BUDAPEST BANK

BUDAPEST HITEL ÉS FEJLESZTÉSI BANK LTD

CONSOLIDATED ANNUAL REPORT

UNDER THE INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) ADOPTED BY THE EUROPEAN UNION

31 DECEMBER 2018

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Independent Auditors’ Report

To the shareholder of Budapest Hitel- és Fejlesztési Bank Zrt.

Opinion

We have audited the 2018 consolidated financial statements of Budapest Hitel- és Fejlesztési Bank Zrt. and its subsidiaries (hereinafter referred to as “the Bank”), which comprise the consolidated statement of financial position as at 31 December 2018, which shows total assets of MHUF 1,236,735, the consolidated statement of profit or loss , which shows profit for the year of MHUF 12,539, and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Bank as at 31 December 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU (hereinafter referred to as “EU IFRSs”) and those are prepared, in all material respects, in accordance with the provisions applicable to entities preparing consolidated annual financial statements in accordance with EU IFRSs of Act C of 2000 on Accounting in force in Hungary (hereinafter referred to as “the Act on Accounting”).

Basis for Opinion

We conducted our audit in accordance with Hungarian National Standards on Auditing and applicable laws and regulations in Hungary. Our responsibilities under those standards are further described in the Auditors’ Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Bank for the purposes of our audit of the consolidated financial statements, as provided in applicable laws in force in Hungary, “The Policy on Rules of Conduct (Ethics) of the Audit Profession and on Disciplinary Procedures” of the Chamber of Hungarian Auditors, as well as with respect to issues not covered by these, in the “Code of Ethics for Professional Accountants” issued by the International Ethics Standards Board for Accountants (the IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

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

Measurement of loans and advances to customers (HUF 826,408 million)

See Notes 2.4.1, 4.1 and 5.5 to the consolidated financial statements.

The key audit matter	*How the matter was addressed in our audit*
The impairment of loans and advances to customers is considered to be a key audit matter due to the significance of loans and advances to customers. Loans and advances to customers (HUF 826,408 million) account for 67% of total assets, while impairment of loans and advances to customers amounted to HUF 61,617 million as of 31 December 2018. Without an appropriate impairment allowance the carrying amount of loans and advances to customers can either be over or understated. Calculating the impairment on loans requires an expert estimate, and entails some significant assumptions. Estimating collateral values and future cash flows requires expertise and involves assumptions. New impairment models and parameters determine the levels of impairment, which can significantly alter the provisioning methodology.	Our audit procedures included the following: We evaluated the Group's decisions and the controls introduced, which ensure the impairment on loans is complete and accurate. We tested the key controls over impairment and collateral calculations, checking whether the system calculates the days in default correctly. We analysed what was discussed at the monthly Provision and Portfolio Quality Reviews. We conducted a loan review on a sample of individually significant customer loans. Our loan review included interviews with account managers, checking client and collateral monitoring, consideration of assumptions applied by the Bank and re-performance of key calculations. We reviewed the assumptions based on our professional judgement and industry knowledge. We assessed the collateral values based on the valuations carried out by the appraisers appointed by the Bank. With the involvements of our experts we evaluated the impairment models and the estimation parameters. With the help of our IT specialists we tested the system-integrated control mechanisms for provisioning and the general IT security environment. We examined whether the disclosures prescribed by IFRS 9 were complete, accurate and relevant.

Introduction of IFRS 9 – Impairment

See Notes 2.4.1, 3.2.3 and 4.1 to the financial statements.

The key audit matter	*How the matter was addressed in our audit*
The introduction of IFRS 9 Financial Instruments is considered to be a key audit matter since the amendments caused by the transition are determined based on complicated accounting requirements, and necessitate subjective assumptions to define the impairment rating categories and the expected credit loss (ECL). Material accounting policy decisions were made in relation to the options available as of the transition and to applying practical solutions. The transition required the introduction of new processes and a revision of existing processes. The reliability and relevance of past, reporting-year and future data and information used for the calculation of expected credit loss (ECL) are risk factors. Evaluating the reasonableness and corroboration of the judgements used in the calculations constitutes a further challenge.	Our audit procedures included the following: We evaluated the compliance of the accounting policies with the requirements of IFRS 9, our business understanding and the requirements of industry practice. With the help of our IT experts we tested the IT systems and relevant controls. Involving our financial risk management experts we examined the impairment models and the compliance of the ECL calculation, we recalculated the expected credit loss and we examined the sensitivity of the impairment parameters. We evaluated the Group's key decisions and the reasonableness of estimates with regard to the amendments brought about by the transition, including the selection of methods as well as the evaluation of models, assumptions and source data. With the help of our experts we examined whether the disclosures triggered by the transition were complete, accurate and relevant.

Other Information

The other information comprises the 2018 Consolidated Business Report of the Bank. Management is responsible for the other information, including the preparation of the consolidated business report in accordance with the Act on Accounting and other applicable legal requirements, if any.
Our opinion on the consolidated financial statements expressed in the Opinion section of our report does not cover the consolidated business report.

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

Based on the Act on Accounting, we are also responsible for assessing whether the consolidated business report has been prepared in accordance with the Act on Accounting and other applicable legal requirements.

With respect to the consolidated business report, based on the Act on Accounting, we are also responsible for checking that the information referred to in Section 95/C and Section 134 (5) of the Act on Accounting has been provided in the consolidated business report.

In our opinion the 2018 consolidated business report of the Bank is consistent, in all material respects, with the 2018 consolidated financial statements of the Bank and the applicable provisions of the Act on Accounting.

There are no other legal requirements that are applicable to the consolidated business report of the Bank, therefore, we do not express an opinion in this respects.

We confirm that the information referred to in Section 95/C and Section 134 (5) the Act on Accounting has been provided in the consolidated business report.

In addition, in light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the consolidated business report, and if so, the nature of such misstatement. We have nothing to report in this regard.

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

As part of an audit in accordance with Hungarian National Standards on Auditing and applicable laws and regulations in Hungary, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

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

• Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

• Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

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

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

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

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

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

Report on Other Legal and Regulatory Requirements

We were appointed by members meeting on 25 May 2018 to audit the consolidated financial statements of the Bank for the financial year ended 31 December 2018. Our total uninterrupted period of engagement is 22 years, covering the periods ending 31 December 1997 to 31 December 2018.

We confirm that:

• our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated14 March 2019;

• we have not provided to the Bank the prohibited non-audit services (NASs) as set out by Article 5(1) of EU Regulation (EU) No 537/2014 and in terms of the member state derogations by the Act LXXV of 2007 on the

Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors in force in Hungary. We also remained independent of the audited entity in conducting the audit.

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

Budapest, 15 May 2019

KPMG Hungária Kft.

Registration number: 000202

István Henye
Partner, Professional Accountant
Registration number: 005674

CONSOLIDATED BALANCE SHEET

data in HUF M

Description	Comments	31.12.2018	31.12.2017	01.01.2017
Cash and cash equivalents	5.1	59 023	98 609	112 996
Derivative financial assets	5.2	2 613	1 872	789
Securities	5.3	307 483	209 463	184 736
Loans and advances to banks	5.4	7 201	11 752	71 588
Loans and advances to customers	5.5 & 4.1	826 408	669 302	590 462
Property, plant and equiments	5.7	9 610	9 090	9 214
Intangible assets	5.7	12 929	11 409	9 490
Tax receivables	5.8	1 111	1 424	2 480
Other assets	5.9	10 357	17 794	14 204
TOTAL ASSETS		**1 236 735**	**1 030 715**	**995 959**
Derivative financial liabilities	5.2	3 405	1 933	471
Deposits from banks	5.10	163 388	160 614	151 283
Deposits from customers	5.11	892 073	699 488	684 260
Provisions	5.12 & 4.1	2 245	2 302	1 737
Tax liabilities	5.8	1	22	14
Other liabilities	5.13	21 571	24 532	24 217
Total liabilities		1 082 683	888 891	861 982
Share capital	5.14	19 396	19 396	19 396
Reserves	5.15	134 656	122 428	114 581
Total Equity		154 052	141 824	133 977
TOTAL EQUITY AND LIABILITIES		**1 236 735**	**1 030 715**	**995 959**

Budapest, 15 May 2019.

Dr. Koppány Lélfai
Chairman of BoD & Chief Executive Officer

Keresztyénné Katalin Deák
Chief Financial Officer

CONSOLIDATED INCOME STATEMENT

data in HUF M

	Comments	31.12.2018	31.12.2017
Interest income		37 868	40 155
Interest expense		(905)	(905)
Net interest income	6.1	**36 963**	**39 250**
Dividend income		-	-
Fee and commission income		39 943	37 945
Fee and commission expense		(6 057)	(7 128)
Net fee and commission income	6.2	**33 886**	**30 817**
Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)	6.3	1 877	(1 055)
Net trading income/(losses)	6.4	50	(316)
Net income /(loss) from financial instruments valued at FVTPL	6.5	(354)	328
Net foreign exchange gain		1 491	405
Other operating income	6.6	5 497	4 602
Other operating expenses	6.6	(19 031)	(17 920)
Personnel expenses	6.7	(26 342)	(24 953)
Other administrative expenses	6.7	(15 694)	(13 874)
Depreciation and amortisation	6.8	(5 855)	(4 604)
Net (impairment loss)/ reversal of impairment loss on financial assets&provision	6.9	2 470	4 162
Pofit before income tax		**14 958**	**16 842**
Income tax expense	6.10	(2 419)	(2 403)
Profit for the year		**12 539**	**14 439**

Budapest, 15 May 2019.

Dr. Koppány Lélfai
Chairman of BoD & Chief Executive Officer

Keresztyénné Katalin Deák
Chief Financial Officer

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

data in HUF M

	31.12.2018	31.12.2017
PROFIT FOR THE YEAR	**12 539**	**14 439**
Other comprehensive income to be reclassified to profit/loss	**(1 415)**	**130**
Change in net fair value of securities valued at fair value through other comprehensive income	(2 061)	538
Net amount reclassified to profit/loss of securities valued at fair value through other comprehensive income	646	(408)
Income tax related to items to be reclassified to profit or loss	**127**	**(12)**
OTHER COMPREHENSIVE INCOME, NET OF TAX	**(1 288)**	**118**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**11 251**	**14 557**
OF WHICH: - Attributable to non-controlling interest	-	-
- Attributable to the owners of the Bank	11 251	14 557

Budapest, 15 May 2019.

Dr. Koppány Lélfai Chairman of BoD & Chief Executive Officer	Keresztyénné Katalin Deák Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

data in HUF M

	Share capital	Total reserves	Valuation reserve	Retained Earnings	Statutory reserves	Total equity
Balance as at 1 January 2017	**19 396**	**114 581**	**659**	**111 284**	**2 638**	**133 977**
Total comprehensive income						-
Profit for the year	-	14 439	-	14 439	-	14 439
Other comprehensive income	-	118	118	-	-	118
Total comprehensive income	**-**	**14 557**	**118**	**14 439**	**-**	**14 557**
Transactions with equity holders						-
Share issuance	-	-	-	-	-	-
Dividends	-	(6 710)	-	(6 710)	-	(6 710)
Transactions with owners	-	-	-	-	-	-
Total transactions with equity holders	**-**	**(6 710)**	**-**	**(6 710)**	**-**	**(6 710)**
Other transactions						-
Transfer of retained earnings to statutory reserve	-	-	-	(1 390)	1 390	-
Total other transactions	**-**	**-**	**-**	**(1 390)**	**1 390**	**-**
Balance as at 31 December 2017	**19 396**	**122 428**	**777**	**117 623**	**4 028**	**141 824**
Balance as at 31 December 2017	**19 396**	**122 428**	**777**	**117 623**	**4 028**	**141 824**
Effect of application of IFRS 9 as at 1 January 2018	-	977	391	586	-	977
Restated balance as at 1 January 2018	**19 396**	**123 405**	**1 168**	**118 209**	**4 028**	**142 801**
Total comprehensive income						
Profit for the year	-	12 539	-	12 539	-	12 539
Other comprehensive income	-	(1 288)	(1 288)	-	-	(1 288)
Total comprehensive income	**-**	**11 251**	**(1 288)**	**12 539**	**-**	**11 251**
Transactions with equity holders						
Share issuance	-	-	-	-	-	-
Dividends	-	-	-	-	-	-
Transactions with owners	-	-	-	-	-	-
Total transactions with equity holders	**-**	**-**	**-**	**-**	**-**	**-**
Other transactions						
Transfer of retained earnings to statutory reserve	-	-	-	(934)	934	-
Total other transactions	**-**	**-**	**-**	**(934)**	**934**	**-**
Balance as at 31 December 2018	**19 396**	**134 656**	**(120)**	**129 814**	**4 962**	**154 052**

There is no non-controlling interests in the Bank, or in its subsidiaries.

Budapest, 15 May 2019.

Dr. Koppány Lélfai	Keresztyénné Katalin Deák
Chairman of BoD & Chief Executive Officer	Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT

		data in HUF M
	2018	**2017**
Operating cash flow		
Pofit before income tax	14 958	16 842
Adjustments		
Depreciation (+), Amortisation (+)	5 855	4 604
Release of impairments & provision loss (+)	(2 470)	(4 162)
Non-realised foreign exchange gains/losses (+/-)	(1 491)	(405)
Deferred tax	64	74
Net interest income (-)	(36 963)	(39 250)
Dividend income (-)	-	-
Change in derivative financial assets (- increase, + decrease)	(243)	(1 083)
Change in portfolio of FVTPL securities (- increase, + decrease)	(151)	-
Change in loans and advances to banks (- increase, + decrease)	5 040	59 152
Change in loans and advances to customers (- increase, + decrease)	(145 481)	(73 947)
Change in other assets (- increase, + decrease)	2 363	(3 610)
	-	-
Change in deposits from banks, non-refinancing	40	16 667
Change in deposits from customers (+ increase, - decrease)	185 809	17 960
Change in derivative financial liabilities (+ increase, - decrease)	18	1 462
Change in other liabilities (+ increase, - decrease)	(1 285)	375
	-	-
Interest received (+)	38 751	40 379
Interest paid (-)	(912)	(957)
Dividends received from subsidiaries (+)	-	-
Corporate tax paid	(2 458)	(1 425)
Net cash flows from operating activities	**61 444**	**32 676**
Investment cash flow		
Investments in subsidiaries, joint ventures and associates	-	-
Investments in other enterprises	-	-
Acquisitions of property, plant and equipment	(2 751)	(2 083)
Proceeds from sale of property, plant and equipment, other derecognitions	176	235
Acquisitions of intangible assets	(5 350)	(4 876)
Proceeds from sale of intangible assets, other derecognitions	30	76
Purchase of non-FVTPL securities	(368 931)	(95 697)
Disposal of non-FVTPL securities	274 244	70 983
Dividends received from investments	-	-
Net cash flows used in investing activities	**(102 582)**	**(31 362)**
Financing cash flow		
Dividends paid	-	(6 710)
Increase of deposits from banks, refinancing	58 908	100 287
Decrease of deposits from banks, refinancing	(58 796)	(107 398)
Payments to shareholders other than dividends	-	-
Net cash flows from financing activities	**112**	**(13 821)**
Net change in cash and equivalents	**(41 026)**	**(12 507)**
Foreign currency revaluation on cash and equivalents	1 444	(1 880)
Cash and equivalents at the beginning of year	98 605	112 996
Cash and equivalents at the end of period	**59 023**	**98 609**

The 2017 published closing cash and equivalents under the Accounting Act and the 2017 transition value depart from the 2018 opening cash and equivalents under IFRS 9 by HUF 20,892 M and HUF 4 M, respectively. See details in transition tables relating to balance sheets in Chapter 3.

Budapest, 15 May 2019.

Dr. Koppány Lélfai	Keresztyénné Katalin Deák
Chairman of BoD & Chief Executive Officer	Chief Financial Officer

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1 GENERAL INTRODUCTION

1.1 Introduction of Budapest Bank

Budapest Hitel és Fejlesztési Bank Zrt ("Budapest Bank" or "Bank" or “Company”seat address: 1138 Budapest, Váci út 193, http://www.budapestbank.hu/)) was founded on 1 January 1987, at the time of the establishment of the two-tier banking system, as a joint venture of the Hungarian State, state-owned companies and cooperatives. The Bank was privatised in December 1995 with the involvement of General Electric Capital, EBRD and ÁPV Rt. With step by step acquisitions, General Electric Capital became the Bank’s majority owner, in 2012 it squeezed out the remaining minority stake. As a result, it became the Bank’s 100% owner.

On 13 February 2015 GE Capital signed an agreement with the Hungarian State on the sale of the Bank. The purchase price was financially settled on 29 June 2015. Corvinus Nemzetközi Befektetési Zrt (seat address: 1027 Budapest, Kapás utca 6-12 2nd floor; www.corvinus.hu) proceeding on behalf of the State became the 100% owner, whose owner’s rights were exercised by Magyar Fejlesztési Bank Zrt in 2018. Budapest Bank Group (hereinafter referred to as the “Bank” or “Bank Group” or “Company”) is fully consolidated into the consolidated report of Corvinus Nemzetközi Befektetési Zrt.

In 2012 the General Meeting changed the Bank’s legal form into a private company limited by shares; at present, the Bank issues no securities. On 31 December 2018 the Company’s share capital amounted to HUF 19,396 million. The Bank Group’s branch network is currently comprised of 95 bank branches and the Operations Centre located in Békéscsaba, in addition to the Budapest head office.
Bank Group’s average statistical staff: 2,911 in 2017; 2,952 in 2018.

The Bank is licensed to engage in comprehensive credit institution activities both in HUF and in foreign currencies. The part of the Annual Report “Consolidated Business and Non-Financial Report” contains a detailed introduction of Budapest Bank’s business strategy.

Based on Section 155 of the Accounting Act, audits are mandatory for the Company. Company’s auditor: KPMG Hungária Kft., (address of KPMG: 1134 Budapest, Váci út 31), István Henye (card number: 005674). The Company accounted for an audit fee of HUF 52 million for the audit of the 2018 report (HUF 50 million for 2017).

The person responsible for supervision of the accounting and financial reporting services: Zoltán Szűcs (registration number: MK178499 in the register of the licensed accountants kept by the Ministry of Finance).

The Company will also publish this report and the attached business report on its Internet website at www.budapestbank.hu/info/irattar/.

1.2 Introduction of subsidiaries of Budapest Bank Group

Budapest Bank provides some of its services through specialised, legally separate subsidiaries forming part of the Bank Group in which it directly holds 100% stakes.

Budapest Alapkezelő Zrt**.**

The Bank established Budapest Alapkezelő Zrt in 1992; this subsidiary is responsible for managing the assets of investment funds and pension funds. Investment units are traded primarily in Hungary, via the branch network of Budapest Bank; however, the foreign trading of investment units – in the Czech Republic – also accounts for a material proportion of the Company's total annual sales volume. The total assets of pension funds reached HUF 115 billion, while the assets of investment funds amounted to HUF 346 billion on 31 December 2018. Within the framework of asset management, the provision of services for investment funds and pension funds is also a primary focus of the Company.

The Company is permitted to invest in the newly launched funds in order to facilitate the initial phases of their operation; however, it disposes any such funds within a short time of their initial operation, typically within a month. Accordingly, the assets managed by the Company are not consolidated into the books of Budapest Alapkezelő Zrt. The Company generates the majority of its revenues on the basis of pre-fixed price levels set in fund regulations or in management contracts.

