKB Bank and its customers.

In managing credit risk associated with off-balance sheet financial instruments, MKB Bank ensures that its off-balance sheet portfolio is well diversified, both in terms of instrument type, industry and customer concentration. In addition, the Bank obtains collateral to further mitigate such credit exposure where determined appropriate.

Off-balance sheet items are subject to the same qualification and classification system as loans, and debtors are subject to review of financial position, solvency, and payment history. In addition, the probability of crystallisation of the liability is also taken into consideration. These criteria are reflected by a net release of specific and collectively assessed provision of HUF 363 million for guarantees and other contingent liabilities for the period. At present, HUF 1,284 million provision is set aside for anticipated future costs.

Provision for Resale and Other Assets

Other assets also include resale assets that are property and equipment acquired mainly through foreclosures or through full or partial take-over of mortgage as collateral for loans and disclosed among other assets. At December 31, 2005, such assets were carried at HUF 532 million and valued at the lower of cost or net fair value. In 2006, such assets were sold and the provision was fully utilised.

CONSOLIDATED FINANCIAL ANALYSIS

(International Financial Reporting Standards, IFRS)

The following analysis provides a discussion and analysis of MKB Group's financial condition and results of operations for 2006. The forthcoming evaluations are based on figures reported in MKB Bank's and its most significant subsidiaries and jointly controlled companies' (hereinafter "MKB Group" or the "Group") consolidated financial statements prepared under International Financial Reporting Standards ("IFRS") as at, and for the financial year ended, December 31, 2006 and audited by KPMG Hungária Ltd. chartered accountants. On this basis, the analysis focuses on the performance of a group of entities. In some relevant cases, the contributions from MKB Bank (or "the Bank"), and individual subsidiaries as well as jointly controlled entities to consolidated figures were also discussed.

OVERVIEW

Parallel with MKB Bank's own resilient results and subsequent to the sound 2005 performance, MKB Group's business achievements reflected the success in the execution of the Group's major strategic and business policy targets and the apt reaction to market challenges in 2006. Total assets increased by 21.4% from HUF 1,644.8 billion to HUF 1,997.2 billion in 2006. The pace of organic volume growth exceeded previous year's 12.2% figure by 9.2 percentage points. Persistently increasing business volumes and turnovers as well as more intense cross-selling resulted in a gross operating income of HUF 80.5 billion which surpassed even the remarkable 2005 figure of HUF 63.8 billion by 26.1%. Meanwhile profit before taxation of HUF 23.5 billion was 21.8% in excess of the previous year's amount of HUF 19.3 billion. Business volumes both on the asset and deposit side produced significant rates of growth, due to the fact that the Group became wider during the business year with two foreign banks (Romexterra and MKB Unionbank). In the overall increase of asset volumes, the pace of growth in customer loans was again high in 2006 while the credit quality of the portfolio as a whole continued to be strong.

The growth in overall business volumes was primarily driven by the Bank's own performance, though other group companies, especially banking, finance, leasing and fund management firms, also produced healthy indicators.

The main features of MKB Group's business and financial performance in 2006 are discussed below.

FINANCIAL PERFORMANCE

In 2006, the Group accounted for increased interest, commission and fee revenues from customer services. The Group's gross operating income growth continued in 2006 with a year-over-year rise at 26.1% to HUF 80,466 million (2005: HUF 63,832 million). Like in preceding years, the share of net interest income in gross operating income was still dominant (the 2005 figure of 72.7% decreased to 71.0%) in 2006. The share of net commission and fees increased by 1.7 percentage point comparing to previous year's level and amounted to HUF 18,182 million at the end of the year. The growth in net commission and fee income was 36.4% while net interest income rose 23.2% over year 2005. The increasing share of commission and fee revenues can be explained by the fact that income derived from commissions and fees on payment services, card services and credit related fees grew more dynamically than those earnings resulted from the expansion of interest-earning items.

Consolidated gross operating income was up by 26.1% to HUF 80,466 million (2005: HUF 63,832 million) which was higher than the Bank's own gross operating income (HUF 74,913 million in 2006) by 7.4%, reflecting the contributions from banking, finance, leasing and fund management companies. MKB-Eurocredit, MKB-Alapkezelő and Filease accounted for pre-adjustment gross operating income of HUF 3,791 million, HUF 841 million and HUF 641 million respectively (2005: HUF 4,847 million, HUF 124 million and HUF 318 million, respectively). MKB Unionbank' gross operating income, which was accounted from the acquisition date, amounted to HUF 1,881 million. The growth in gross operating income at the group company level was propelled by both the higher net interest and net commission and fees income realised from the increasing business volumes. Pre-provision net operating profit after deducting costs was HUF 36,298 million, up 38.6% from HUF 26,198 million in 2005.

Consolidated profit before taxation of HUF 23,527 million for 2006 exceeded the 2005 profit of HUF 19,322 million by 21.8%, as the strong growth in gross operating income was only partially counterbalanced by higher net impairments and provision charges, and the rise in operating costs. Profit before tax on the MKB Group level slightly exceeded the profit realised on the unconsolidated basis by HUF 435 million, or 1.9%, while it missed the unconsolidated basis by HUF 594 million, or 3.1% in 2005. The most relevant contributions to pre-consolidation-adjustment profit before taxation came from MKB-Eurocredit amounting to HUF 936 million (2005: HUF 928 million).

MKB Group's consolidated pre-tax ROAE (the calculation method of the average shareholder's equity was based on prior year end and current year end) and ROAA for 2006 were 15.5% and 1.3%, respectively, down from 16.0% and up from 1.2% for 2005, respectively. The pre-tax ROAE at MKB Bank's level was 15.2% (the calculation method was the same as at Group level) for 2006 (2005: 16.7%) including the effect of capital rises.

The Group's sustained high operating profitability is reflected by the ratios of the relevant key income items to average total assets. Gross operating margin (gross operating income to average assets) of 4.4% for 2006 was up from 4.1% in 2005 (Bank: 4.3% in 2006 and 3.9% in 2005), whereas relative operating costs represented the same figure of 2.4% as in previous year. Meanwhile, the relative net provision charge of 0.7% for 2006 was above 0.5% in 2005.

Net interest income

Net interest income, the largest component of revenue, amounted to HUF 57,134 million, 23.2% in excess of HUF 46,372 million in 2005. The growth in net interest income over the previous year resulted primarily from the additional revenue earned on the solid business expansion resulting in the persistent increase in average interest-earning assets, particularly domestic commercial loans denominated in foreign currencies granted by the Bank and increased retail lending. As far as retail lending is concerned, private housing loans denominated in foreign currencies had a dominant share in the total growth of volume. Meanwhile, market competition still remained intense in 2006.

Consolidated net interest income was HUF 11,562 million higher than in the Bank while the excess was HUF 7,904 million in 2005. The growth in this income element was driven by the Bank's own as well as subsidiary companies', particularly MKB-Eurocredit, strong performance in leasing and consumer loans. While the Bank's own net interest earnings increased 22.6% over HUF 37,873 million in 2005 to HUF 46,442 million for 2006, MKB-Eurocredit realised an individual net interest income growth of 7.0% from HUF 7,413 million in 2005 to HUF 7,930 million in 2006. Unionbank also produced healthy net interest income result of HUF 1,579 million in 2006 2H. The added interest income from subsidiaries was only moderately offset by the deduction of intra-group interest payments. The subsidiaries earned HUF 12,209 million additional net interest income disregarding the effect of intra group transactions.

Non-interest income

For 2006, the Group's non-interest income increased from its previous year level and amounted to HUF 23,332 million (2005: HUF 17,460 million), representing 29.0% of gross operating income, compared to 27.4% in 2005. The growth in the nominal amount was the net result of different factors.

Total net commission and fee income of HUF 18,182 million, the largest component in non-interest income, was up 36.4% from HUF 13,330 million in 2005. The consolidated growth in this income element was propelled by the healthy growth at the Bank. All fee-income elements grew as compared to 2005, with notable growth rates in payment services, card services and credit related fees. Meanwhile, income from securities and brokerage fees for 2006 also increased from its 2005 level, due to higher income at the Bank. The vivid growth at the Bank was the outcome of the continued expansion of fee-generating activities. The most significant growth occurred in fee expenses derived from brokerage and other securities businesses.

The subsidiaries contributed HUF 721 million net commission and fees expenses to the Group's figure disregarding the effect of intra group transactions. However, MKB Unionbank earned HUF 452 million net commission income in 2006 2H.