Risk management policy and activities of Budapest Alapkezelő are established together with the Bank, on the basis of group principles.

In accordance with the Bank's liquidity and capital strategy, the Company usually distributes its annual profits to the owner in the form of dividends. Average statistical staff of Alapkezelő in 2018: 16 persons.

Alapkezelő Zrt's 2018 year-end total assets amounted to HUF 4,349 million; its share capital to HUF 500 million; its equity to HUF 4,179 million.

Budapest Lízing Zrt.

The most important activities of Budapest Lízing Zrt, established by the Bank in 1992, are the purchase and lease of long-term tangible production assets. It is primarily engaged in providing finance leases for heavy utility vehicles, production and agricultural machinery, equipment, buses and other assets, and eventually automobiles and small utility vehicles.

According to the legislation currently in force, in addition to finance lease – both HUF and currency based; closed-end and open-end –, the Company is allowed to provide loans and advances solely for corporate customers only.

Risk policy and financing activities of Budapest Lízing Zrt are established together with the Bank, on the basis of group principles. The Company constitutes a single VAT group together with other members of the Bank Group.

The Company's lending activities are financed almost solely by Budapest Bank, and the few special projects refinanced by other banks are managed also via the Bank. In order to increase the self-financing level, the Company reinvests its annual profits and typically pays no dividends to the owner.

➡ Consolidated Footnotes – General introduction

Company's average statistical staff in 2018: 25 persons. The company's 2018 year-end total assets amounted to HUF 120,375 million; its share capital to HUF 62 million; its equity to HUF 10,117 million.

Budapest Eszközfinanszírozó Zrt.

Budapest Eszközfinanszírozó Kft was established by the Bank in 1991. Budapest Eszközfinanszírozó ZRt. was created in 2013 by renaming of SBB Zrt, where Budapest Flotta Zrt and Budapest Eszközfinanszírozó Kft were medged.

Budapest Eszközfinanszírozó Zrt as a member of Budapest Bank Group is engaged in the financing of automobiles, small utility vehicles, heavy utility vehicles, production machinery, equipment and other instruments in operating lease arrangements. The company is under joint management with Budapest Lízing Zrt.

The Company's activities can be divided into two different divisions: the production asset financing division is now engaged in the activities formerly pursued by Budapest Eszközfinanszírozó Kft, while the fleet financing division – whose business portfolio terminated in 2015 – is now only responsible for the management of Budapest Bank Group's automobile fleet taken over from the legal predecessor Budapest Flotta Zrt.

Risk management policy and financing activities of Budapest Eszközfinanszírozó Zrt are established together with the Bank, on the basis of group principles. The Company constitutes a single VAT group together with other members of the Bank Group.

The Company's lending activities are financed almost solely by Budapest Bank, and the few special projects refinanced by other banks are managed also via the Bank.

Company's average statistical staff in 2018: 23 persons. The company's 2018 year-end total assets amounted to HUF 5,756 million; its share capital to HUF 11 million; its equity to HUF 2,140 million.

Budapest Autófinanszírozási Zrt.

Budapest Autófinanszírozási Zrt was formerly engaged in finance lease and retail car finance. It merged to the Bank on 1 January 2017.

2 ACCOUNTING POLICY

The general accounting principles applied by the Bank are laid down in detail in an internal policy prescribed for financial institutions on a mandatory basis, in the Accounting Policy, which was approved by the Bank's management and reviewed by the Bank's auditor. The Bank's Accounting Policy was prepared in accordance with the IFRS standards; consequently, the fundamental principles, laid down in the IFRS Framework principles, the IAS 1 " Presentation of Financial Statements and the IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors", constitute its basis.
The policy entitled "A Budapest Bank Zrt. és Leányvállalatainak IFRS számviteli politikája és értékelési szabályzata" *[IFRS Accounting Policy and Valuation Rules of Budapest Bank and its Subsidiaries]* is summarised in the following breakdown:

2.1 General Accounting Principles

A. Applied accounting standards
B. Consolidation
C. Foreign currency valuation

2.2 Accounting principles for the net income items

D. Interest income and expense
E. Commissions
É. Net gains or losses arising from derecognition of financial assets (valued at not FVTPL)
F. Net income or loss from financial instruments valued at FVTPL
G. Other operating income and expenses
H. Income tax

2.3 Accounting principles for the balance sheet items

2.3.1 Financial instruments

2.3.1.1 Fundamental accounting principles as of 1 January 2018 and for comparative period

2.3.1.2 Amortised cost (AC)

I. Debt-securities for investment purposes
J. Loans and advances to customers
K. Loans and advances to banks
L. Financial liabilities classified into amortised cost valuation category
M. Cash and cash equivalents
N. Equity

2.3.1.3 Fair Value through Profit or Loss (FVTPL)

O. Held-for-trading debt-securities
P. Derivative transactions
Q. Financial liabilities classified into fair valuation category

2.1 General Accounting Principles

A. Basis of preparation

The Bank Group prepared its consolidated financial statements in accordance with the standards (IFRS) of the International Accounting Standards Board ("IASB") adopted by the EU.

In relation to areas not regulated by the IFRS standards, the Bank Group applies the following most important legislative acts; fundamentally not with respect to valuations, but in respect of disclosure and administration:

- Act 100 of 2000 on Accounting (hereinafter referred to as the "Accounting Act" or "AA")
- Act 237 of 2013 on Credit Institutions and Financial Enterprises
- Government Decree No. 250/2000. (XII.24.) on the specificities of the annual reporting and bookkeeping obligations of credit institutions and financial enterprises ("Government Decree")
- Decree No. 39/2016. (X.11.) of the National Bank of Hungary on the prudential requirements relating to non-performing exposures and restructured receivables
- Decree No. 40/2016. (X.11.) of the National Bank of Hungary on the prudential requirements relating customer and partner rating and collateral valuation.

The Bank Group publishes its full annual report approved by the Owner, which also contains an auditor's report, in accordance with the provisions of Chapter IX of AA, and thereby meets its statutory obligation of publication.

The Bank Group compiled these consolidated financial statements on the basis of going concern principles.

In the consolidated financial statements, assets and liabilities are measured under historical cost, except fianancial assets and liabilities measured at fair value through profit or loss and financial instruments measured at fair value through other comprehensive income .

The Bank Group's business year coincides with the calendar year (1 January – 31 December), while the last day of the reporting period (effective date) is 31 December. The Bank Group prepares the financial statements once annually, for the balance sheet effective date, in which the comparative information is is the preceding year of the current reporting period.

As part of the financial statements, the Bank and its Subsidiaries prepare the following statements:

- Statement of Financial Position (Balance Sheet),
- Net income statement (Statement of profit and loss and other comprehensive income),
- Statement of changes in equity
- Cash flow statement
- Footnotes

The Business Report and Non-Financial Reports under AA are also prepared.

The Bank Group as first-time adopter implemented its recordkeeping in accordance with the IFRS standards since 1 January 2018, and prepared its first financial statements under the IFRS standards for the 2018 reporting year. In 2017 and before, it prepared its financial statements in conformity with the Accounting Act.

The day of implementation of IFRS 1 standards is 1 January 2017 which is also the date of the opening balance sheet under IFRS.
In compiling the comparative data of the first consolidated financial statements under IFRS (for the period between 1 January and 31 December 2017, and 2017 profit and loss data), the Bank Group applied the relevant Hungarian accounting requirements to *items under the IFRS 9 standard* instead of the IFRS 9 requirements, based on the first year exemption rules in paragraphs E1-E2 of IFRS 1.
In the case of *items not under the IFRS 9 standard,* the comparative data were compiled in compliance with the relevant IFRS standards.
Due to the above, differences arose between the Bank Group's consolidated financial statement prepared for 31 December 2017 and the consolidated financial statement as at 1 January 2018 which the Bank Group treated – based on paragraph E2 of IFRS 1 – as a change in the accounting policies, and accounted for the financial effect on 1 January 2018 as an adjustment to the opening retained earnings.
Additionally, likewise on the basis of the above-mentioned exemption rule, the Bank Group did not apply the publication requirements of IFRS 7 to the comparative data.

In the 2017 comparative year, the Bank Group kept its books primarily in accordance with the provisions of the Accounting Act, and therefore this transition had a material effect on the balance sheet and the equity. See specific issues and the financial effects of the transition in Chapter 3.

IASB issues new standards continuously which, depending on their status, may have a significant impact on the Bank Group's consolidated financial statements. According to the status of their entry into force, new standards can be:

- issued by the IASB and adopted by the EU effective as of 1 January 2018
- issued by the IASB and adopted by the EU, but not yet in effect
- issued by the IASB, but not yet adopted by the EU

Standards and interpretations issued by the IASB and adopted by the EU which are already in effect in relation to the current reporting periods beginning as of 1 January 2018 or thereafter:

- IFRS 9 Financial Instruments standard – the International Accounting Standards Board (IASB) issued the final version of the standard in July 2014 which was adopted by the EU on 22 November 2016,
- IFRS 15 Revenue from Contracts with Customers standard and further amendments thereto – adopted by the EU on 22 September 2016,
- Amendments to the IFRS 4 Insurance Contracts standard – Application of IFRS 9 Financial Instruments standard with IFRS 4 Insurance Contracts standard adopted by the EU on 3 November 2017,
- IFRIC 22 Interpretation – Foreign Currency Transactions and Advance Consideration – adopted by the EU on 28 March 2018,
- Amendments to the IAS 40 Investment Property standard – Reclassification of Investment Property – adopted by the EU on 24 March 2018,
- Amendments to the IFRS 2 Share-Based Payment standard – Classification and Valuation of Share-Based Payment transactions – adopted by the EU on 26 February 2018.

According to the Bank Group's expectation, the initial application of these amendments, new standards and interpretations will not significantly affect the consolidated financial statements. An exception is the application of the IFRS 9 standard whose financial impact is assessed and introduced in Part 3.2 of this report. Accounting for fees and commissions not in the scope of IFRS 9 will not change with the introduction of IFRS 15 in the Management's view.

Standards and interpretations issued by the IASB and adopted by the EU which have not yet entered into force:

- IFRS 16 Leases – Adopted by the EU on 31 October 2017, applicable to reporting periods beginning on 1 January 2019 or thereafter.
- IFRIC 23 Uncertainty over Income Tax Treatments – Adopted by the EU on 23 October 2018, applicable to reporting periods beginning on 1 January 2019 or thereafter.

According to the Bank Group's expectation, the initial application of these amendments, new standards and interpretations will not significantly affect the consolidated financial statements.

An exception is the application of the IFRS 16 standard. The Bank Group carried out an impact analysis related to the initial application of the IFRS 16 standard. According to the analysis, the vast majority of impacts are related to office buildings and bank branch leases. Based on this, the Bank Group expects significant changes in the Balance Sheet, while the impact on the Profit and Loss Account will not be significant. The reason for this is that, based on the standard, the lessee recognises a right for use of assets, while the lease liability is the liability related to the payment of the lease amortisation payments. Short-term leases and leases of low value come under exemption. The lessor's accounting procedure is similar to the procedure featured in the current standard – the lessor continues to classify lease contracts into operating and finance lease categories.
The introduction of the IFRS 16 standard will, on the whole, increase the Bank Group's total assets by HUF 13,348 million as expected.
As lessor the Bank Group does not expect a significant impact due to the transition.
The Bank Group applies the modified retrospective approach to the transition to IFRS 16, meaning that it does not restates periods in the consolidated financial statements concerning 2019, but accounts for the effect of the initial application of IFRS 16 against the opening retained earnings on 1 January 2019.

Standards and interpretations issued by the IASB and not yet adopted by the EU:

- IFRS 17 Insurance Contracts (applicable, as expected, to reporting periods beginning on 1 January 2022 or thereafter),
- Amendments to the IAS 28 Investments in Associates and Joint Ventures standard – Long-term Interests in Associates and Joint Ventures (applicable to reporting periods beginning on 1 January 2019 or thereafter).
- Annual developments for the IFRSs, term between 2015-2017 – As a result of the IFRS Development Project, amendments have been made to some standards (IFRS 3, IFRS 11, IAS 12 and IAS 23), primarily in the interest of eliminating inconsistencies and clarifying explanations (applicable to reporting periods beginning on 1 January 2019 or thereafter).
- Amendments to IAS 19 Employee Benefits standard – Plan amendment, curtailment or settlement (applicable to reporting periods beginning on 1 January 2019 or thereafter),
- Amendments to references to the Conceptual Framework in the IFRS standards (applicable to reporting periods beginning on 1 January 2020 or thereafter)
- Amendments to the IFRS 3 Business Combinations standard (applicable to reporting periods beginning on 1 January 2020 or thereafter),
- Amendments to the IAS 1 and IAS 8 standards – Definition of Materiality (applicable to reporting periods beginning on 1 January 2020 or thereafter).

According to the Bank Group's expectation, the initial application of these amendments, new standards and interpretations will not significantly affect the consolidated financial statements.

B. Consolidation

Based on the provisions of IFRS 10, the Bank prepares consolidated financial statements because as a parent company it controls multiple business units. The Bank itself established all its current subsidiaries in full, and therefore states no goodwill in its books. At present, the Bank states no non-controlling interests in the consolidated equity because it owns 100% of the business units involved in consolidation. Only the Bank's subsidiaries are consolidated currently; the Bank has no jointly managed companies or associated businesses. Upon compiling its consolidated financial statements, the Bank values all the assets and liabilities of its subsidiaries on the basis of common group valuation principles. The valuation procedures applied by the Bank as parent company are disclosed in this financial report. The Bank compiles the consolidated report in a single currency, in Hungarian Forint. All individual accounts providing the basis of these consolidated financial statements have the same effective date, which is 31 December.

The Bank eliminated its investments against the equity elements of the subsidiaries at the time of the first consolidation so that only the assets and liabilities of the subsidiaries remained in the Group's balance sheet. Subsequently, the Bank eliminates any revenues and expenditures arising from intercompany transactions between the Bank and its subsidiaries in the income statement. Any interim profits or losses recognised in the individual balance sheets are eliminated from the balance sheets and the current year net income statements. The interim profits or losses eliminated in the previous years are carried forward as a change in the equity of the Bank with no effect for the current year net income.

The Group's relevant subsidiary is responsible for managing the assets of investment funds and pension funds. The Group is allowed to invest in these funds in order to facilitate the initial phases of their operation; however, it disposes any such investment within a short time of their initial operation, typically within a month. Other than as referred to above, the Group generally purchases the investment units of the managed funds for liquidity purposes and typically keeps them for short periods. With these purchases it does not acquire control over the investment or other funds as they are typically publicly traded funds operating with the participation of numerous investors. Accordingly, the assets of the funds managed by the Group are not consolidated in these financial statements.

C. Foreign currency valuation

The functional currency of the financial statements is the Hungarian forint. Data in the financial statements are rounded up or down to million forints (HUFM or HUF million). The Bank Group pursues business activities almost exclusively in Hungary, and the vast majority of its transactions originally come into being in forints. Therefore, the functional currency used in the Bank Group's accounting systems is the Hungarian forint (HUF). The Bank Group measures any non-HUF foreign currency items at the foreign exchange rate quoted by the National Bank of Hungary. The Bank Group accounts for currency revaluation difference only in case of monetary asset and liability items denominated foreign currency. Monetary items are all cash and equivalents as well as those assets and liabilities which can only be settled with cash. Any non-monetary asset items originally denominated in foreign currencies are not revalued. These include intangible assets, real estate, machinery, equipment and inventories which are stated in the balance sheet at original cost. Any impairments and provisions arisen in foreign currencies are revalued if the underlying transaction itself is also denominated in a foreign currency.

The Bank Group records any foreign cash, as well as bank accounts, receivables, financial instruments, securities and liabilities denominated in foreign currencies in the original currencies, which are revalued daily at the official foreign exchange rate quoted by the National Bank of Hungary. Any revaluation difference is recorded in the " Net foreign exchange gains or losses" line of the income statement.
Any foreign currency items purchased for forints are recorded in the forint equivalent amounts, and the exchange rate is determined on the basis of the amount of forints actually paid. Any cross-currency conversion items are entered in the books on the basis of the actual cross currency rates, and are then revalued at the official exchange rate quoted by the National Bank of Hungary.

2.2 Accounting principles for net income items

D. Interest income and expense

Accounting policy in effect as of 1 January 2018

Financial assets and financial liabilities

The Bank recognises interest income and expense for financial instruments by using the effective interest rate method, excluding any interest accounted for held-for-trading financial instruments and instrument measured at FVTPL. The effective interest rate is the rate which discounts the cash payments or cash receipts through the expected life of a financial instrument exactly to the gross carrying amount of the financial asset or to the amortised cost the financial liability. The Bank estimates any future cash flows by taking into consideration all revenues and expenditures of the individual transactions as specified in the relevant contracts. The following items have an impact on the calculation of the effective interest rate (EIR):

- Revenues from contract conclusion and amendment fees
- Revenues from loan disbursement fees + loan commitment fees + loan assessment fees
- Revenues from prepayment option and life term amendment fees
- Appraiser and notarial fees expenditures
- Agent's commissions expenditures
- Agent's commissions revenues
- Built-in insurance premiums

The Bank recognises the above so-called "amortisable items" as interest, and amortises them i) either in line with the calculated effective interest ii) or linearly during the term of the financial instrument.

The Bank Group carries out the EIR method during the term in the case of the following financial instruments:

- Closed-end loans to customers or banks(including LOC-type credit card receivables)
- Loans from banks (refinancing)
- Securities

The effective interest rate is determined upon the initial recognition of financial assets and liabilities, and is not altered thereafter unless:

- a new type of amortisable item arisen (procedure is the same as applied at the beginning of the term, the item is amortised during the remaining term)
- re-pricing occurs in case of variable interest instruments (loans, securities)

For the financial instrument categorised into Stage 1 and Stage 2 for expected credit loss (see definitions in Comment 2.4.1), the Bank Group calculates the interest income by applying the EIR to the gross book value. In the case of Stage 3 financial instruments (see definition in Comment 2.4.1), for the calculation of interest incomes the Bank Group applies the EIR to the gross book value minus impairment.

The Bank Group accounts for interest expenses in relation to financial liabilities by applying the EIR to the amortised cost of financial liabilities.

Upon termination, the Bank accounts the interest income for the net credit balance using the pre-termination effective interest rate.

Finance lease transactions

In the case of finance lease transactions, the Bank Group accounts for interest revenues by applying the implicit interest rate of the lease to the net investment in the lease (see Comment 5.5).

The implicit interest rate of the lease is the discount rate at the beginning of the lease which represents the present value of the minimum lease payments (see Comment 5.3) and the non-guaranteed residual value (see Comment 5.5) equalling the total of the fair value of the leased asset and the initial direct costs incurred by the Bank Group.

The Bank Group recognises finance lease interest revenues in the interest income line of net income statemetn.

Interest income – Accounting policies relating to comparative period (main rules under the Hungarian AA):

The Bank Group recognised its interest income as per the relevant customer contracts; there were no items adjusting the contractual interest, and the Bank Group used no EIR-based calculations. The Bank Group suspended contractual interest accrual for customers in arrears for more than 30 days and did not record it in the income statement, only as legal claims.

<u>E. Commissions</u>

Accounting policy in force as of 1 January 2018

All revenues and expenditures arising from financial services provided by the Bank, which are not interest and are not considered in the determination of the original cost of assets and liabilities, are classified as fee and commission. These mainly include paid or received fees and commissions related to services in respect of money transfers, securities, fund management, lending, insurance and currency transactions (including currency conversion fees).

Fee and commission revenues are accounted for in two ways:

- the fees of services provided over a given period are accrued during the term of the service period. These fees include, inter alia, guarantee fees;
- “point in time” revenues charged for the provision of services (e.g. transaction charges).

Fee revenues arising from asset management

In its fund/asset management contracts, the Bank Group assumes a contractual obligation to manage the assets of a given fund. Fund/asset management contracts do not include any other services (other contractual obligations on the Group’s part). In the contracts:

- fixed commissions laid down in the Fund Management Rules are billed,
- term regarding payment is typically prompt payment, there is no financing component,
- purchase agreements do not include reimbursement obligations,
- the Bank cannot alter the amounts or timing of the revenues specified in the customer contracts

The Bank Group’s fund management/asset management contracts only stipulate fixed fees proportionate to the net asset value.

The asset management fee income from funds and pension funds managed by the Bank Group are recorded on this line. In case of each investment and pension funds managed by the Bank Group, a fixed commission level is calculated according to the individual Fund Management Rules. Calculation of the commission is based on the daily net asset values of the funds, multiplied by the fee percentage laid down in the Fund Management Rules. Fees are billed to funds once monthly.

The Bank Group identifies the individual funds as the customers of its asset management contracts. The Bank Group accounts for all its asset management fee revenues during the given period.

Accounting policies relating to comparative period (main rules of the Hungarian AA):

The Bank Group accounted for all commissions received or paid under contracts as commission revenues or expenditures during the period in which they arose, in the amounts stated in the contracts. As the Bank Group was not allowed to use the effective interest rate method under the Hungarian accounting standards, it had no paid or received commissions accounted for as part of the effective interest rate and not presented as interest income or interest expense.

É. Net gains or losses arising from derecognition of financial assets (valued at not FVTPL)

The Bank Group recognises hereto any net profit or loss realised on financial instruments not measured at fair value through profit or loss (profit or loss on sale of loans; profit or loss on de-recognition of loans in consequence of material contract amendments provided for customers, i.e. the difference of the book value of the derecognised loan and the fair value of the new loan).

The Bank Group recognises the net realized gain or loss on the sale of securities not measured at fair value as referred to in paragraphs 2.3.1.2 and 2.3.1.4.

F. Net income or loss from financial instruments valued at FVTPL

The line "Net income or loss from financial instruments measured at fair value through profit or loss" includes all net realised profits or losses arising from the purchase or sale of financial assets measured at fair value through profit or loss and any non-realised fair value changes. It does not include the profit or loss of financial instruments valued at fair value through other comprehensive income.

The Bank Group classifies instruments into this category if it eliminates or significantly reduces any valuation or presentation inconsistency (referred to as accounting mismatch) which would have arisen if assets or liabilities are valued and the related gain or loss recognised on a different basis.
These financial instruments can be designated as held-for-trading or for non-trading purposes, but to be measured at fair value through profit or loss on a mandatory basis or determined such as at the Bank's discretion. An instrument is held for trading if it is purchased for the purpose of resale within a short time. Chapter 2.3.1.2 discloses the detailed criteria of classification, while Chapter 2.4.2 describes the fair valuation methods.

After purchase, these instruments are to be measured at fair value; in the case of interest-bearing instruments, the change in the difference of the fair value and the amortised cost value is accounted for in the net income statement in the net income or loss line from financial instruments measured at fair value through profit or loss. Interest revenues are accounted for in the same profit/loss line together with the fair value valuation. The Bank Group carries out fair value measurements monthly for all its instruments measured at fair value.

G. Other operating income and expenses

All costs which are not closely related to the costs of banking operations are presented in the profit and loss account as "Other operating expenses", while all revenues which cannot be regarded as revenues derived from banking operations are presented as "Other operating income" on a gross basis.
The following material items are included here:

- Since 2010 financial enterprises in Hungary have been obliged to pay a so-called bank tax. As the bank tax is not based on the current-year net revenue values, it cannot be regarded as an income tax under IFRS, and therefore the Bank Group recognises it as other operating expenses.

In the case of Budapest Lízing Zrt, the tax base is 6.5% of the net interest income and net commission and fee income calculated on the basis of the revenues and expenditures stated in the report of the second year preceding the current year.

In the case of the Group's parent company, the base of the bank tax is the total assets stated in the report of the second year preceding the current year, adjusted by the balances arising from certain interbank transactions. The rate of the bank levy is 0.15% up to HUF 50 billion, and 0.2% for the part above that limit.

Consequently, the bank tax amounts stated in these consolidated financial statements were calculated in relation to tax bases in accordance with the Hungarian accounting standards.

- In 2013 a financial transaction duty was introduced in relation to certain transaction types (cash transactions and transfers). This duty is payable by financial service providers with Headquarters' in Hungary. The financial transaction duty is accounted for as other operating expense at the time of the occurrence of the corresponding business event. However, the duty on bank card transactions is accounted for in one sum at the beginning of the year and is based on the previous calendar year's payment transactions.

- The purpose of the Investor and Deposit Protection Funds is to provide partial compensation for any financial losses sustained by investors and deposit holders due to the possible insolvency of investment service providers and banks. Members pay the funds annual fees, which the Bank accounts for in one sum in the year of the report.

- The Insolvency Fund set up in 2014 is financed by credit institutions and investment enterprises to ensure that the costs of any insolvency problems emerging in the financial sector are covered by the sector itself. The fund is covered from the annual fees paid by members. The Bank accounts for the fee payable to the fund in one sum in the reporting year. The Bank additionally pays mandatory statutory membership fees to several agencies proceeding as authorities, primarily to the National Bank of Hungary.

- For VAT purposes, incoming invoices can be arranged into three groups: i) the VAT on purchases solely for services subject to VAT can be deducted in full, ii) the VAT on purchases solely for services exempt from VAT cannot be deducted at all, iii) in the case of purchases which cannot be clearly assigned to activities that are all subject to VAT or are all exempt from VAT, the VAT can be deducted pro rata. In this ratio the numerator is the value subject to VAT of the revenues of the VAT group created by the Bank, while the denominator is the total of revenues subject to VAT and exempt from VAT. All VAT that cannot be deducted or can only be deducted pro rata is accounted for as other operating expense

- The Bank Group presents the derecognition gain/loss of inventories given on a lease, the net profit/loss of the disposal of real properties, machinery, equipment and intangible assets, and any related impairment release in this profit/loss category.

H. Income tax

The Bank Group treats corporate profit tax and local taxes as income taxes.

Local taxes form part of the profits tax in the consolidated profit and loss account due to the fact that they are not value added-based. Local taxes include the trade tax and the innovation tax.

The Bank presents in the balance sheet deferred tax receivables and liabilities on all deductible and taxable temporary differences in accordance with the IAS 12 standard. Any changes therein are presented in the profit/loss as tax expenditures if they are related to transactions to be accounted for in the profit/loss, or as other comprehensive income if they are related to transactions to be accounted for in other comprehensive income. Deferred tax receivables are accounted for on any deductible temporary differences, but only if sufficient taxable profits are likely to be generated against which they can be offset. The Bank Group fundamentally relies on its business plans for supporting future taxable profits. See deferred tax in detail in Chapter CC.
In Hungary the tax authority can inspect accounting records and adjust the tax levied at any time within six years of the end of any given fiscal year. Accordingly, in the event of an inspection by the tax authority, tax adjustments may occur at the Bank Group level as well. The tax authority inspected the Bank Group's tax returns up to 2011, and closed the relevant tax returns. The Bank Group is not aware of any material tax liability in arrears which could emerge in connection with the years not yet audited by the tax authority.

2.3 Accounting principles for balance sheet items

2.3.1 Financial instruments

2.3.1.1 General accounting principles as of 1 January 2018 and for comparative period

a-i.) Initial recognition and valuation – Accounting policy applicable as of 1 January 2018

Upon initial recognition, the Bank Group values financial assets and financial liabilities at fair value, plus or minus – if the financial assets or financial liabilities are not measured at fair value through profit or loss – the transaction charges which can be attributed directly to the issuance or acquisition of the financial assets or financial liabilities.

The Bank Group recognises in its books all financial instruments purchased or sold on the value date of the transaction as balance sheet items. Derivative financial instruments are recognised on the transaction day.

Upon initial recognition, the transaction price is the best proof of fair value, meaning the fair value of the consideration given or received. If the Bank Group decides that the fair value at the time of initial recognition is different from the transaction value and the fair value cannot be proved with a price quoted on an active market for the same asset or liability, and neither is it based on a valuation technique which only uses data derived from observable markets, then the financial instrument must be measured at fair value at the time of its initial recognition, adjusting it in such a way that the difference of the fair value at the time of initial recognition and the transaction value is deferred. After initial recognition, the difference is accounted for in the profit or loss on a proportional basis during the lifespan of the instrument, but no later than when the measurement becomes fully supported with observable market data or when the transaction is closed. If the fair value can be supported with a price quoted on an active market for the same asset or liability, or it is based on a valuation technique which only uses data derived from observable markets, the Bank Group accounts for the difference of the transaction price and the fair value in the profit or loss at the time of the initial recognition of the instrument.

a-ii.) Initial recognition – Accounting policies relating to comparative period (main rules under the Hungarian AA)

The Company recognises in its books all financial instruments purchased or sold on the value date as balance sheet items and at the contractual value rather than at fair value.

The Company recognises all other financial instruments at the contractual value at the time when financial receivables or liabilities are legally arosen.

b) Classification and valuation after initial recognition – Accounting policy applicable as of 1 January 2018

Upon initial recognition, the Bank Group classifies financial instruments as valued at amortised cost value, at fair value through other comprehensive income or at fair value through profit or loss.

c-i.) Follow-up valuation – Accounting policy applicable as of 1 January 2018

The Bank Group measures its financial instruments at amortised cost value if i) the sole purpose of the business model related to the portfolio of the instrument is the collection of contractual cash flows, and ii) the contractual cash flows solely extend to principal and the interest due on the outstanding principal where principal means the fair value of the disbursed amount, while interest reflects the credit risk, funding cost, profit margin and the time value of money.

The amortised cost value according to the provisions of IFRS 9 is the initial value of the instrument, minus principal repayments, adjusted by the interest based on the effective interest rate method, and minus any impairment. The Bank Group accounts for and enters in its books interest revenues and interest expenses on the basis of the effective interest rate method defined in the chapter “Interest income and expenses” in relation to the profit/loss, and determines the amortised cost value or book value of the instrument. In the case of non-defaulting financial assets (stages 1 and 2), the interest revenue accounted for with the effective interest rate method and is calculated on the basis of the gross book value, while in the case of impaired (defaulting – stage 3) transactions, it is calculated on the basis of the gross amortised cost value, minus impairment. The impairment is updated monthly.

c-ii.) Follow-up valuation – Accounting policies relating to comparative period (main rules under the Hungarian AA)

In the case of its financial assets and liabilities, the Company reduces their book value by the principal repayments. Additionally it recognises the accrued interest in the balance sheet according to the related contract terms. The Company does not employ amortised cost valuation. Neither adjust the Company for the cash flows effects of the contract amendments in the profit/loss.
Any transaction charges and fees related to financial assets and liabilities are accounted in the transaction date as other than interest income and interest expenses.

d-i.) Derecognition – financial assets – Accounting policy applicable as of 1 January 2018

The Bank Group derecognises a financial asset if

- claims relating to the cash flows arising from the financial asset expire, or
- it transfers the contractual rights relating to the receipt of the cash flows arising from the financial asset in a transaction in which
    - effectively all risks and rewards related to ownership of the financial asset are transferred, or
    - it does not transfer and does not keep effectively all risks and rewards related to ownership of the financial asset, and likewise does not retain control of the given financial asset.

Upon the derecognition of a financial asset, the difference between the book value of the asset (or the book value assigned to the derecognised part of the asset) and the consideration received is recognised in the profit/loss.

If the contractual terms of financial assets are modified, the Bank Group assesses whether the cash flows arising from the modified financial assets are materially different. If the cash flows are materially different, the contractual rights relating to the cash flows arising from the original financial assets ceased to exist. Any such modifications must be accounted for as derecognition of the original financial asset and the recognition of a new financial asset. In every instance the Bank Group regards a contract amendment as extinguishment if the interest is changed from fixed to variable or from variable to fixed, or if the currency of the financial asset is modified.

If the cash flows arising from a modified financial asset valued at amortised cost value are not materially different from the pre-modification contractual cash flows, the modification will not result in the derecognition of the original financial asset. In this case, the Bank Group re-calculates the gross book value of the financial asset (as the present value of the post-modification cash flows calculated at the original effective interest rate) and recognises the difference between the new and the pre-modification gross book values in the income statement as a gain or loss due to modification.

d-ii.) Derecognition – financial liabilities – Accounting policy applicable as of 1 January 2018

The Bank Group derecognises in the books a financial liability when it has been extinguished – when the obligations defined in the contract have been redeemed –, has been cancelled or has expired.

The Bank Group also regards an instance as extinguishment if the contractual terms of a financial liability have been modified and the cash flows arising from the modified financial liability are materially (by minimum 10%) different from the pre-modification cash flows. If this condition is not met, the Bank Group still regards the contract amendment as extinguishment if the interest is changed from fixed to variable or from variable to fixed, or if the currency of the liability is modified.
In this case, the Bank Group recognises the new financial liability corresponding to the modified terms at fair value. The Bank Group recognises the difference between the book value of the extinguished financial liability and the book value of the new, modified financial liability in the profit/loss.

If the cash flows arising from the financial liability are not materially different from the pre-modification contractual cash flows, the modification will not result in the derecognition of the original financial liability. In this case, the Bank Group re-calculates the amortised cost value of the financial liability (as the current value of the post-modification cash flows calculated at the original effective interest rate) and recognises the difference between the new and the pre-modification gross book values in the income statement as gain or loss due to modification. Any fees or charges of the modification modify the effective interest rate and the amortised cost value of the financial liabilities, and are amortised in the profit/loss during the remaining term.

d-iii.) Derecognition – Accounting policies relating to comparative period (main rules under the Hungarian AA)

Typical scenarios of derecognition are settlement and expiry as stipulated in the contract, or cancellation or sale initiated by the Company. The Company accounts for derecognition in the event of the legal extinguishment of a financial asset or financial liability. The gross book value upon derecognition (receivables and liabilities) is accounted for against the profit/loss, such as the received revenue (if relevant).
Any contract amendments which materially change the original contractual cash flows do not result in the derecognition of the original financial asset or financial liability.

e-i.) Impairment – Accounting policy in force as of 1 January 2018

At each effective reporting date, the Bank Group assesses whether its financial assets measured at amortised cost value are impaired. A financial asset qualifies as impaired if one or multiple events have occurred which have a negative impact on the estimated future cash flows of the financial asset. See detailed description of methodology of impairment in paragraph 2.4.1.

The Bank Group recognises a loss accounted for in relation to the expected credit losses of the following financial assets not measured at fair value through profit or loss:

- receivables from finance leases;
- loans and advances to customers;
- issued financial guarantee contracts; and
- issued loan commitments.

The Bank Group accounts for a 12-month expected credit loss as of the date of initial recognition in relation to financial assets in the case of transactions where credit risks have not significantly increased since initial recognition (Stage 1 or Phase 1 – performing transactions). If credit risks have significantly increased since initial recognition (Stage 2 or Phase 2 – underperforming loans) or the transaction becomes impaired (Stage 3 or Phase 3 – impaired, non-performing transactions), a lifetime expected credit loss is accounted for.

Lifetime expected credit loss: The expected credit loss arising from possible non-performance events during the expected life of the financial instrument.

12-month expected credit loss: part of the lifetime expected credit loss; the expected credit loss which may arise from possible non-performance events related to the financial instrument within 12 months of the effective date of the report.

The Bank Group applies this valuation principle to receivables arising both from financial leases and loans provided for customers.

In case of loans and advances to customers and financial leases, the Bank Group does not avail itself of the option, under IFRS9 5.5.10, of regarding certain financial instruments as low-credit-risk financial instruments. In case of securities and bank deposits, the Bank Group avails itself of the above mentioned exemption, see in more detail in Chapter 2.4.1.

e-ii.) Valuation of expected credit loss

Expected credit losses are estimates of credit losses arising during the expected lifetime of financial assets, weighted with probability. Expected credit losses are determined as follows:

- *Financial assets which are not impaired at the effective date of the report*: difference of the contractual cash flows due to the Bank Group under contracts and the cash flows expected by the Bank Group;
- *Financial assets impaired at the effective date of the report*: difference of the gross book value and the present value of the estimated future cash flows;
- *Undrawn loan commitments*: present value of the difference between the contractual cash flows due to the Bank Group if the loan commitment holder draws on the loan and the cash flows expected by the Bank Group in the event of the drawing of the loan;
- *Financial guarantee contracts*: the amount expected to be paid to the holder for reimbursing its credit loss, minus the amounts which the Bank Group expects to receive from the holder, the debtor or any other third party.

e-iii.) Recognition of expected credit losses in the statement of the financial position

The Bank recognises expected credit losses as:

- impairment decreasing the gross book value in case of financial assets valued at amortised cost value,
- provisions in case of financial guarantee contracts and loan commitments.

e-iv.) Write-off

Loans and debt instruments are written off (partly or fully) if the Bank Group does not reasonably expect the recovery of the entirety or a part of the financial asset. This is generally the situation if the Bank concludes that the debtor does not have sufficient revenues to generate a cash flow to repay the amount to be written off. At the same time, the financial assets to be written off may also constitute the subject-matter of liquidation processes.

e-v.) Impairment – Accounting policies relating to comparative period (main rules under the Hungarian AA)

For the purpose of assessing impairment, the Bank Group reduces the value of the risk-weighted assets and off-balance-sheet items by the value of the accepted collateral. This net risk is multiplied by the impairment % of the customers' lowest-rated receivables which determine the amount of the impairment. The Bank Group has created other, general provisions in respect of the non-rated (problem-free) customer portfolio in connection with credit/lease risks.
For the purpose of calculating impairment, the Bank Group disregards the time value of money, the weighting of probabilities and other prospective information.

Financial instruments are presented in financial statements in the following categories and according to the following valuation principles:

2.3.1.2 Amortised cost (AC)

The Bank values instruments falling into the following categories at amortised cost value:

I. Debt investment securities

Based on a business model, the Bank classifies those securities into this category, if the goal is to collect contractual cash flows. The Bank typically holds these securities until maturity in every instance. Contractual cash flows only extend to principal and interest. These securities can be both fixed and both variable interest. Prepayment and the alteration of the term are not typical occurrences, and in the event of payment deferral there is no interest-free period. The discount or premium when securities purchased below or above face value treated as not part of the accumulated interest.

J. Loans and advance to customers

Based on the Bank Group's principal activity, loans provided for retail, corporate and credit institution customers are classified into this category. The purpose of the business model of instruments classified into this category is to collect contractual interest and the disbursed principal. The Bank Group classifies a credit product into the amortised cost measurement category if the interest on the loan only covers the time value of money, the associated credit risk and a profit margin. See also Section "S" for the FVTPL classification of loans.

K. Loans and advances to banks

Loans and advances represent items related to activities with other credit institutions such as time deposits placed with other banks.

L. All financial liabilities classified into the amortised cost valuation category

This category includes deposits from customers, deposits from banks and from the central bank (loro accounts, loans received, refinancing funding), and supplier payables.