Other operating income of HUF 5,150 million for the year increased over the total amount of HUF 4,130 million for 2005. An important factor in the increase of other operating income was the unrealized gains concerned derivatives items which comprised the revaluation gain of HUF 6,161 million. This related to Bank level and surpassed the outstanding HUF 4,758 million accounted for in the previous year.

On the other hand, dividend income from investments amounted only to HUF 15 million (2005: HUF 38 million).

Meanwhile, the Group accounted for a total net gain of HUF 1,701 million (2005: HUF 946 million) from trading and revaluation gains on the Bank's securities portfolio, deriving primarily from the liquidation of held-to-maturity portfolio. There was additional decrease of unrealised gain on trading securities which can be related to revaluation of MKB Unionbank's trading securities in amount of HUF 197 million.

Operating costs

Cost discipline remained to be a priority also in 2006, although the Group continued to invest in revenue growth initiatives. In 2006, operating costs totalled HUF 44,168 million, 17.1% higher than a year earlier in nominal terms. The overall increase in operating costs was the result of rising expenses at the Bank, due to running the extended sales capacities and the additional costs of newly launched strategic projects. Meanwhile, the significant IT projects, aiming at the implementation of more advanced systems all across the MKB Bank to promote customer services, also continued in 2006. Cost levels were also leveraged by the business expansion of other group companies whose contributions to the gross operating income growth, however, surpassed these additional costs substantially. Operating costs were HUF 4,051 million, or 10.1% (2005: HUF 2,356 million, or 6.7%) over the Bank's unconsolidated operating expenses that increased 13.5% from HUF 35,348 million in 2005 to HUF 40,117 million in 2006.

General and administrative costs increased to HUF 5,521 million by 21.1% over 2006 while at the Bank level the rate of decrease was 17.9%. This reflects the effect of a part of occupancy costs' conversion into general administrative costs at the Group level.

Personnel costs of HUF 20,571 million comprising 45,3% (2005: 44.3%) of total expenses, increased 23.2% over 2005, compared to a 21.7% rise at the Bank, as the total number of full-time equivalent staff for 2006 increased on the Group level.

The 25.1% nominal rise from HUF 1,799 million to HUF 2,251 million in marketing and public relations costs reflected the more intensive support of volume growth, business development and product initiatives at the group level, as well as intensive support of sales initiatives and the promotion of newly opened delivery units at the MKB Bank level.

Occupancy costs increased by 3.4% from HUF 7,240 million to HUF 7,488 million, well below the 20.6% rate of the average rise in overall costs. Occupancy costs comprise the depreciation charges which were accounted for expansion of property at Group level. Simultaneously, communication and data processing expenses grew 29.7%, mainly because the Bank continued to invest in information technologies to leverage alternative, lower-cost electronic delivery channels in order to improve customer service and introduce new products. Moreover, creating the high standard information and technology background of 16 new branches opened in 2006 also contributed to the increase in communication and data processing expenses. Expenses were incurred in building the Bank's data mining and customer relationship management capacities to enlarge sales capabilities as well as in supporting some functional tasks. Meanwhile, irrecoverable VAT and other tax expenses increased by 2.4% over 2005. From 2005, goodwill is not amortised but to be tested for impairment instead.

MKB Group's cost-to-income ratio for 2006 was 54.9%, which improved compared to the 58.7% figure of 2005, reflecting the cost discipline to manage the costs-leveraging effects of enlarged sales capacities, revenue growth initiatives and the fact that gross operating income grew more dynamically than operating expenses in 2006.

Impairments and provisions for losses

In 2006, MKB Group's credit portfolio performed again well in a less favourable and riskier market environment, and credit quality remained in good condition. Customer-focused as well as up-to-date credit approval procedures and portfolio management practices, that completely meet modern risk management principles and standards, ensure consistently high credit quality and early recognition of any problem loans. In classifying its exposures, the Group has prudently taken full account of all recognisable and estimated risks and all provision requirements for assets and off-balance sheet items has been covered. In 2006, the total amount of provisions charged for customer loans increased over 2005. On the basis of the Group's conservative management of credit risks, provisions are set aside wherever it is assumed that some loss to the Group might arise in the future, even when the loan is currently performing.