M. Cash and cash-equivalents

In this category the Bank recognises highly-liquid securities with a maturity of less than three months (or with a remaining term of less than three months at the time of purchase) which can therefore be converted into cash within a short time. This category also includes cash in hand, bank accounts held at other banks (nostro accounts) and overnight deposits.

N. Equity

The Bank recognises as equity the principal placed by the owners at the Bank's disposal and the after-tax profits left with the Bank. The equity consists of the share capital, capital reserve, retained earnings, accumulated other comprehensive income, and statutory reserves.
The Bank recognises the components of the equity in the balance sheet at book value. The Bank has no repurchased own shares, and has not adjust its share capital or issued shares recently. Any transaction charges, net of tax effects, attributable to equity transactions (e.g. issuance of own shares) would decrease directly the equity, more specifically retained earnings,
Dividend cannot be paid from the *capital reserve*. The current year after-tax profit is included in the *retained earnings*. The Bank accounts for any dividends payable to the owners as a reduction in the retained earnings. It is accounted in the period when the dividend is approved, i.e. the owner earns the right to dividends. In the *accumulated other comprehensive income,* the Bank recognises those net income items which have not yet been realised and therefore cannot be recognised as part of the annual profit. At present, it only includes the cumulative balance of the fair valuation differences of liquidity purpose securities measured at fair value through comprehensive profit or loss. In the *statutory reserves*, the Bank states the general reserves transferred from the retained earnings as regulated by the relevant statutory legislation. The Bank creates no further reserves beyond the mandatory, statutory reserves amounting to 10% of the after-tax profit.

2.3.1.3 Fair Value through Profit or Loss (FVTPL)

If according to the business model the goal is not to collect contractual cash flows, but to earn a profit or gains from sale or trading, or the contractual terms result in future cash flows which are not exclusively payments of principal and the interest due on the outstanding principal amount, then in every instance the financial instrument must be valued at fair value through profit or loss. No impairment is accounted for financial assets classified into this category. The Bank Group carries out fair value valuations monthly in respect of all its instruments valued at fair value. The fair value valuation difference is recognised as a net sum in a separate profit and loss account line in the current-year profit and loss account. The fundamental principles of fair value valuation are introduced in Chapter 2.4.2.

The Bank values the instruments in the following categories at fair value through profit or loss:

O. Held-for-trading debt-securities

Securities purchased for trading purposes in order to realise of profits in the short term are classified into this category. Securities purchased on behalf of customer orders and sold on to customers are also classified into this category.

P. Derivative transactions

The Bank primarily concludes derivative transactions for hedging purposes. Occasionally, the Bank also may conclude trading derivative transactions to realize short term profit. The notional amounts of the derivative transactions are recorded as off-balance-sheet items at the time of their inception.

Derivative financial instruments are accounted at fair value on the deal day, and are subsequently also re-measured at fair value.
Any change in the fair value of derivative financial instruments is accounted for in the profit and loss account. The difference between the fair value and cost value of each derivative transaction is stated as an asset or liability, depending on its nature.
Derivative transactions which are made to hedge the positions of the Bank's risk management positions, but do not qualify as hedge accounting transactions under the IFRS 9 standard are classified for trading derivatives. They are therefore presented at fair value, and any non-realised profit or loss is stated directly in the profit and loss account. The details of hedge accounting are introduced in Chapter 2.4.3.
The Bank is engaged in the following derivative transaction types: forward, currency rate swap (CRS), interest rate swap (IRS), cross-currency interest rate swap (CIRS). The Bank Group has no embedded derivative products.

Q. Financial liabilities classified into fair value valuation category

The Bank designates a financial liability as a liability to be valued at fair value through profit or loss if this improves consistency and helps to avoid any accounting mismatch. Currently, there are no such instruments.

R. Instruments to be valued at fair value through profit or loss on a mandatory basis

Instruments of this type are e.g. shares listed on a stock exchange.

S. Loans and advances to customers

The Bank Group classifies loans provided for customers into the AC or FVTPL valuation categories on the basis of the business model test and the so-called Solely Payments of Principal & Interest (SPPI) test which is carried out individually for each loan product group. The Bank Group classifies a loan product into the amortised cost valuation category if the interest on the loan solely covers the time value of money, credit risk and a profit margin, and the loan principal represent the fair value of the disbursed principal. The loans are classified into the FVTPL category if the following criteria are not met:

- The purpose of lending is the collection of contractual cash flows
- The contractual cash flows solely represent principal and interest.
- The business purpose of the loans is not future sale, despite the fact that the Bank Group regularly sells bad credit portfolios as part of its collections activities.
- In the event of prepayment, modification of the maturity date and restructuring, the prepayment fees are not material (typically 2-3%).
- In the event of variable interest, the interest rate moves parallel, with the change in the designated reference interest rate, into the same direction and the frequency of the fixing of the interest rate coincides with the interest periods.
- The Bank Group records any unpaid principal and interest as overdue receivables.
- In the event of the deferred payment, there is no interest-free period or it is not significant.

At present, those interest-subsidised loans are classified into the FVTPL category where the rate of the interest is determined by law, and therefore the interest does not solely include time value, credit risks and a profit margin (e.g. family housing benefit-subsidised “CSOK” loans).

2.3.1.4 Fair value through other comprehensive income (FVTOCI)

If according to the business model the business purpose is the collection of contractual cash flows and, in given circumstances the sale of the asset, and the contractual cash flows only covers principal and the interest thereon, then the financial instrument must be valued at fair value through other comprehensive income. The instruments classified into this category on the basis of the business model serve two functions: on one hand, the collection of contractual cash flows, and on the other,

the management of daily liquidity. The securities classified into this category can be sold at any time to maintain liquidity. The individual securities are classified into business models on the basis of the expected frequency and volume of sales for liquidity reasons.
The interest relating to financial instruments falling into this category is accounted for with the effective interest method.
In the case of debt-instruments, the Bank Group transfers the amount of valuations accounted for in other comprehensive income to the current-year profit/loss (typically in case of sale).

The impairment rules also apply to financial instruments classified into this category if their credit risks are not negligible. Any credit impairment is accounted for in the valuation reserve against the impairment loss.

The Bank Group fair values the following instruments through other comprehensive income (FVTOCI):

T. Debt-securities for liquidity purposes

Contractual cash flows only extend to principal and interest. Prepayment and maturity modifications are not typical. These may be securities bearing both fixed and variable interest. In the case of variable interest, the interest rate moves parallel with the change of the designated reference interest rate, in the same direction. The Bank Group registers any unpaid principal and interest as overdue receivables.

U. Shares for investment purposes

In case of shares for investment purposes, the Bank Group did not elect the option to designate any such instruments for valuation through other comprehensive income.

2.3.2 Non-financial instruments

V. Leases

Accounting policy applied as of 1 January 2018

The Bank Group as lessor

The Bank Group presents financial lease receivables in “Loans and advance to customers” valued at amortised cost value in the balance sheet.

The Bank Group as lessor classifies those agreements as lease receivables, when the lessor transfers the rewards of an asset to the lessee against the payment of a fixed amount and for a fixed term. Lease transactions can be finance or operating lease transactions.

If substantially all risks and rewards of ownership are transferred through the transaction as set forth in the IAS 17 standard, the Bank Group treats the transaction as a finance lease.

In the case of a finance lease transaction, at the beginning of the lease, the Bank Group as lessor recognises lease receivables in the amount of the net lease payments. The net lease payments are the present value of the total of future minimum lease payments and the guaranteed and non-guaranteed residual value, discounted by the implicit interest rate of the lease (see definition in Chapter 2.2. D). Any costs at the beginning of the lease transaction which are directly attributable to the agreement, such as agent's commissions, contract conclusion and amendment fees and appraisal fees, adjust the cost value of the lease receivables and are accounted for during the term.

After the initial recognition of financial lease receivables, the principal part of the lease fees paid reduces the amount of the lease receivables, while the interest part is accounted for as interest income (see Chapter 2.2. D). Any impairment accounted for during the period decreases the book value of lease receivables.
The Bank Group applies the same rules to the impairment of lease receivables as for other financial assets (see in more detail in paragraph 2.4.1).

Leases where substantially all risks and rewards of ownership remain with the Bank Group are classified as operating leases. The asset leased continues to remain in the Bank Group's books. The lease fees received are accounted for linearly in the profit/loss during the relevant period.

In the case of leased assets received, the Bank Group recognises a financial lease liability at the lower of the present value of the minimum lease payments and the fair value of the assets received. Financial lease liabilities are subsequently valued based on the effective interest rate method.

At present, the Bank Group does not pursue operating lease transactions under the criteria of the IAS 17 standard.

The Bank Group as lessee

Any leases where substantially all risks and rewards of ownership remain with the lessor and are not transferred to the Bank Group are classified as operating leases. The Bank Group does not recognise assets related to operating leases in its balance sheet. The Bank Group accounts for lease fees paid linearly during the term in the other administrative expenses line.

Leases - Accounting policies relating to comparative period (main rules under the Hungarian AA):

The Bank Group as lessor

The same the accounting policy as applied as described above, with the exception that the Bank Group applied the Hungarian accounting standards to the impairment of lease receivables.

The reason for this is that while the recognition and valuation of lease transactions do not fall within the scope of IFRS 9, while the impairment of lease transactions is in the scope of IFRS 9, to which the Bank Group applies the Hungarian accounting standards, using the exemption rules under IFRS 1. E1-E2 (see Chapter 2.1. A).

The Bank Group as lessee

The Bank Group does not recognise assets in its books in the case of operating leases (rental agreements), and accounts for the lease fees (rentals) on a straight-line basis during the term of the lease in the other administrative expenses line.

W. Property, plant and equipment

The Bank recognises an incurred expense as a tangible asset if the purchased asset serves the Bank's activities directly or indirectly for a term of more than one year, the economic benefits associated with the item will probably flow to the Group and the cost can be measured reliably. In the Bank's initial IFRS balance sheet, properties and automobiles were stated at cost value presumed under IAS 16 which is the fair value of these assets as on the day of the opening balance sheet (1 January 2017). See also Chapter 2.1. ”A”.

The Bank records tangible assets in its books at cost value. The cost value includes the purchase price, plus any non-deductible VAT, customs duties and official charges, minus any discounts; costs necessary for bringing an asset to working condition for its intended use, and expected costs of dismantling of the asset if any. The Bank does not regard bank funding related to the acquisition because lending form part of its credit institutions activities, and therefore the interest thereon is not capitalised.
The Bank recognises office equipment below the limit of HUF 15,000 as other material expenses at the time of acquisition. All individually purchased assets with a cost value of less than HUF 100,000 are entered in fixed assets register and are depreciated in one sum immediately after recognition. The Bank and its subsidiaries can purchase low-value assets of the same type in group, and capitalise and depreciate them in group during their useful life.

Following capitalisation, the Bank measures all its tangible assets according to the cost value model. Based on this, the book value of assets is the cost value, minus the accumulated depreciation and accumulated impairment accounted for, to be adjusted on a mandatory basis by any costs capitalised subsequently if the value of the cost to be capitalised exceeds 25% of the cost value of the asset. Property, plant and equipment cannot be revalued due to this valuation model.
During depreciation, the Bank write offs the cost of an asset monthly during its useful life, pro rata for each day, with the straight -line method, as operating expense. The Bank determines the useful life of each asset group which is reviewed and adjusted if necessary annually. In case of refurbished assets, if the value of the refurbishment exceeds 25% of the cost value of the refurbished asset, the useful life is reviewed (in particular for investments carried out in rented properties). Investments made in rented properties are written off based on the expiry of the rent agreement.

The Bank recognises the following asset groups and depreciation rates based on the typical expected useful life are as follows:

Description	Life
Buildings	50 years
Land	n/a
Networks (computer, telecommunications)	12.5 years
Investments in rented properties	as per rental agreement
Furnishings	7 years
Security equipment	7 years
Bank and office equipment	7 years
Personal computers	3 years
Other computer equipment	3 years
Mobile telephones	2 years
Automobiles	5 years

Based on experiences, for most of the Bank's tangible assets, the residual value is not material. Therefore, the Bank only determines residual value for these assets if their expected value is above HUF 1 million. For automobiles, a residual value is always determined on the basis of the future value quoted at the time of purchase.
The Bank derecognises a tangible asset or intangible asset from its book if it disposes the asset or no longer expects any further benefit from the use of the assets. The profit/loss effect of disposal is recognised in the profit/loss as net operating income or expense, which is the difference of the proceeds of the sale and of the book value of the disposed assets.

Z. Intangible assets

The Bank recognises those incurred expenses as intangible assets which relate to the purchase or production of an identifiable, non-tangible asset over which the Bank has a controlling right, which is expected to generate economic benefits, and whose cost value can be determined reliably. An intangible asset is identifiable if it can be sold independently or arises from contractual or legal rights.
The cost of the acquired assets is the acquisition cost which is determined based on the initial measurement rules applicable to Property, plant and equipment, with the difference that dismantling costs are never capitalised in the cost value of intangible assets. The Bank regards only in house designed software as internally developed intangible assets. The cost value of self-developed software products includes all costs which incurred directly in the interest of their development during the development phase, such as the costs of materials and services, wage costs and incidental contributions, expert fees (e.g. project management costs), consulting fees and licensing costs. The Bank regards the useful life of intangible assets as fixed, and amortise them linearly during the expected useful life. In case of software, providing the majority of intangible assets, the useful live is 5 years.

X. Inventories

Upon acquisition, inventories are recorded at cost value which includes the purchase price, any non-deductible VAT, import customs duties and transportation costs. Any foreign currency difference at financial settlement does not adjust the purchase price. The repossessed collaterals Bank holds with the purpose of resale and carries it at the value of which the Bank excepted as the offset for its receivable. Upon the repossession of leased asset, the Bank records the asset in the inventories at a forced sale market price as determined by an appraiser. If the cost value of an inventory is not expected to be recovered (because of damage or obsolescence), the Bank writes down the inventory to the net realisable value.

AA. Other assets and liabilities

Other assets and liabilities not qualifying as financial instruments are recorded at transaction price. The transaction price is the amount stated in the relevant contract, invoice or any other accounting certificate.
The Bank recognises among these items receivables due from employees, liabilities due to the State Budget (taxes and social security liabilities), non-interest-type accruals and various active and passive accounts.

Customer contracts typically relate to sales of leased assets at the end of the term, in the case of which:

- the leased asset is transferred to the buyer directly by the lessee (typically within the framework of a repurchase agreements with the supplier),
- the term of payment is in general prompt payment and there is no financing component,
- the purchase agreements typically do not stipulate returning or reimbursement obligations,
- the sale is based on a guaranteed repurchase agreement concluded with the original supplier of the leased asset.

The Bank Group does not make decisions in connection with customer contracts to modify the amount and timing of the contract revenues

BB. Contingent liabilities and provisions

The Bank recognises provisions in its balance sheet if, in consequence of an event in the past, it has an obligation of an uncertain amount whose value can be reliably estimated and the fulfilment of the obligation is probable to result in an outflow of resources. The Bank regards the obligation as probable if the probability exceeds 50%.

Provisions are made for:

- Guarantees provided as part of lending activities
- Credit lines provided as part of lending activities
- Pensions and severance pay
- Pending litigation
- Restructuring events

- Other provisions

An obligation is recognised as a contingent liability if it is

(a) *a possible obligation* which arises from events in the past and whose existence will only be confirmed by the occurrence or non-occurrence of one or several uncertain future events not entirely under the Bank’s control; or

(b)*an existing obligation* which arises from events in the past, but where

(i) the settlement of the liability is not likely (with a probability of less than 50%) to result in an outflow of resources; or

(ii) the amount of the obligation cannot be reliably measured.

The Bank Group does not recognise contingent liabilities in its balance sheet; however, the following contingent liabilities are stated in the books separately:

- Financial guarantees provided to customers
- Credit line liabilities
- Contingent liabilities related to pending litigations

All guarantees provided are accounted for as contingent liabilities. The received guarantee fees are stated as the initial balance sheet values of the financial guarantees provided. The value of expected losses arising from guarantees is stated as provisions in subsequent measurements.

The amounts of undrawn credit lines which exist on the basis of customer contracts are also stated as contingent liabilities. The Bank determines the initial balance sheet value of credit lines as zero, while the value of expected losses as a follow-up value. For contingent liabilities related to loans falling into the performing (stage 1) and underperforming (stage 2) portfolios the Bank accumulates provisions with regard to a credit conversion factor estimated with statistical methods. The Bank applies a 100% drawdown probability rate to contingent liabilities related to non-performing (impaired) loans (stage 3). Similar to the impairments of loans, the Bank estimates the expected cash flows, calculates the present value and accounts for the provisions as the difference between the value of the contingent liabilities and the present value of the recoveries.

Provisions are made for pending litigations are determined individually for each case based on an legal expert opinion as the most likely amount the Bank is expected to be required to pay on the basis of the probability of losing the lawsuit and the value of litigation.

Provisions determined for early-retirement pensions and severance pay should cover the amounts to be paid in the future due to staff reductions approved and communicated during the business year.

Provisions made for guarantees and credit liabilities are presented in compliance of IAS 37 standard.

CC. Deferred tax

A taxable temporary difference is recognised in respect of an asset or liability if the related tax is not payable during the current period, but in the future. In the case of a deductible temporary difference, the tax payable in the current period becomes deductible in the future.
The Bank prepares its balance sheets for financial reporting and tax purpose monthly, and the differences between the two balance sheets are classified into the classes of permanent and temporary difference on an itemised basis. A permanent difference has no deferred tax implication, while temporary differences are designated as taxable or deductible.

A temporary difference may typically arise in the following cases:

- Depreciation charge of assets (due to difference between the tax and accounting depreciation rates)
- Impairments of certain assets (due to deductibility/non-deductibility from income tax)
- Certain provisions (due to deductibility/non-deductibility from income tax)

The following may additionally result in deferred tax receivables:

- Accrued loss (unused negative tax base)
- Unused tax credit

The Bank offsets its current period tax receivables and tax liabilities against one another. If based on the available business plans no future taxable income will be available against which the deferred tax receivables could be offset, tax receivables will be recognised only to the extent that tax benefit can be realised.

The tax balance sheet necessary for determining any deferred tax is prepared in accordance with the tax regulations in force at the balance sheet date. Deferred tax receivables and liabilities are determined all times at the corporate tax rate in force or published. The Bank does not apply an average tax rate, because pursuant to the corporate tax law in force, the corporate tax rate is flat which is not likely to change in the future.

DD. Employee benefits

If an employee is entitled to a benefit payable in the future which is likely to be paid, the Bank recognises an employee benefit liability, and the relevant cost will be accounted for in respect of the period when the employee completed the service.
Accruals for short-term benefits are only recognised in the balance sheet if they relate to the current period, but payment is only expected to take place during the following period. Those provisions created for benefit elements are recognised as long-term benefits which are expected to be paid beyond a period of 12 months following the completion of service.

As part of this, the Bank recognises accrual- or provisions-type liabilities in the following cases:

- salaries, premiums, bonuses and other benefits provided as short-term benefits if they are paid after the current period (accrual),
- salaries and contributions due for unused, accumulated vacation provided as a short-term benefit if they are likely to be paid or used after the current period (accrual),
- the percentage of loyalty bonuses provided as long-term benefits (jubilee bonus) which is likely to be payable in the future (provisions),

- the percentage of deferred remuneration provided as a long-term benefit (business plan -performance driven bonuses) which is likely to be payable in the future (accrual),
- expected severance pay (provisions).

The Bank states its employee benefit liabilities to be recognised in the balance sheet at the value which the Bank is expected to pay in connection with the settlement thereof. The estimation of liabilities relating to unpaid leave is based on the assumption that the entire unused leave will be taken or paid for during the following period. The Bank recognises service time as part of the loyalty bonus programme. The Bank rewards 5, 10, 15, 20, 25 and 30 years of service. The Bank calculates its future payment liability according to an actuarial calculation method, with regard to fluctuation, age and service time, on the basis of historical data, for each employee, and then discounts this value.
The Bank's shares are not listed on any stock exchange and have no market price. For the purposes of compensatory performance measurement, the Bank calculates a theoretical share price. The performance-driven remuneration of management is determined based on the calculated share price. 50% of the performance-linked remuneration is long-term, deferred remuneration. The deferral period used by the Bank is 3 years during which the deferred part is paid in instalments of 33%-33.5%-33.5%. The rate of the reward actually payable in each year is subject to the employee's current-year evaluation and to the Bank's performance.
Severance pay is recorded when its future payment is obliged and communicated with the persons concerned.

2.4 <u>Material estimates applied by the Bank</u>

2.4.1 Impairment

According to the provisions of IFRS 9, the Bank accounts for impairments on the basis of changes in the expected credit risks in respect of financial assets measured at amortised cost value (loans, bank deposits) and financial assets measured at fair value through comprehensive profit or loss (securities). The Bank applies different methods for determining impairments on loans, bank deposits and securities.

Based on the expected credit losses and the extent of credit risks, in accordance with IFRS 9, the Bank distinguishes three stages. In the case of Stage 1 – performing – assets, a twelve-month credit loss is accounted for since the initial recognition. If the expected loss significantly increases after initial recognition (stage 2 – underperforming assets) or there is objective evidence suggesting non-performance (stage 3 – non-performing assets), an expected lifetime credit loss is accounted for.

Criterias relating to a significant rise in credit risks since initial recognition can be the following:

- a significant deterioration in rating/probability of default compared with the initial rating/probability of default (1.5% increase in PD or a four-notch rating deterioration),
- transfer to watch list – in case of corporate loans,
- extent of delay – at the worst from 30 days,
- certain collection indicators – in the case of retail loans, even below a delay of 30 days certain collection activities indicate an increased credit risk (the correlation between early

collections and subsequent default probabilities determines which collection actions the Bank should consider in the case of different products).

PD: probability of default; notch: risk rating category

Indicators showing an increase in the above credit risks determine the stage 2 classification of financial instruments, and also the accounting for expected lifetime losses, instead of expected losses for a period of 12 months. If the conditions of a stage 2 classification do not exist, the instrument can be transferred back to stage 1 category.

The Bank does not avail itself of the option under IFRS 9 5.5.10; this would allow the Bank to regard certain financial instruments as low-credit-risk instruments.

If, during valuation at the reporting date, default is identified for an individual transaction on the basis of objective evidence, the transaction is transferred to stage 3.

We regard a loan as non-performing and transferred it to the stage 3 category if the following criteria are met at the valuation date:

- there is a legal procedure is under way against the customer or any member of the company group (liquidation, bankruptcy, forced deregistration, etc.),
- the Bank declared a transaction of the customer or any member of the customer group as successful fraud,
- the customer or customer group has a terminated deal
- the customer or any member of the customer group is under collections management,
- the number of days in delay:
    - exceeds 30 days in case of a corporate customer,
    - exceeds 60 days in case of micro-customers,
    - exceeds 90 days in case of automobile customers
    - exceeds 90 days in case of mortgage and unsecured retail transactions,
- individual factors in case of retail loans: private bankruptcy, deceased customers, successful fraud, revoked execution proceedings in case of mortgage transactions affected by void related litigations.

Individual impairments are only cralculated for corporate non-performing loans if there is objective evidence. This, irrespective of the limit, covers the portfolio of the corporate division (not including automobile financing) and managed by the Bank's collections unit.
In determining individual impairments, the Bank estimates the expected future cash flows related to the given instrument which also includes the expected recovery from the available collateral, with regard to an optimistic and a pessimistic scenario. Weighting the scenarios with different probabilities of occurrence, the credit loss is the difference of the gross book value and the estimated future cash flow, discounted by the original effective interest rate.

For all other financial instruments the Bank values the expected credit loss on a collective basis with different models.
Instruments are grouped on a product basis, breaking down the portfolio into sub-segments for each product group so that instruments with similar characteristics are placed into a single group.

The Bank divides its portfolio into the following products/sub-segments:

- mortgages
- automobile loans:
  - retail
  - corporate
- credit cards
- current accounts
- personal loans and sales finance
- corporate loans:
  - revolving
  - closed-end
  - micro-loans
- leases

For retail products, there is further segmentation into delay categories, currency at disbursement and portfolios with a delay of more than 90 days in case of forced HUF conversion of currency loans. For the corporate portfolio, the Bank creates different pools on the basis of risk ratings (OR, Obligor Rating).

Expected loss = PD (probability of default)* LGD (loss given default)* EAD (exposure at default)

PDs are point-in-time estimates, measured on the basis of 12-month default rates with time windows of 2 to 4 years; in the case of retail portfolios transition matrices, while in of corporate portfolios survival-type models are used.

For the purposes of the stress test, the Bank takes account of macro-economic indicators and assumptions such as changes in GDP, inflation, unemployment rate, base rate and earnings. The Bank builds prospective macro-economic information into the PD estimate with adjustments. One of the scenarios is a base course, while the second scenario is a stress course, the stress test macro scenario of the Bank. During the weighting of scenarios, the base course dominates.

In the case of corporate loans, the lifetime PD estimate calculates the probability of default with regard to the entire lifetime of the transaction on the basis of cumulative PD curves measured for periods of 1 to 4 years in the different pools, considering the economic lifetime of the transaction.

In the case of retail loans, the Bank calculates the lifetime PD estimates by raising the matrices used for the measurement of the 12-month PDs to the power.

The loss rate is the LGD used in capital models, not including the downturn factor and indirect costs.

The exposure at default (EAD) is calculated as the amount of the balance sheet exposures and off-balance-sheet exposures, multiplied by the credit conversion factor. The credit conversion factor shows, based on empirical figures, the proportion of the off-balance-sheet items to be drawn (calculated mainly for revolving and credit card products).

The Bank does not use a separate model for the portfolios of restructured loans; however, restructured retail loans cannot be transferred to a category better than stage 2 within 24 months of the date of restructuring. Most of the corporate restructuring takes place in portfolios managed by collections, on the basis of individual arrangements.

Impairments of securities and loans to banks

The Bank classifies all its securities and loans to banks serving liquidity (FVOCI) and investment (AC) purposes into the stage 1 category, and keeps this rating as long as, based on the issuer's credit rating, the securities can be regarded as investment-grade (i.e. the Bank regards these securities as low-credit-risk securities). This is determined on the basis of the credit ratings published by credit rating institutions (S&P, Fitch, Moody's) with respect to issuers in cases where such ratings are available. The Bank regards the securities as investment-grade if the issuer's credit rating is BBB or Baa3 or better.

In cases where external credit ratings are not available, the Bank's internal credit rating is used for determining whether a given security is investment-grade or not.

If at the reporting date a security cannot be regarded as investment-grade, the Bank transfers the security to the stage 2 or stage 3 category and the impairment is made based on partner rating information and the extent of the delay. In stage 2 and stage 3 the Bank determines a lifetime expected loss.

For quantifying the impairment, the amortised cost value is multiplied by the PD percentage driven by the customer rating of the issuer of the security and a currency dependant LGD percentage.

Securities and loans to banks are transferred to the stage 2 category when the instrument is in arrears for more than 30 days, while the issuer of the instrument is rated by external credit rating agencies better than "CCC+", "Caa1", or if the issuer is rated lower and the delay is less than 30 days. An instrument is transferred to the stage 3 category if the instrument is in arrears for more than 90 days, or if the instrument is in arrears for between 30 and 90 days, and the issuer of the instrument is rated for "CCC+", "Caa1", or lower.

2.4.2 Assessment of fair value

The Bank measures the financial instruments listed in paragraphs 2.3.1.2 and 2.3.1.3 at fair value. These can be effectively *securities, derivative transactions and loans to customers.* Additionally, the Bank carries out fair value assessment for disclosure purposes, and also performed fair value assessment in the case of its properties and vehicles in order to determine the presumed cost value in the IFRS opening balance sheet.

Fair value per definition is the cash received upon the sale of an asset or paid upon the settlement of a liability on the basis of a transaction concluded between a market player and the Bank under the usual market terms and conditions at the time of measurement. The data and measurement procedures used for fair value measurement determine which level of the fair value hierarchy the applied method belongs to. If measurement is carried out solely on the basis of observable data, it is level 1 of the hierarchy. If observable data is available indirectly, it is level 2 of the hierarchy. If material non-observable data can be used during fair value assessment, it is level 3 fair value measurement.

Level 1 data is the price of the asset or liability quoted on its active market. An active market is a market where transactions relating to the asset or liability are carried out with sufficient frequency and in sufficient numbers in order for the market to supply continuous pricing information.
Level 2 data is the price of a similar asset quoted on the asset's active or non-active market, or any other observable data of the asset (e.g. yield curves, interest rates, credit spreads). Data derived from active market data, too, qualifies as level 2 data.
Level 3 data is determined, in every instance, to a significant degree on the basis of assumptions, but must reflect pricing and risks on the market.

The Bank measures *securities* by using active market prices, meaning level 1 and 2 input data. The Bank purchases securities at market price, and so there is no initial fair value difference. In the case of government bonds, the market price used in the follow-up measurement is the buy rate published by Államadósság Kezelő Központ Zrt (ÁKK) every day in the afternoon. In the case of debt-securities issued by other financial institutions, the order of prices used, are: selling price, closing price, theoretical price. In case of non-liquid bonds, the Bank uses the prices available from the Varitron, Bloomberg and Reuters systems, or theoretical prices. In case of treasury bills, the Bank regards the daily average rate of the Budapest Stock Exchange as the market price; in the absence of such a rate the Bank uses a theoretical price. Theoretical prices are calculated and yield curves are estimated from ÁKK data with the spline method.
The fair value difference is recorded for the securities portfolio in the profit/loss monthly on gross basis.

In case of *investment fund units,* the Company regards the net asset value of one unit published daily by investment funds multiplied by the number of investment units at the Fund manager as the fair value of a given investment fund. As all the investment funds from which the Company purchases investment units are open-end funds traded continuously, on a daily basis, the Company regards the published net asset value as the quoted market price (level 1 input of fair value measurement).

For the fair value measurement of *derivative transactions,* the Bank uses both market data and adjusted market data. In the case of these transactions, the price applied for measurement is the price which the Bank would use if it were to close the given transaction at the moment of measurement, i.e. the deal price of a reverse transaction relating to the remaining life of the transaction to be measured. Upon measurement the Bank estimates the price at which it would be able to close the given transaction on the market and compares it with the deal price of the original transaction. In case of forwards and foreign exchange swaps, the Bank generates this closing price by adding the swap points to the price of the day (which is determined by the interest difference of the two currencies of the derivative), thereby creating a market futures price. The current-day fair value is the difference of the deal price of the transaction and the market forward price of the transaction – calculated from the total of the current-day foreign exchange closing rate and the current-day closing FX swap points –, multiplied by the face value of the transaction. The profit/loss effect of multiple forward transactions concluded with individual customers is hedged by a large amount of single forward transaction. The Bank uses one-to-one hedge for high value customer forward deals by concluding a reverse transactions with the same maturities and amounts as the given customer transactions. In the case of these related transactions, the Bank does not use hedge accounting and does not prepare hedging documentation, consequently, it does not link together the customer and the offsetting transactions in the accounting records.

The fair value of interest swaps is calculated through the discounting of future cash flows, using the appropriate yield curve. The valuation system estimates the unknown cash flows of the variable leg of IRSs and CIRSs with the help of the yield curves which is used both to calculate the forward interest rates and used for discounting.

Interest-subsidised loans provided are measured at fair value on the basis of the SPPI test described in paragraph 2.3.1.2 S. The fair value is measured in two steps and at transaction level. First, all future cash flows are discounted at a market reference interest rate, and then this value is adjusted by the change in the fair value attributable to credit risks.

For disclosure purposes the Bank Group determines fair value as the present value of the estimated future contractual cash flows of financial instruments where the discount rate is an interest rate compiled from observable market interest rates adjusted by the risk of default.

2.4.3 Accounting for hedging transactions

The Bank offsets the fluctuating net income effects of the fair value and the cash flow changes of certain financial instruments through hedge transactions and related hedge accounting.

The Bank establishes a hedge relationship on the basis of the provisions of IFRS 9 if i) every leg of the hedge pair is a transaction identifiable and matched against one another, except for the so called portfolio-based macro-hedges, ii) the hedging efficiency requirements are met and iii) hedge documentation is available and up to date. The Bank terminates an existing hedge if any of the three criteria is not satisfied or the hedge expires. At present, the Bank hedges only loans bearing fixed interest rate (macro-hedge).
Only derivative transactions are designated as hedge instruments. The Bank does not designate option-type derivative transactions as hedge items. If forward contracts are selected as hedge instruments, the entirety of the forward transactions is involved in the hedging transaction. The Bank can involve both entire financial instruments and a pro rata part into a hedge relationship, in order to match the maturity dates of the hedge and hedged transactions as close as possible. The Bank can designate individual items or a group of items as hedged items.
The Bank prepares hedging documentation for the day of the establishment of the hedge relationship. The documentation contains the purpose of the hedge relationship, the ID codes, the terms and conditions of the hedged and hedge transactions, and the risk intended to be hedged and the method for measuring hedging efficiency. The Bank assesses hedging efficiency on the day of the creation of the hedge pair and monthly thereafter, at the end of the month. Assessment methods used: dollar-offset and scenario analysis (changing the interest rates of the transactions under the terms and conditions by +/-50 basis points). The Bank regards a hedge relationship as effective if there is an economic relationship between the hedged and the hedge items (interest rates or foreign exchange rates move between the hedging transaction and the underlying transaction in the same way, in the opposite directions) and the hedge effectiveness is at a pre-fixed required level.

The Bank macro-hedges the changes in the fair value of multiple products measured at amortised cost (at present: mortgage and corporate loans with fixed interest) through interest rate swaps (pay-fixed receive-variable IRS). In each product type, the reference interest rate of the credit products bearing variable interest is the BUBOR, while in the long term the BUBOR also affect the pricing of products bearing fixed interest. Therefore, the Bank pulls into group and hedges only those assets which share the same risk exposure, i.e. homogeneous from the respect of the risk hedged.

The fair value of the loans included in the hedging is measured by discounting the cash flows of the transactions. For the calculation of this value the Bank uses a so-called hypothetical transaction; each parameter of this transaction is identical to that of the loans, except the interest rate, instead of which it uses the fixed rate of the IRS. Upon the measurement at fair value of the instruments included in the hedge relationship, the Bank only considers the impacts attributable to interest risk, while excluding the effect of credit risk of customers.
In accordance with the IAS 39 carve-out rules, the Bank measures efficiency both retrospectively and prospectively. For portfolio hedging, there is effectiveness between the hedging and the underlying transactions if, according to the scenario analysis, upon shifting the interest curve in either direction the relative percentage of changes in the fair values of the hedged and hedging transactions falls between 80 and 125%.

Any changes in the fair value of derivatives designated as effective hedging transactions are accounted for in the same profit/loss line as the adjustment of the fair value of the underlying transaction. This is true even if the hedged item is otherwise measured at amortised cost value. The non-effective part of the hedging transaction is recorded directly in the net income.

3 EFFECT OF IFRS CONVERSION

The Bank as first-time adopter has kept its books in accordance with the IFRS standards since 1 January 2018, and prepares its first financial statements under the IFRS standards for the 2018 reporting year. Accordingly, the transition day under IFRS 1 is 1 January 2017 which is also the date of the IFRS opening balance sheet. In the 2017 comparative year, the Bank kept its books in conformity with the Accounting Act (“AA” or “HAS”), and also prepared its official annual reports in compliance with AA.

During transition to IFRS, the Bank applied the following transition exemptions granted on the basis of IFRS 1:

- In the opening balance sheet and in the comparative year, the provisions of the Hungarian AA were applied to all items under IFRS 9 (financial instruments, credit lines, financial guarantee contracts) comprehensively as well as to the impairment of lease receivables.

- All vehicles and properties were recognised at presumed fair value relating to the transition day. Software products in excess of net HUF 100 million were recalculated in accordance with IFRS provisions since initial recognition dates.

Notes to the IFRS conversion tables:

- While the balance sheet and profit and loss account descriptions under AA depart in several instances from the descriptions of lines under IFRS (e.g. instead of “tangible assets” the IFRS balance sheet features the description “Property, plant and equipment”), and the structures of the two balance sheets are also different, still certain lines of the balance sheet under HAS correspond in substance to lines in the IFRS balance sheet. The descriptions featured in these financial statements follow the IFRS structure, and wherever it was necessary, items of the balance sheet under AA were reclassified into the corresponding IFRS lines.

- The IFRS 1 standard requires data for the 2017 opening, 2017 closing and 2018 opening dates.

➡ Consolidated Supplementary Comments – Effect of IFRS Transition

3.1.1 Reconciliation of balance sheets under Hungarian accounting standards and IFRS as at 1 January 2017

The differences of the IFRS revaluations carried out during the opening IFRS balance sheet conversion were accounted for in the retained earnings and other comprehensive income (OCI) lines according to the summary below. Differences between the balance sheet items under the Hungarian accounting standards and IFRS before IFRS9 implementation, and the reclassification of the % provisions for the problem-free portfolio as they are, in effect, loss allowance for impairments.

data in HUF M

Description	HAS 31.12.2016	IFRS etained earnin	#	IFRS OCI	#	IFRS 01.01.2017
1. Cash and cash equivalents	112 996	-		-		112 996
2. Derivative financial assets	789	-		-		789
3. Securities	184 736	-		-		184 736
4. Loans and advances to banks	71 588	-		-		71 588
5. Loans and advances to customers	590 749	(287)	1*	-		590 462
7. Property, plant and equipment	13 869	(4 655)	2*	-		9 214
8. Intangible assets	8 377	1 113	3*	-		9 490
9. Tax receivables	1 805	740	4*	(65)	9*	2 480
10. Other assets	14 292	(88)	5*	-		14 204
TOTAL ASSETS	**999 201**	**(3 177)**		**(65)**		**995 959**
1. Derivative financial liabilities	471	-		-		471
2. Deposits from banks	151 283	-		-		151 283
3. Deposits from customers	684 260	-		-		684 260
4. Provisions	7 196	(5 459)	6*	-		1 737
5. Tax liabilities	-	14	7*	-		14
6. Other liabilities	24 475	(258)	8*	-		24 217
7. Share capital	19 396	-		-		19 396
8. Reservers	112 120	2 526		(65)		114 581
TOTAL EQUITY AND LIABILITIES	**999 201**	**(3 177)**		**(65)**		**995 959**

➡ Consolidated Supplementary Comments – Effect of IFRS Transition

The Bank carried out the following IFRS conversion steps in the individual balance sheet lines:

data in HUF M

#	Comments	Amount
1*	Change in gross lease portfolio due to capitalisation rules different from Hungarian standards	315
1*	Reclassification of operating lease under Hungarian standards to finance lease	4 318
1*	Reclassification of provisions created for portfolio rated as performing	(4 920)
2*	Reclassification of operating lease under Hungarian standards to finance lease	(4 059)
2*	Change in book value due to rules different from Hungarian standards	(596)
3*	Reclassification of operating lease under Hungarian standards to finance lease	(255)
3*	Change in book value due to rules different from Hungarian standards	1 368
4*	Deferred tax due to IFRS standards	740
5*	Derecognition of accrual related to operating lease under Hungarian standards	(88)
6*	Derecognition of provisions created for future expenses in IFRS	(539)
6*	Reclassification of provisions created for portfolio rated as performing	(4 920)
7*	Deferred tax under IFRS standards	14
8*	Derecognition of accrual related to operating lease under Hungarian standards	(108)
8*	Derecognition of negative goodwill under Hungarian standards	(150)
9*	Settlement of deferred tax for securities valued at fair value through OCI	(65)

Detailed explanations to material items listed above:

Regarding 1*, 2* and 3*:
In compliance with the Hungarian accounting standards, the Group accounted for several lease contracts as operative leases, in connection with which it recognised tangible assets and intangible assets as required under the Hungarian accounting standards. According to IAS 17, these lease contracts qualify as finance leases; therefore, the amounts recognised among tangible assets were reclassified into finance lease receivables (balance sheet line Loans and advances to customers), while their value also changed because the valuation rules relating to tangible assets and intangible assets under the Hungarian accounting standards differ from the valuation rules of IAS 17 applicable to finance lease receivables (e.g. according to IAS 17, any paid agent's commissions form part of the of the lease receivable)

Regarding 6*:
The Bank made provisions for future liabilities, in respect of which the IFRS standards do not allow to set up provisions (e.g. the future costs related to the merger of Budapest Autófinanszírozási Zrt).