During 2006, the Group charged total net provisions of HUF 12,631 million against income that were 74.4% higher than the HUF 7,242 million set aside in 2005 (Bank: increased by 109.0% to HUF 11,712 million in 2006 from HUF 5,603 million in 2005), because impairments and provision charges significantly increased over 2005. This growth reflected a prudent rise in specific loan loss provisions mainly at the Bank level. The rise in specific provision charging for loan and losses to HUF 11,928 million in 2006 from HUF 9,073 million in 2005, excluding one-off items, reflected partly the prudent approach to sustain an appropriate level of provisions parallel with the portfolio growth, especially in the SME and retail segments, while the credit quality of Group's customer portfolio remained good (Bank: HUF 11,001 million in 2006 and HUF 7,463 million for 2005). Concerning to other specific risk categories the provisions charged sustained at the Bank's level amounting to HUF 334 million.

In 2006, total provision charges for losses were HUF 927 million or 8.5% in excess of the charges at the Bank (2005: HUF 1,628 million or 28.2%), in which additional provisions for credit losses at Leasing Group of HUF 737 million for 2006 (2005: HUF 1,589 million at MKB Eurocredit) played a significant role. While there was significant written off amount of HUF 545 million due to improvement of leasing credit portfolio. Provisions at the car financing company showed the prudent aim to cover the customer portfolio with proper provision levels. MKB Unionbank set up additional provision related to financing loan exposures of SME corporate which amounted to HUF 186 million.

On the above grounds, the net provision charge to average total assets ratio for 2006 was 0.7%, up from 0.5% in 2005 (Bank: 0.4% in 2005 and 0.7% in 2006).

The total amount of provisions for customer loan losses at the end of 2006 was HUF 30,864 million, 25.3% higher than HUF 24,632 million in 2005, and represented 2.1% (2005: 2.0%) of outstanding customer loans (Bank: 1.8% in 2006 and 1.7% in 2005).

BALANCE SHEET

In 2006, the Group continued to build its customer base, with asset and deposit growth in all strategic business lines. MKB Group's total assets were up 21.4% from HUF 1,644.8 billion at previous year-end to HUF 1,997.2 billion at December 31, 2006, with sustaining the remarkably high share of customer asset balances in the total. In asset growth, the Bank's own performance was dominant.

Consolidated total assets were HUF 153.9 billion, or 8.4% (2005: HUF 1.7 billion, or 0.1%) in excess that of the Bank. In MKB Group, Romexterra, Unionbank, MKB-Eurocredit Rt. and MKB Üzemeltetési Kft. had the most significant individual total asset figures of HUF 90.3 billion, HUF 80.0 billion, HUF 63.4 billion (2005: HUF 76.7 billion) and HUF 52.1 billion (2005: HUF

46.8 billion), respectively. The total consolidated asset was deducted by investments in participations which caused HUF 99.0 billion decrease while accounted goodwill increased the consolidated total asset by HUF 40 billion.

In 2006, growth in total assets was primarily driven by customer lending whose net volume was up 20.1% from HUF 1,205.5 billion in 2005 to HUF 1,447.6 billion. At December 31, 2006, the largest contributions to the Bank's own loan portfolio came from MKB-Eurocredit, Romexterra and Unionbank amounting to HUF 56.6 billion, HUF 52.8 billion and HUF 45.5, respectively. Customer loan portfolio was the largest component in the balance sheet as it represented 72.5% of total assets at period-end, down from 73.3% at 2005 year-end (Bank: 72.9% in 2006 and 73.2% in 2005). MKB Bank Nyrt. played a significant role in the increase of the portfolio. The bulk of the nominal growth came from three main sources. Expansion of long-term, foreign exchange denominated loans to domestic large enterprises played a major role in the growth of the portfolio. Besides large corporate exposures, lending to SMEs and loans to the retail clientele increased to a meaningful extent on the annual basis. In the growth of retail financing, foreign exchange denominated housing loans, MKB Bank's traditionally strong products, real estate (project finance) and trading industrial loans were key drivers. Finance leasing and consumer credits at MKB-Eurocredit were also key drivers. Romexterra also contributed to the dynamic growth of the Group's customer loan portfolio as loans to private sector and SME corporate customers amounted to HUF 18.4 billion and 36.2 billion, respectively. The customer loan portfolio of Unionbank amounted to HUF 38.8 billion that mainly related to SME customers.