Regarding 1* and 6*:
In accordance with the Hungarian accounting standards, the Bank also made provisions for good performing portfolios. As the Bank created these provisions for expected credit losses they were transferred to loss allowance in the IFRS opening balance sheet, (including in line loans and advances to customers).

3.1.2 Reconciliation of equity under Hungarian accounting standards and IFRS as at 1 January 2017

data in HUF M

	SHARE CAPITAL	RESERVES	Capital reserve	Accumulated other comprehensive income	Retained earning	Statutory reserves	Other reserves	TOTAL EQUITY
HAS balance as at 1 January 2017	**19 396**	**112 120**	**-**	**724**	**108 758**	**2 638**	**-**	**131 516**
Lease portfolio capitalisation rules different from HAS		**315**			315			**315**
Deferred tax for securities valued at fair value through OCI		**(65)**		(65)				**(65)**
Deferred tax under IFRS standards		**726**			726			**726**
Derecognition of provisions for future expenses in IFRS		**539**			539			**539**
Change in book value due to rules different from Hungarian standards		**772**			772			**772**
Reclassification of operating lease under HAS to finance lease		**4**			4			**4**
Derecognition of accrual related to operating lease under HAS		**20**			20			**20**
Derecognition of negative goodwill under HAS		**150**			150			**150**
IFRS balance as at 1 January 2017	**19 396**	**114 581**	**-**	**659**	**111 284**	**2 638**	**-**	**133 977**

In the table above, Statutory reserve represents the general reserves to be created on the basis of the provisions of Act 237 of 2013 (Credit Institutions Act) (see also comments 2.3 paragraph N).

In the case of certain securities, the Group opted for fair valuation already under the Hungarian accounting standards. For these securities, the Bank recognised any positive changes in fair value above carrying value directly in the equity, while it accounted for any decrease in fair value below carrying value as impairment against the profits/losses. In the table above, the value of accumulated other comprehensive income as at 1 January 2017 represents the fair value differences of securities valued at fair value which were accounted for directly in the equity.

3.1.3 Reconciliation of balance sheets under Hungarian accounting standards and IFRS as at 31 December 2017

data in HUF M

Descrtiption	HAS 31.12.2017	IFRS retained earning	#	IFRS OCI	#	IFRS 31.12.2017
1. Cash and cash equivalents	77 717	20 892	1*	-		98 609
2. Derivative financial assets	1 872	-		-		1 872
3. Securities	230 355	(20 892)	2*	-		209 463
4. Loans and advances to banks	11 752	-		-		11 752
5. Loans and advances to customers	670 723	(1 421)	3*	-		669 302
6. Investments in subsidiaries, joint ventures and associates	-	-		-		-
7. Property, plant and equipment	13 157	(4 067)	4*	-		9 090
8. Intangible assets	9 605	1 804	5*	-		11 409
9. Tax receivables	828	672	6*	(76)	11*	1 424
10. Other assets	17 850	(56)	7*	-		17 794
TOTAL ASSETS	**1 033 859**	**(3 068)**		**(76)**		**1 030 715**
1. Derivative financial liabilities	1 933	-		-		1 933
2. Deposits from banks	160 614	-		-		160 614
3. Deposits from customers	699 488	-		-		699 488
4. Provisions	7 505	(5 203)	8*	-		2 302
5. Tax liabilities	1	21	9*	-		22
6. Other liabilities	24 784	(252)	10*	-		24 532
7. Share capital	19 396	-		-		19 396
8. Reserves	120 138	2 366		(76)		122 428
TOTAL EQUITY AND LIABILITIES	**1 033 859**	**(3 068)**		**(76)**		**1 030 715**

➡ Consolidated Supplementary Comments – Effect of IFRS Transition

The Bank carried out the following conversion measures in the individual balance sheet lines:

data in HUF M

#	Comments	Amount
1*	Reclassification of securities with a remaining term of less than 3 months upon purchase	20 892
2*	Reclassification of securities with a remaining term of less than 3 months upon purchase	(20 892)
3*	Change in gross lease portfolio due to capitalisation rules different from Hungarian standards	(312)
3*	Reclassification of operating lease under Hungarian standards to finance lease	4 164
3*	Reclassification of provisions created for portfolio rated as performing	(5 273)
4*	Change in gross lease portfolio due to capitalisation rules different from Hungarian standards	546
4*	Reclassification of operating lease under Hungarian standards to finance lease	(4 037)
4*	Change in book value due to rules different from Hungarian standards	(576)
5*	Change in gross lease portfolio due to capitalisation rules different from Hungarian standards	100
5*	Reclassification of operating lease under Hungarian standards to finance lease	(100)
5*	Change in book value due to rules different from Hungarian standards	1 804
6*	Deferred tax under IFRS standards	672
7*	Derecognition of accrual related to operating lease under Hungarian standards	(56)
8*	Difference of provisions created under Hungarian and IFRS standards	70
8*	Reclassification of provisions created for portfolio rated as performing	(5 273)
9*	Deferred tax under IFRS standards	21
10*	Derecognition of accrual related to operating lease under Hungarian standards	(102)
10*	Derecognition of negative goodwill under Hungarian standards	(150)
11*	Settlement of deferred tax for securities valued at fair value through OCI	(76)

Detailed explanations to material items listed above:

Regarding 1* and 2:

The Hungarian accounting standards do not regard securities with a term of less than 3 months upon purchase as cash equivalents. Similar to the opening balance sheet, these securities were reclassified into the cash and cash equivalents line at 31 December 2017, as this reclassification is not an IFRS9 requirement.

Regarding 3*, 4* and 5*:

In compliance with the Hungarian accounting standards, the Group accounted for several lease contracts as operative leases, in connection with which it recognised tangible assets and intangible assets as required under the Hungarian accounting standards (depending on the type of the fix asset). According to IAS 17, these lease contracts qualify as finance leases; therefore, the amounts recognised among tangible assets were reclassified into finance lease receivables (balance sheet line Loans and advances to customers), while their value also changed because the valuation rules relating to tangible assets and intangible assets under the Hungarian accounting standards differ from the valuation rules of IAS 17 applicable to finance lease receivables (e.g. according to IAS 17, any paid agent’s commissions form part of the of the lease receivable)

Regarding 3* and 8*:

In accordance with the Hungarian accounting standards, the Bank also made provisions for good performing portfolios. As the Bank created these provisions for expected credit losses they were transferred to loss allowance in the IFRS opening balance sheet, (including in line loans and advances to customers).

3.1.4 Reconciliation of equity under Hungarian accounting standards and IFRS as at 31 December 2017

data in HUF M

	SHARE CAPITAL	RESERVES	Capital reserve	Accumulated other comprehensive income	Retained earning	Statutory reserves	Other reserves	TOTAL EQUITY
HAS balance as at 31 December 2017	**19 396**	**120 138**	**-**	**853**	**115 257**	**4 028**	**-**	**139 534**
Lease portfolio capitalisation rules different from HAS		**334**			334			**334**
Deferred tax for securities valued at fair value through OCI		**(76)**		(76)				**(76)**
Deferred tax under IFRS standards		**651**			651			**651**
Derecognition of provisions for future expenses in IFRS		**1 228**			1 228			**1 228**
Change in book value due to rules different from Hungarian standards		**(70)**			(70)			**(70)**
Reclassification of operating lease under HAS to finance lease		**27**			27			**27**
Derecognition of accrual related to operating lease under HAS		**46**			46			**46**
Derecognition of negative goodwill under HAS		**150**			150			**150**
IFRS balance as at 31 December 2017	**19 396**	**122 428**	**-**	**777**	**117 623**	**4 028**	**-**	**141 824**

In the table above, Statutory reserve represents the general reserves to be created on the basis of the provisions of Act 237 of 2013 (Credit Institutions Act) (see also comments 2.3 paragraph N).

In the case of certain securities, the Group opted for fair valuation already under the Hungarian accounting standards. For these securities, the Bank recognised any positive changes in fair value above carrying value directly in the equity, while it accounted for any decrease in fair value below carrying value as impairment against the profits/losses. In the table above, the value of accumulated other comprehensive income as at 31 December 2017 represents the fair value differences of securities valued at fair value which were accounted for directly in the equity.

3.1.5 Reconciliation of comprehensive income under Hungarian accounting standards and IFRS for 2017

The table below shows the differences in the 2017 comprehensive income under the Hungarian accounting standards and IFRS. These differences are not IFRS 9 related:

data in HUF M

Description	HAS 31.12.2017	IFRS modifications	#	IFRS 31.12.2017
1. Interest income	39 854	301	1*	40 155
2. Interest expense	(905)	-		(905)
Net interest income	**38 949**	**301**		**39 250**
3. Dividend income	-	-		-
4. Fee and commission income	38 989	(1 044)	2*	37 945
5. Fee and commission expense	(7 128)	-		(7 128)
Net fee and commission income	**31 861**	**(1 044)**		**30 817**
6. Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)	(1 055)	-		(1 055)
7. Net trading income/(losses)	(316)	-		(316)
8. Net income /(loss) from financial instruments valued at FVTPL	328	-		328
9. Net foreign exchange gain	405	-		405
10. Other operating income	4 602	-		4 602
11. Other operating expenses	(17 805)	(115)	3*	(17 920)
12. Personnel expenses	(24 953)	-		(24 953)
13. Other administrative expenses	(13 758)	(116)	4*	(13 874)
14. Depreciation and amortisation	(6 098)	1 494	5*	(4 604)
15. Net (impairment loss)/ reversal of impairment loss on financial assets&provision	4 769	(607)	6*	4 162
16. Reversal of impairments or provisions for subsidiaries	-	-		-
17. Pofit before income tax	**16 929**	**(87)**		**16 842**
18. Income tax expense	(2 329)	(74)	7*	(2 403)
19. Profit for the year	**14 600**	**(161)**		**14 439**
General reserves	(1 390)	1 390	8*	-
20. Other comprehensive income to be reclassified to profit/loss	-	130	9*	130
a) Debt-securities valued at fair value through OCI	-	130	9*	130
aa) Change in net fair value of securities valued at fair value through other comprehensive income	-	538	9*	538
ab) Net amount reclassified to profit/loss of securities valued at fair value through other comprehensive income	-	(408)	9*	(408)
21. Income tax related to items to be reclassified to profit or loss	-	(12)	10*	(12)
22. OTHER COMPREHENSIVE INCOME, NET OF TAX	**-**	**118**		**118**
23. TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**13 210**	**1 347**		**14 557**

➡ Consolidated Footnotes – Effect of IFRS transition

The Bank carried out the following IFRS conversion steps in the net income lines:

data in HUF M

#	Comments	Amount
1*	Difference of implicit interest under Hungarian standard and IAS17 standard	92
1*	Settlement difference of operating leases under Hungarian standard and finance leases under IAS17 standard	209
2*	Settlement difference of operating leases under Hungarian standard and finance leases under IAS17 standard	(1 044)
3*	Settlement difference of operating leases under Hungarian standard and finance leases under IAS17 standard	(73)
3*	Effect of different derecognition rules of Hungarian standard and IFRS standard	(42)
4*	Settlement difference of operating leases under Hungarian standard and finance leases under IAS17 standard	(116)
5*	Settlement difference of operating leases under Hungarian standard and finance leases under IAS17 standard	996
5*	Effect of different depreciation under Hungarian standard and IFRS standard	91
5*	Effect of different amortisation under Hungarian standard and IFRS standard	407
6*	Difference of provisions created under Hungarian and IFRS standards	(607)
7*	Deferred tax under IFRS standards	(74)
8*	Reversal of general provisions under Hungarian standard	1 390
9*	Other comprehensive income did not form part of official Hungarian profit and loss account	130
10*	Settlement of deferred tax for securities valued at fair value through OCI	(12)

Detailed explanations to material items listed above:

Regarding 1* and 5*:

In compliance with the Hungarian accounting standards, the Group accounted for several lease contracts as operative leases, in connection with which it recognised tangible assets and intangible assets and related as required under the Hungarian accounting standards. According to IAS 17, these lease contracts qualify as finance leases; therefore, were classified as finance lease receivables. The received fees were accounted for partly as interest income partly as a decrease in finance lease receivable. At the same time there is no depreciation charge, as there is no depreciable asste related to these contracts.

For the purpose the above reconciliation the lease income under AA In 2017 column were classified as fee and commission income.

Regarding 8*:

Based on the Credit Institutions Act, the Bank is requested to set up general reserves. The Bank made these reserves, in accordance with the Hungarian accounting standards, by charging against the net income. According to the IFRS standards, making any statutory reserves is a transfer within the equity. In consequence of this, the 2017 IFRS profit is higher than the profit under the Hungarian accounting standards by the amount of the general reserves.

Regarding 9*:

The Hungarian accounting standards do not disclose other comprehensive income, while according to the IFRS standards it is obligatory to prepare a statement of other comprehensive income.

3.1.6 2017 IFRS cash flow conversion

data in HUF M

	2017 HAS	2017	Difference	
Operating cash flow				
Pofit before income tax	16 929	16 842	87	
			-	
Modifying factors			-	
			-	
Depreciation (+), Amortisation (+)	6 098	4 604	1 494	1*
Release of impairments & provision loss (+)	(4 769)	(4 162)	(607)	
Non-realised foreign exchange gains/losses (+/-)	(405)	(405)	-	
Deferred tax	-	74	(74)	
Net interest income (-)	(38 949)	(39 250)	301	
Dividend income (-)	-	-	-	
			-	
Change in derivative financial assets (- increase, + decrease)	(1 083)	(1 083)	-	
Change in portfolio of FVTPL securities (- increase, + decrease)	-	-	-	
Change in loans and advances to banks (- increase, + decrease)	59 152	59 152	-	
Change in loans and advances to customers (- increase, + decrease)	(74 728)	(73 947)	(781)	
Change in other assets (- increase, + decrease)	(3 881)	(3 610)	(271)	
	-	-	-	
Change in deposits from banks, non-refinancing	16 667	16 667	-	
Change in deposits from customers (+ increase, - decrease)	17 960	17 960	-	
Change in derivative financial liabilities (+ increase, - decrease)	1 462	1 462	-	
Change in other liabilities (+ increase, - decrease)	366	375	(9)	
			-	
Interest received (+)	40 133	40 379	(246)	
Interest paid (-)	(957)	(957)	-	
Dividends received from subsidiaries (+)	-	-	-	
Corporate tax paid	(1 351)	(1 425)	74	
Net cash flows from operating activities	**32 644**	**32 676**	(32)	
			-	
Investment cash flow			-	
			-	
Investments in subsidiaries, joint ventures and associates	-	-	-	
Investments in other enterprises	-	-	-	
Acquisitions of property, plant and equipment	(3 364)	(2 083)	(1 281)	
Proceeds from sale of property, plant and equipment, other derecognitions	1 201	235	966	
Acquisitions of intangible assets	(4 557)	(4 876)	319	
Proceeds from sale of intangible assets, other derecognitions	104	76	28	
Purchase of non-FVTPL securities	(116 589)	(95 697)	(20 892)	2*
Disposal of non-FVTPL securities	70 983	70 983		
Dividends received from investments	-	-	-	
Net cash flows used in investing activities	**(52 222)**	**(31 362)**	(20 860)	
			-	
Financing cash flow			-	
			-	
Dividends paid	(6 710)	(6 710)	-	
Increase of deposits from banks, refinancing	100 287	100 287	-	
Decrease of deposits from banks, refinancing	(107 398)	(107 398)		
Payments to shareholders other than dividends	-	-	-	
Net cash flows from financing activities	**(13 821)**	**(13 821)**	-	
			-	
			-	
Net change in cash and equivalents	**(33 399)**	**(12 507)**	(20 892)	
			-	
Foreign currency revaluation on cash and equivalents	(1 880)	(1 880)	-	
Cash and equivalents at the beginning of year	112 996	112 996	-	
			-	
Cash and equivalents at the end of period	**77 717**	**98 609**	(20 892)	3*

There is a difference of HUF 20,892 million between the 2017 closing cash and cash equivalents under AA and under the transition standards. See details in the conversion tables relating to balance sheets presented in Chapter 3.

The Bank carried out the following IFRS conversion measures in the individual cash flow lines:

Explanations for significant differences:

1* HUF 1048M depreciation, amortisation of operating lease contracts under the Hungarian standards which were reclassified as finance leases under IFRS. The difference arises from the different depreciation calculation methods.
2* Reclassification of securities with a remaining term of less than 3 months upon purchase.
3* Reclassification of securities with a remaining term of less than 3 months upon purchase.

3.2.1 Effects of first-time adoption of IFRS 9 – classification categories and book values of financial instruments

The table below demonstrates the valuation categories and carrying values of financial instruments under the Hungarian accounting standards and under IFRS 9 as at 1 January 2018 (the differences arise from the valuation rules of IFRS 9 and those of the Hungarian accounting standards):

data in HUF M

Description	Measurement method			
	HAS	IFRS	HAS	IFRS
1. Cash and cash equivalents	CC	AC	98 609	98 605
2. Derivative financial assets	FVTPL	FVTPL (mandatory)	1 872	2 369
3. Securities	AC	FVOCI	54 656	56 068
3. Securities	AC	FVTPL (mandatory)	2 537	2 537
3. Securities	FVOCI	FVOCI	27 638	27 638
3. Securities	AC	AC	124 632	125 427
4. Loans and advances to banks	AC	AC	11 752	11 760
5. Loans and advances to customers	CC	AC	669 302	668 359
5. Loans and advances to customers	CC	FVTPL (mandatory)	-	3 726
1. Derivative financial liabilities	FVTPL	FVTPL (mandatory)	1 933	3 386
2. Deposits from banks	AC	AC	160 614	160 636
3. Deposits from customers	AC	AC	699 488	699 622

Legend:

- AC (2018) – amortised cost (IFRS rule)
- FVOCI (2018) –fair value through other comprehensive income (IFRS rule)
- FVOCI (2017) –fair value through other comprehensive income with the exception that any decrease in fair value below carrying value is accounted for as allowance for impairment (Hungarian accounting standards)
- CC (2017) – carrying cost of outstanding principal and due unpaid interest (Hungarian accounting standards)
- FVTPL–fair value through profit or loss

➡ Consolidated Footnotes – Effect of IFRS transition

Comments to table above:

Derivative financial assets and liabilities: Budapest Bank used measurement at fair value also under the Hungarian accounting standards. As a result, it valued its derivative transactions (only Budapest Bank had such transactions among the Group's member companies) at fair value through profit or loss even under the Hungarian accounting standards. The difference between the 31 December 2017 and 1 January 2017 book values arises from reclassification, see the following table.

Securities: The Group carried certain securities at purchase cost plus accumulated, unpaid interest; while other securities at fair value where the difference arising from the fair value change over carrying cost was accounted for directly in the equity, and any decrease in fair value below carrying cost value was accounted for as allowance for impairment in the net income. (The valuation method of the these securities is marked as "FVOCI" in the table above also in 2017)

➡ Consolidated Footnotes – Effect of IFRS transition

3.2.2 Reconciliation of 2017 balance sheet for IFRS 9 conversion

data in HUF M

Description	IFRS 31.12.2017	IFRS reclassifications	#	IFRS profit reserve	#	IFRS OCI	#	IFRS 01.01.2018
AC								
1. Cash and cash equivalents	98 609	-		(4)	21*	-		98 605
3. Securities	124 631	777		17	22*	-		125 425
10. Other assets		777	1*					
4. Loans and advances to banks	11 752	9		(1)	23*	-		11 760
10. Other assets		9	2*					
5. Loans and advances to customers	669 302	(2 137)		1 195	24*	-		668 360
5. Loans and advances to customers - FVTPL		(3 729)	3*					
10. Other assets		1 592	4*					
FVTPL								
2. Derivative financial assets	1 872	497		-		-		2 369
10. Other assets		420	5*					
1. Derivative financial liabilities - FVTPL		77	6*					
3. Securities	2 538	-		-				2 538
5. Loans and advances to customers	-	3 729		(4)	25*	-		3 725
5. Loans and advances to customers - AC		3 729	7*					
FVOCI								
3. Securities	82 294	1 285		(301)	26*	429	32*	83 707
10. Other assets		1 285	8*					
N/A								
6. Investments in subsidiaries, joint ventures and associates	-	-		-		-		-
7. Property, plans and equipment	9 090	-		-		-		9 090
8. Intangible assets	11 409	-		-		-		11 409
9. Tax receivables	1 424	-		(377)	27*	(38)	33*	1 009
10. Other assets	17 794	(4 083)		(95)	28*	-		13 616
3. Securities - AC		(777)	9*					
4. Loans and advances to banks - AC		(9)	10*					
5. Loans and advances to customers - AC		(1 592)	11*					
2. Derivative financial assets - FVTPL		(420)	12*					
3. Securities - FVOCI		(1 285)	13*					
TOTAL ASSETS	**1 030 715**	**77**		**430**		**391**		**1 031 613**
ACV								
2. Deposits from banks	160 614	22		-		-		160 636
6. Other liabilities		22	14*					
3. Deposits from customers	699 488	134		-		-		699 622
6. Other liabilities		134	15*					
FVTPL								
1. Derivative financial liabilities	1 933	1 453		-		-		3 386
2. Derivative financial assets - FVTPL		77	16*					
6. Other liabilities		1 376	17*					
N/A								
4. Provisions	2 302	-		308	29*	-		2 610
5. Tax liabilities	22	-		(21)	30*	-		1
6. Other liabilities	24 532	(1 532)		(443)	31*	-		22 557
1. Derivative financial liabilities - FVTPL		(1 376)	18*					
2. Deposits from banks - AC		(22)	19*					
3. Deposits from customers - AC		(134)	20*					
7. Share capital	19 396	-		-		-		19 396
8. Reserves	122 428	-		586		391		123 405
TOTAL EQUITY AND LIABILITIES	**1 030 715**	**77**		**430**		**391**		**1 031 613**

➡ Consolidated Footnotes – Effect of IFRS transition

The Bank carried out the following IFRS conversion steps in the individual balance sheet lines:

data in HUF M

#	Comments	Amount
1*	Interest accrual reclassification	777
2*	Interest accrual reclassification	9
3*	Reclassification of loans valued at fair value through profit or losss	(3 729)
4*	Interest accrual reclassification	1 592
5*	Interest accrual reclassification	420
6*	Reclassification due to gross interest settlement method under IFRS standards	77
7*	Reclassification of loans valued at fair value through profit or loss	3 729
8*	Interest accrual reclassification	1 285
9*	Interest accrual reclassification	(777)
10*	Interest accrual reclassification	(9)
11*	Interest accrual reclassification	(1 592)
12*	Interest accrual reclassification	(420)
13*	Interest accrual reclassification	(1 285)
14*	Interest accrual reclassification	22
15*	Interest accrual reclassification	134
16*	Reclassification due to gross interest settlement method under IFRS standards	77
17*	Interest accrual reclassification	1 376
18*	Interest accrual reclassification	(1 376)
19*	Interest accrual reclassification	(22)
20*	Interest accrual reclassification	(134)
21*	Impairment for liquid assets under IFRS9 standard	(4)
22*	Change in amortised cost value of securities	27
22*	Impairment for Treasury assets under IFRS9 standard	(10)
23*	Impairment for loans and advances to banks under IFRS9 standard	(1)
24*	IFRS9 conversion effect of amortised cost value of gross loans and advances to customers	3 594
24*	Difference of impairments for loans and advances to customers under Hungarian standards and IFRS9 standard	(2 399)
25*	IFRS9 conversion effect of value of gross loans and advances to customers valued at fair value through profit or loss	(4)
26*	IFRS9 conversion effect of amortised cost value of FVOCI securities	(293)
26*	Impairment for FVOCI securities under IFRS9 standard	(8)
27*	Deferred tax effect of conversion to IFRS9 standards	(377)
28*	Reversal of accruals under Hungarian standards attached to gross loans and advances to customers upon IFRS9 conversion	(50)
28*	Difference of impairments for loans and advances to customers under Hungarian standards and IFRS9 standard	(45)
29*	Recognition of difference of credit provisions under Hungarian standards and IFRS9 standard	308
30*	Deferred tax effect of conversion to IFRS9 standard	(21)
31*	Reversal of accruals under Hungarian standards attached to gross loans and advances to customers upon IFRS9 conversion	(443)
32*	Valuation difference of FVOCI securities due to IFRS9 conversion	429
33*	Deferred tax effect of conversion to IFRS9 standard	(38)

Detailed explanations to material items listed above:

Regarding 1* and 7*:

In accordance with IFRS 9, the Bank carried out the SPPI test assessing contractual cash flows with respect to its credit portfolio. As a result, in case of certain loans, the Bank came to the conclusion that the contractual cash flows embody not sole principal and interest payments on outstanding principal amounts, and in consequence, the loans in question should be valued at fair value through profit or loss. The portfolio concerned includes primarily retail, state-subsidised loan products which interest calculation formula includes leverage.

Regarding 24* (amortised cost):

The difference is partly because under the Hungarian accounting standards, the Group accounted for transaction charges and fees against net income immediately, while under the IFRS standards they are recognised during the term with the effective interest method.

The other reason for the difference is that the interest (both contractual and default interest) and interest-type fees due on certain overdue receivables should be suspended at the due date during the year. Suspending means that the interest or fees cannot be accounted for as receivables and interest income (interest accrual, if unpaid, is reduced via a reversing entry), furthermore no provision or allowance can be made for these items. On the contrary, the amount of interest and fees suspended under the Hungarian accounting standards must be recognised in the financial position and the net income statement prepared under the IFRS standards. Consequently according to the IFRS standards, suspended interest and fees form part of the receivables, and therefore it is necessary to account for impairment, considering the expected recovery.

Regarding 24* (impairment):

There is a conversion difference between the impairment calculation requirements of the Hungarian accounting standards and of IFRS 9.
According to the Hungarian accounting standards, the Bank created a pool provision on the performing portfolio as well which it recognised as impairment in substance on 31 December 2017 and 1 January 2017, deducting from loans and advances to customer (on 31 December 2017: HUF 5,273 million). The conversion in comment 24* is for the difference between the expected loss under IFRS 9 as at 1 January 2018 and the amount of the impairment made under the Hungarian accounting standards including the above described provisions.

3.2.3 Reconciliation of 2018 opening impairment under IFRS 9

The impairment of financial instruments was materially adjusted, compared to the Hungarian accounting standards, in accordance with the IFRS 9 standard which came into force on 1 January 2018. The conversion adjustments are shown in the tables below:

data in HUF M

Description	IFRS 31.12.2017	IFRS impairment	#	IFRS 01.01.2018
1. Cash and cash equivalents	-	(4)	*1**	(4)
3. Securities	-	(18)	*2**	(18)
4. Loans and advances to banks	-	(1)	*3**	(1)
5. Loans and advances to customers	(81 641)	(2 400)	*4**	(84 041)
10. Other assets	(260)	(45)	*5**	(305)
TOTAL IMPAIRMENT OF ASSETS	**(81 901)**	**(2 468)**		**(84 369)**
4. Provisions	(563)	(308)	6*	(871)

data in HUF M

#	Comments	Amount
1*	Impairment for liquid assets under IFRS9 standard	(4)
2*	Impairment for Treasury assets under IFRS9 standard	(18)
3*	Impairment for loans and advances to banks under IFRS9 standard	(1)
4*	Difference of impairments for loans and advances to customers under Hungarian standards and IFRS9 standard	(2 400)
5*	Difference of impairments for loans and advances to customers under Hungarian standards and IFRS9 standard	(45)
6*	Recognition of difference of credit provisions under Hungarian standards and IFRS9 standard	(308)

3.2.4 IFRS change in 2018 opening equity

data in HUF M

	SHARE CAPITAL	RESERVES	Capital reserve	Accumulated other comprehensive income	Retained earning	Statutory reserves	Other reserves	TOTAL EQUITY
IAS39 balance 31 December 2017	**19 396**	**122 428**	**-**	**777**	**117 623**	**4 028**	**-**	**141 824**
IFRS9 effect on receivables valued at fair value through profit or loss		**(4)**			(4)			**(4)**
Change in amortised cost value of securities		**27**			27			**27**
IFRS9 conversion effect on amortised cost value of FVOCI securities		**(293)**			(293)			**(293)**
Valuation difference of FVOCI securities due to IFRS9 conversion		**429**		429				**429**
Impairment for FVOCI securities under IFRS9 standard		**(8)**			(8)			**(8)**
Difference of credit provisions under IFRS9		**(308)**			(308)			**(308)**
Impairment for loans and advances to banks under IFRS9		**(1)**			(1)			**(1)**
Effect of conversion to IFRS9 standard on deferred tax		**(394)**		(38)	(356)			**(394)**
Reversal of provisions for performing credit portfolio under HAS		**5 273**			5 273			**5 273**
Impairment for liquid assets under IFRS9		**(4)**			(4)			**(4)**
Impairment for Treasury assets under IFRS9		**(10)**			(10)			**(10)**
IFRS9 conversion effect on amortised cost value of receivables		**3 594**			3 594			**3 594**
Reversal of HAS receivables accruals		**393**			393			**393**
Impairments for receivables under Hungarian and IFRS9 standards		**(7 717)**			(7 717)			**(7 717)**
IFRS9 balance 1 January 2018	**19 396**	**123 405**	**-**	**1 168**	**118 209**	**4 028**	**-**	**142 801**

For further details on statutory reserves, see comments to the tables 3.1.2 and 3.1.4 below.

4 RISK MANAGEMENT

Banking activities are exposed to a number of risks. The Bank regards risks as a fundamental feature of its banking service, and treats them inherent to its business activities. The Bank operates a system which precisely measure, appropriately manage and limits risks. The most significant risks affecting the Bank are as follows:

4.1 Credit risk

Credit risk is the possibility of a loss which the Bank may sustain if the borrower becomes insolvent or fails to meet its payment obligations on time. The Bank pursues credit risk management on the basis of an underwriting, monitoring and collateral management process.

Underwriting

Upon acceptance, the Bank rates all its retail and corporate customers on the basis of statistical or expert assessment models. The Bank Group uses multiple authorization levels for proper management. As a general rule, the customer's rating, the risk appetite and the value of the collateral determine the appropriate decision-making level.

Monitoring

The Bank operates a transaction-level and portfolio-level monitoring mechanism in order to be able to operate a loan rating system which complies with the statutory regulations, and to promptly identify any exposures and customers who are unable or are likely to become unable to meet their contractual obligations in the future.

Collateral – credit risk mitigation

The Bank primarily expects the repayment of loans from revenues derived as part of the customer's normal course of business, but in order to cover the risks of non-repayment, the Bank requests customers to supply collateral. The range of collateral items that the Bank accepts may vary from segment as well as for each process and product type, but the basic principle is that the collateral must be enforceable and realisable. In the case of property and tangible collateral, assets are valued on the basis of expert appraisals, and the collateral must be insured during the entire term of the loan.

Expected credit loss, impairment

The information below relates to impairments accounted for expected credit losses recorded in the books as at 31 December 2018. During the comparative period, impairment was measured according to the Hungarian accounting standards.

Relying on the above processes, the Bank accounts for impairments in respect of expected credit losses in accordance with the provisions of IFRS 9 and the methodology defined by Budapest Bank (see in Chapter 2.4.1) on a monthly basis.

4.1.1 Loans and advance to customers by ratings and non-performing portfolio

The Bank accounted for the following impairment amounts in respect of the rating stages defined in IFRS 9 and its non-performing portfolio:

data in HUF M

	Stage 1	Stage 2	Stage 3	FVTPL loans*	Other receivables	Total
2018 opening balance						
Gross balance of loans and advances to customers	555 728	98 596	95 017	3 726	3 058	756 125
Of this non-performing portfolio	-	-	*88 983*	-	-	*88 983*
Impairment of loans and advances to customers	2 463	3 739	77 839	-	-	84 041
Net balance of loans and advances to customers	**553 265**	**94 857**	**17 178**	**3 726**	**3 058**	**672 084**
2018 closing balance						
Gross balance of loans and advances to customers	755 886	53 603	68 701	3 851	5 984	888 025
Of this non-performing portfolio	-	-	*62 477*	-	-	*62 477*
Impairment of loans and advances to customers	5 145	3 006	53 466	-	-	61 617
Net balance of loans and advances to customers	**750 741**	**50 597**	**15 235**	**3 851**	**5 984**	**826 408**

FVTPL* means loans valued at fair value.

In the opening balance sheet the non-performing portfolio accounts for 11.8% of the total portfolio. In the closing balance sheet this percentage fell to 7%.

At the Bank Group the portfolio of restructured loans amounted to HUF 61,541 million on 31 December 2018 and to HUF 71,619 million on 31 December 2017, respectively.

In 2017, the portfolio quality and loss allowance for impairment was prepared in accordance with Hungarian accounting standards, given that the Company did not prepare financial statements on the basis of IFRS 9 in 2017. Portfolio quality table prepared in 2017 is as follows:

As at 31 December 2017

data in HUF M

Description	DPD 0-30	DPD 31-90	DPD >90	Total credit portfolio	Impairment	NPL (DPD >90) / Loans	Impairment / Loans
Corporate loans	**438 112**	**725**	**14 145**	**452 982**	**14 261**	**3%**	**3%**
- Corporate loans/leases	421 278	647	12 878	434 803	13 065	3%	3%
- Individual entrepreneurs	16 834	78	1 267	1 879	1 196	7%	7%
Retail loans	**218 500**	**3 735**	**68 181**	**290 416**	**61 919**	**23%**	**21%**
- Mortgage loans	130 457	1 720	30 472	162 649	24 503	19%	15%
- Other loans	88 043	2 015	37 709	127 767	37 416	30%	29%
Other customer receivables	**449**	**0**	**187**	**636**	**189**	**29%**	**30%**
Total	**657 061**	**4 460**	**82 513**	**744 034**	**76 369**	**11%**	**10%**

DPD: days past due
NPL: non-performing loans

The provisions for loans, made on collective pool basis, were not included in the table above.

4.1.2 Movements of allowances made for impaired loans and advances to customers

In 2018 the following impairment allowance movements occurred between the different rating stages which include not only possible reclassifications, but also movements arising from new loans and the cessation loans:

data in HUF M

Description	Stage 1	Stage 2	Stage 3	Total
Balance as at 1 January	**2 463**	**3 739**	**77 839**	**84 041**
	-	-	-	-
Growth from formation and purchase	2 712	625	726	4 063
Decrease from derecognition	(401)	(201)	(17 631)	(18 233)
Change from change in credit risk (net)	-	-	-	-
- Classification did not change	273	(51)	(3 597)	(3 375)
- Reclassification from Stage 1	(254)	970	1 936	2 652
- Reclassification from Stage 2	351	(2 112)	497	(1 264)
- Reclassification from Stage 3	2	32	(531)	(497)
Change from modification not resulting in derecognition	-	3	7	10
Decrease from write-offs and cancellations	-	-	(5 780)	(5 780)
	-	-	-	-
Balance as at the end of reporting period	**5 146**	**3 005**	**53 466**	**61 617**

The reclassifications between stages in the table above show not only the effect of reclassification, but also the changes in impairments in consequence of the reclassifications.

De-recognition decrease of HUF 15,503 million is related to release of sold loans, while HUF 48 million increase arise from foreign currency revaluation, and such as, these items do not affect the net impairment loss stated in section 6.9.

Sold and written-off loans are not part of any legal proceedings.

In 2017, the impairment movements table was prepared in accordance with Hungarian accounting standards, given that the Company did not prepare financial statements on the basis of IFRS 9 in 2017. Portfolio quality table prepared in 2017 is as follows:

data in HUF M

Description	Opening balance	Settlement of impairment	Derecognition of impairment of written-off receivables	Impairment reversal	Exchange rate *	Closing balance
Impairment for securities	**-**	-	-	-	-	**-**
Impairment for other invested financial assets	**10**	2	-	-	-	**12**
Impairment for receivables	**92 645**	1 032	(10 497)	(6 806)	(5)	**76 369**
Impairment for other receivables	**438**	40	-	(257)	271	**492**
Impairment for assets registered as inventories	**119**	-	-	(91)	34	**62**
Total impairment	**93 212**	**1 074**	**(10 497)**	**(7 154)**	**300**	**76 935**

* Also includes opening reclassification

The provisions for loans, made on collective pool basis, were not included in the table above.

4.1.3 Changes to Provisions

Similar to loans and advances to customers, the Bank makes provisions for off-balance-sheet credit risks and other contingent liabilities pursuant to the rules of IFRS 9 and IAS 37:

data in HUF M

31.12.2018	**Gross**	Stage 1	Stage 2	Stage 3	IAS 37	*Total provisions*
Contingent liabilities						
Undrawn lines of credit and guarantees	343 770	462	201	290	-	*953*
Other contingent liabilities (including lawsuits)	1 393	-	-	-	1 292	*1 292*
Total contingent liabilities	**345 163**	**462**	**201**	**290**	**1 292**	***2 245***

See definitions of State 1, Stage 2 and Stage 3 in comment 2.4.1.