In the case of the Group, the share of the retail portfolio increased compared to the corporate portfolio due to the above mentioned reasons. This reflects the retail business activity of the key driver subsidiaries (MKB Eurocredit, MKB Unionbank, Romexterra, Filease Rt).

Total balances on current and deposit accounts held at MKB Group by corporate and private customers have grown, altogether by 28.9% to HUF 1,078.7 billion from HUF 837.1 billion in 2005 (Bank: HUF 960.3 billion in 2006 and HUF 841.9 billion in 2005). At period-end, corporate accounts and deposits stood at HUF 631.7 billion, representing 39.2% growth in the recent 12 months, while personal deposits accounted for HUF 447.0 billion, up 16.6% over 2005. On the above basis, the share of customer balances in total financing was up to 54.0% in 2006 from 50.7% in 2005 (Bank: 52.1% in 2006 and 51.2% in 2005).

Overall inter-bank assets (MNB and other commercial bank placements and loans) in nominal terms have increased by HUF 38.5 billion, or 17.7%, over 2005 on the consolidated level. The rise was the net outcome of the 27% growth in placements with the central bank which can be related to the Bank's activity. While commercial inter-bank balances increased 9.4% which comprised the inter banking business activity of the two foreign banks in amount of HUF 22.5 billion, disregarding intra group placements.

Securities portfolio decreased altogether 37.8% to HUF 71.4 billion, due to the liquidation of the Bank's held-to-maturity portfolio. Meanwhile, equity investments in associated companies increased because of the Bank's new acquisition (Romexterra Leasing).

Inter-bank financing amounted to HUF 371.2 billion, 4.1% down during the last 12 months (2005: HUF 386.9 billion) which was caused mainly by the HUF 55.4 billion repayment of a part of MKB Bank's borrowings from other banks. The contribution of the two foreign banks to the inter-bank financing was HUF 10.2 billion.

Borrowed funds and issued debt securities were up 14.9% and amounted to HUF 271.8 billion at 2006 year-end (2005: HUF 236.7 billion). The net growth in such balances resulted from the securities issues under the renewed domestic and foreign bond programs, and the EUR 120 million growth in subordinated debt. Included in other borrowed funds was altogether HUF 65.6 billion (2005: HUF 35.4 billion) debts that represent direct, unsecured and unconditional obligations of the Bank and are subordinate to the claims of the Bank's depositors and other creditors. In 2006, through the issuance of debt securities under the EMTN program, an additional subordinated loan of EUR 120 million was borrowed from the major shareholders. Besides this latter transaction, the difference in the HUF-equivalent amounts reflected only the effects of changing foreign exchange rates. These volumes were identical to the Bank's own amounts as no such funds were raised by other group companies.

Shareholders' equity, including minority interests, increased 50.3% and amounted to HUF 193.1 billion (2005: HUF 128.5 billion). The growth in equity primarily reflected the effect of the execution of three capital increases at the Bank's level in 2006 (two of them occurred to cover the acquisition of Romexterra and Unionbank). Consolidated shareholders' equity exceeded the Bank's own equity by HUF 14.3 billion, or 8.0% (2005: HUF 3.3 billion, or 2.6%).

The Group's strong capital base contributes to its safety, supports its high credit rating and enables it to take advantage of growth opportunities. At 2006 year-end, MKB Group's level of capital remained strong, with capital ratios in excess of regulatory minimum requirements. The Group's regulatory capital base increased 42.5% from HUF 148.6 billion in 2005 to HUF 211.8 billion in 2006 as, besides the organic growth in shareholders' equity, regulatory capital was supported by an additional subordinated debt borrowing of EUR 120 million. Meanwhile, total risk-weighted assets and the market risk charge altogether grew 23.7% to HUF 1,793.6 billion (2005: HUF 1,450.0 billion). As capital was put into more effective use, the capital adequacy ratio of 10.0% at 2005 year-end increased to 11.8% at December 31, 2006 (Bank: 11.3% in 2006 and 10.3% in 2005). The Group's capital adequacy ratio safely exceeded the minimum legal and BIS requirements, and represented the level MKB Group thinks essential for a banking group operating in the CEE region.