In the table above, the amount stated as "gross" represents the maximum available credit line or the maximum amount payable by the Group in connection with financial guarantee contracts. In the case of other contingent liabilities, the "gross" amount is the estimated maximum amount payable by the Group.

The table below shows the movements of provisions in 2018:

data in HUF M

Description	**Lines of credit and guarantees**	**Litigations**	**Other provisions**	**Total**
Opening balance	**871**	**1 081**	**658**	**2 610**
Increase	678	52	174	904
Use	-	(280)	(36)	(316)
Release	(596)	(354)	(3)	(953)
Closing balance	**953**	**499**	**793**	**2 245**

4.1.4 Types of loans and advances to customers and related collateral

Most of the loans and advances to customers which are secured with collateral are presented in the schedule at collateral value, the unsecured loans presented on face value:

31.12.2018 data in HUF M

Description	Gross credit portfolio	Collateral					Total
		Assignment	Guarantee and suretyship	Mortgage	Assets	Security deposit	
Unsecured retail loans	87 920						-
Secured retail loans	276 265	2 131	1 249	242 376	14 358	4	260 118
Corporate loans and leases	514 005	7 206	48 590	153 051	154 556	30 504	393 907
Other receivables	5 984	-	-	-	-	-	-
Receivables valued at AC	**884 174**	**9 337**	**49 839**	**395 427**	**168 914**	**30 508**	**654 025**
Loans valued at fair value	3 851	-	-	4 968	-		4 968
Total	**888 025**	**9 337**	**49 839**	**400 395**	**168 914**	**30 508**	**658 993**

31.12.2017 data in HUF M

Description	Gross credit portfolio	Collateral					Total
		Assignment	Guarantee and suretyship	Mortgage	Assets	Security deposit	
Unsecured retail loans	81 703	-	-	-		-	-
Secured retail loans	253 814	2 471	1 575	212 120	10 757	4	226 927
Corporate loans and leases	412 368	1 045	41 931	146 212	141 933	18 985	350 106
Other receivables	3 058	-	-	-	-	-	-
Total	**750 943**	**3 516**	**43 506**	**358 332**	**152 690**	**18 989**	**577 033**

4.1.5 Concentration of loans and advances to corporate customers by sectors

The Bank's credit portfolio is properly concentrated by sectors at the end of each reporting period:

Period	Agriculture	Processing	Construction	Trade	Transport	Other
31.12.2018	9%	20%	7%	27%	12%	25%
31.12.2017	9%	27%	9%	23%	9%	23%
01.01.2017	12%	32%	8%	18%	11%	19%

4.1.6 Impairment of cash and equivalents, securities and loans and advances to banks

data in HUF M

	Total	Stage 1 FVOCI	Stage 1 AC
Impairment of liquid assets			
Opening balance	(4)	-	(4)
Increase from origination and purchase	(1)	-	(1)
Decrease from maturity and sale	4	-	4
Change in impairment for Stage 1 liquid assets	-	-	-
Effect of change in foreign currency rate	-	-	-
Closing balance	(1)	-	(1)
Impairment of securities			
Opening balance	(18)	(8)	(10)
Increase from origination and purchase	(13)	(2)	(11)
Decrease from maturity and sale	8	5	3
Change in impairment for Stage 1 securities	1	-	1
Effect of change in foreign currency rate	-	-	-
Closing balance	(22)	(5)	(17)
Loans and advances to banks valued at amorised cost value			
Opening balance	(1)	-	(1)
Increase from origination and purchase	(1)	-	(1)
Decrease from maturity and sale	1	-	1
Change in impairment for Stage 1 receivables	-	-	-
Effect of change in foreign currency rate	-	-	-
Closing balance	(1)	-	(1)

In 2017 the Bank did not create impairments for these assets under AA.
See definitions of State 1, Stage 2 and Stage 3 in comment 2.4.1.

Abbreviations:
AC: amortised cost value
FVOCI: valued at fair value through other comprehensive income.

4.2 Liquidity risk

Liquidity risks are managed by the Bank Group centrally through applying standard rules. The purpose of liquidity risk management is to provide access to sufficient funding with which the Bank Group is able to meet its business goals and financial obligations, at a reasonable costs, both in normal and critical operating environments. The risk management framework system was developed partly based on legal regulations and partly on the basis of guidelines defined by the Management.

The Bank Group defines its liquidity risk appetite through prime liquidity indicators and limits assigned thereto:

- In the case of short-term liquidity stress tests, meeting the minimum 30-calendar-day survival period requirement;
- Reaching the minimum level (100%) of the European Union's Liquidity Coverage Ratio (LCR);
- Reaching the minimum level (100%) of the net stable funding ratio (NSFR).

In case of certain assets, the Bank Group uses thresholds, exceeding the thresholds result in an early warning. In addition to its liquidity limit system, the Bank Group also operates a variety of monitoring mechanisms. These mechanisms support the tracking of liquidity risks, draw attention to negative trends, and enable the Bank Group to better comply with its liquidity risk profile.

Liquidity buffers provide the Bank Group with available liquidity with which it is able to cover its short-term liquidity needs which may arise in critical situations. The Bank Group carries out regular as well as case-to-case stress tests in order to assess the development of the Bank Group's liquidity in different scenarios.

The Bank Group seeks to develop a financial structure which is as independent as possible and is based to a significant extent on the collection of customer deposits. Various refinancing from banks also constitute a major part of the Bank Group's funding.

The table below shows the future maturities of financial receivables and liabilities as well as of derivative transactions on the basis of contractual maturities, or where not applicable, on the basis of the so-called deposit maturity model in relation to 31 December 2017 and 2018:

➡ Consolidated Footnotes – Risk Management

data in HUF M

Breakdown by maturity - 31 December 2018	**Perpetual/ Matured/Sight**	**within 1 month**	**1 - 3 months**	**3 months - 1 year**	**1 - 5 years**	**beyond 5 years**	**Total**
Cash and cash equivalents	48 024	10 999	-	-	-	-	**59 023**
Securities	5 341	6 124	-	24 402	261 907	9 709	**307 483**
Loans and advances to banks	4 225	2 976	-	-	-	-	**7 201**
Loans and advances to customers	81 389	38 482	43 776	208 183	311 599	142 979	**826 408**
Total	**138 979**	**58 581**	**43 776**	**232 585**	**573 506**	**152 688**	**1 200 115**
Deposits from banks	480	4 022	8 186	45 522	75 030	30 148	**163 388**
Deposits from customers	20 903	64 393	34 101	61 520	711 156	-	**892 073**
Total	**21 383**	**68 415**	**42 287**	**107 042**	**786 186**	**30 148**	**1 055 461**
Derivative financial assets	-	12 832	4 007	13 017	8 879	1 285	**40 020**
Derivative financial liabilities	2	12 563	4 095	14 495	8 222	1 435	**40 812**
Total	**(2)**	**269**	**(88)**	**(1 478)**	**657**	**(150)**	**(792)**
Undrawn lines of credit and guarantees	64 073	11 002	61 189	156 019	48 353	3 134	**343 770**

data in HUF M

Breakdown by maturity - 31 December 2017	**Perpetual/ Matured/Sight**	**within 1 month**	**1 - 3 months**	**3 months - 1 year**	**1 - 5 years**	**beyond 5 years**	**Total**
Cash and cash equivalents	28 393	70 216	-	-	-	-	**98 609**
Securities	2 557	-	5 000	54 917	133 442	13 547	**209 463**
Loans and advances to banks	4 026	4 976	2 750	-	-	-	**11 752**
Loans and advances to customers	8 724	16 682	35 911	163 142	280 639	164 204	**669 302**
Total	**43 700**	**91 874**	**43 661**	**218 059**	**414 081**	**177 751**	**989 126**
Deposits from banks	193	2 050	10 331	31 111	95 598	21 331	**160 614**
Deposits from customers	12 234	48 291	47 481	64 869	526 613	-	**699 488**
Total	**12 427**	**50 341**	**57 812**	**95 980**	**622 211**	**21 331**	**860 102**
Derivative financial assets	-	19 263	3 692	2 945	13 944	2 233	**42 077**
Derivative financial liabilities	-	19 190	3 634	2 755	13 514	3 045	**42 138**
Total	**-**	**73**	**58**	**190**	**430**	**(812)**	**(61)**
Undrawn lines of credit and guarantees	63 729	6 596	26 992	137 474	45 839	6 318	**286 948**

4.3 Interest rate risk in banking book

An interest rate risk is a risk where the value of financial instruments changes in response to the fluctuations of market interest rates. The Bank attempts to match assets with liabilities with similar interest and amortisation terms in order to minimise interest risks in relation to the Bank Group's entire balance sheet. The Bank develops the composition of its interest-bearing assets and liabilities in a way as to ensure that short-term assets are in harmony with short-term liabilities, and that the interest changes of long-term assets and the related long-term liabilities vary parallel.

While complying with the conservatively defined risk limits, the Asset-Liability Management may undertake a tactical open position if, opening a non-neutral position verifiably supports the Bank's profitability goals best and interest trends are considered long-lasting.

Based on standard yield curve stress scenarios, the Bank Group defines its acceptable interest rate risk tolerance level in line with the acceptable relative change of interest income and principal.

The table below summarises the Bank's open positions arising from interest repricing in the maturity structure of assets and liabilities as at 31 December 2018.

data in HUF M

Repricing gap table Banking book	**0 - 1 month**	**1 - 3 months**	**3 - 6 months**	**6 months - 1 year**	**1 - 2 years**	**2 - 3 years**	**3 - 4 years**	**4 - 5 years**	**beyond 5 years**
Cash and cash equivalents	59 023	-	-	-	-	-	-	-	-
Securities	11 465	-	8 382	16 020	74 447	69 456	63 255	54 749	9 709
Loans and advances to banks	7 201	-	-	-	-	-	-	-	-
Loans and advances to customers	331 397	126 763	97 239	38 195	53 270	48 412	42 946	29 981	58 205
	409 086	**126 763**	**105 621**	**54 215**	**127 717**	**117 868**	**106 201**	**84 730**	**67 914**
Deposits from banks	(17 353)	(6 951)	(39 865)	(31 508)	(25 131)	(19 661)	(10 640)	(6 733)	(5 546)
Deposits from customers	(185 321)	(76 915)	(44 180)	(41 315)	(73 854)	(122 248)	(108 223)	(240 017)	-
	(202 674)	**(83 866)**	**(84 045)**	**(72 823)**	**(98 985)**	**(141 909)**	**(118 863)**	**(246 750)**	**(5 546)**
Off-balance-sheet receivables	40 576	133 501	171 613	41 231	20 838	11 207	10 411	62 851	2 423
Off-balance-sheet liabilities	(58 047)	(144 017)	(103 600)	(23 945)	(15 376)	(30 788)	(15 130)	(63 008)	(41 291)
	(17 471)	**(10 516)**	**68 013**	**17 286**	**5 462**	**(19 581)**	**(4 719)**	**(157)**	**(38 868)**
Discrete gap	**188 941**	**32 381**	**89 589**	**(1 322)**	**34 194**	**(43 622)**	**(17 381)**	**(162 177)**	**23 500**

On 31 December 2017 open positions were as follows:

data in HUF M

Repricing gap table Banking book	**0 - 1 month**	**1 - 3 months**	**3 - 6 months**	**6 months - 1 year**	**1 - 2 years**	**2 - 3 years**	**3 - 4 years**	**4 - 5 years**	**beyond 5 years**
Cash and cash equivalents	96 832	1 777	-	-	-	-	-	-	-
Securities	22 379	20 997	39 176	15 776	47 831	11 609	34 712	2 966	14 017
Loans and advances to banks	11 752	-	-	-	-	-	-	-	-
Loans and advances to customers	222 018	132 238	73 769	48 137	53 507	42 086	35 237	34 716	27 594
	352 981	**155 012**	**112 945**	**63 913**	**101 338**	**53 695**	**69 949**	**37 682**	**41 611**
Deposits from banks	(6 166)	(11 012)	(28 619)	(19 608)	(45 056)	(21 847)	(13 269)	(7 428)	(7 609)
Deposits from customers	(135 035)	(75 641)	(34 502)	(56 157)	(89 126)	(69 410)	(49 764)	(189 853)	-
	(141 201)	**(86 653)**	**(63 121)**	**(75 765)**	**(134 182)**	**(91 257)**	**(63 033)**	**(197 281)**	**(7 609)**
Off-balance-sheet receivables	28 371	113 354	53 002	3 841	100 961	3 299	11 089	10 266	1 645
Off-balance-sheet liabilities	(51 605)	(3 994)	(82 411)	(4 634)	(126 477)	(5 190)	(26 387)	(10 067)	(14 953)
	(23 234)	**109 360**	**(29 409)**	**(793)**	**(25 516)**	**(1 891)**	**(15 298)**	**199**	**(13 308)**
Discrete gap	**188 546**	**177 719**	**20 415**	**(12 645)**	**(58 360)**	**(39 453)**	**(8 382)**	**(159 400)**	**20 694**

The Bank measures interest risks by conducting scenario analyses, as well as using stress tests. These also form part of the Bank's capital requirement calculation models under Pillar 2. The table below summarises the possible effects of financial instruments on profits/losses and capital, assuming a shift in the yield curve by 200 basis points.

data in HUF M

Sensitivity (0% floor)	**Capital sensitivity**		**Profit sensitivity**	
	+200 bp	***-200 bp***	***+200 bp***	***-200 bp***
31.12.2018				
HUF	*(1 019)*	*(1 033)*	*2 151*	*(1 591)*
EUR	*1 674*	*(151)*	*343*	*(80)*
Other currencies	*109*	*(242)*	*75*	*(119)*
31.12.2017				
HUF	8 692	(1 596)	5 929	(961)
EUR	2 987	(587)	118	(106)
Other currencies	364	(232)	176	(133)

4.4 Foreign currency risk

The Bank's goal is to minimise any non-intended end-of-day open foreign currency positions and to effectively manage intra- day position with regard to profitability criteria as well.

The Bank defines its currency risk tolerance level through limits applicable to open foreign currency positions. The Bank Group operates intraday position and stop-loss limits as well as overnight position limits in order to ensure that open held-for-trading foreign currency positions do not exceed the fixed reasonable limits.

During daily banking operations, Treasury manages foreign currency positions generated by customer transactions as well as positions opened for trading purposes by not exceeding open position risk limits.

The Bank's open positions by currencies were as follows on 31 December 2018:

data in HUF M

Currency	Balance sheet net open positions	Spot positions	Net futures positions	Net open positions by currencies
USD	(9 433)	264	9 174	5
CHF	(29)	25	-	(4)
CAD	-	-	-	-
GBP	(9)	19	-	10
DKK	(1)	-	-	(1)
SEK	(1)	-	-	(1)
NOK	10	-	-	10
AUD	22	(20)	-	2
JPY	15	-	(14)	1
RON	(4)	-	-	(4)
EUR	11 913	643	(12 582)	(26)
CZK	4	-	-	4
PLN	(54)	63	-	9

In light of the Bank's minimal open foreign exchange positions, even in the event of a material foreign currency rate fluctuation the Bank would face a low net income change.

On 31 December 2017, the Bank's open positions by currencies represented minimal risks, too:

data in HUF M

Currency	Balance sheet net open positions	Spot positions	Net futures positions	Net open positions by currencies
USD	407	272	(692)	(13)
CHF	(17)	19	-	2
CAD	13	-	-	13
GBP	(23)	19	-	(4)
DKK	6	1	-	7
SEK	2	1	-	3
NOK	25	(18)	-	7
AUD	(6)	-	-	(6)
JPY	12	-	(11)	1
RON	17	-	-	17
EUR	31 165	555	(31 742)	(22)
CZK	17	-	-	17
PLN	(67)	71	-	4

4.5 Market risk in trading book

A market risk represents the risk that the fair value of a financial instrument will fluctuate in response to changes in market prices. From among market risks, the Bank expose itself to foreign currency and interest rate risks in the trading book portfolio; however, the authorised extent of risks is restricted by stringent limits.
For the measurement of market risks the Bank employs the Value-at-Risk (VaR) method which serves to estimate the maximum expected loss for an assumed period and at an assumed confidence level. During the daily measurement of market risks, the Bank uses a 10-day, 99% VaR which indicates that the potential loss that could be sustained over a period of 10 days will not exceed the value of VaR with a 99% probability rate. An advantage of the VaR-based market risk measurement methodology is that it takes account of the volatility observed on the market as well as the diversification and correlation effects between risk types. The Bank quantifies the value of VaR with daily regularity on the basis of a variance-covariance approach, and also carries out a stressed VaR-based calculation, as part of which the covariance and correlation matrix is determined for measuring VaR on the basis of the development of prices during an earlier historical stress period.
The Bank quantifies the VaR value by risk types (foreign currency and interest rate risks) as well as for the entire trading book portfolio. The VaR of the entire trading book portfolio is below the sum of VaR values determined by risk types due to diversification effects.
The Bank checks the reliability of the VaR models monthly, as part of which the results of the daily VaR measurements are compared with the actual changes in the value of the portfolio exposed to market risks. Based on these control measurements, the Bank reviews its measurement methodology if necessary.

In addition of VaR-based market risk measurements, the Bank also monitors market risks in the trading book with other measurements. The Bank carries out daily sensitivity tests by risk types in respect of the trading book portfolio, and furthermore the trading book portfolio stress tested regularly in order to assess how the trading book portfolio would respond to market shocks.
Treasury has been authorised to hold intended overnight FX positions since March 2018, while the holding of securities positions for trading purposes has been permitted since December 2018.
The VaR relating to the trading portfolio can be summed up as follows (in HUF million)

data in HUF M

Parametric VaR (99%, 10 days) - daily average

Risk type	**2018**	**2017**
Foreign exchange	0,43	0,08
Interest rate	1,24	0,29
Total trading book VaR	1,27	0,34
Diversification	0,40	0,03

4.6 Capital management and capital requirements

The Bank prepares its capital requirement calculations in accordance with Basel III/CRR (Regulation 575/2013/EU). The purpose of the Basel III global directives identified within the EU's regulatory framework system is to create security for financial systems, to maintain appropriate capital reserve and liquidity levels whilst ensuring equal opportunities for market players, to develop appropriate risk management capabilities adjusted to each player's activities, and to cover any losses that may emerge during their operations. In Hungary the Capital Requirements Regulation (CRR) is directly in effect.

Basel III rests on three pillars: minimum capital requirements, supervisory review and market disclosure (discipline). Basel III offers three approaches, representing different levels of approach, for the calculation of credit risk capital requirements under Pillar 1. Budapest Bank calculates its capital requirement according to the standardised approach which requires banks to use external credit ratings for determining the risk weights applied to rated counterparties, classifies other counterparties into broad categories, and applies standardised risk weights to these categories. Basel III prescribes a capital requirement for operational risks.
The Bank Group identifies an operational risk tolerance limit for the assessment of internal loss data. This determines the level of financial losses arising from operational risk events which is acceptable for the Bank Group on an annual level. The Bank operates an integrated risk management system in order to explore, analyse and improve the risks and controls built into its processes. At present, for the calculation of capital requirements, the Bank employs the AMA method to determine the capital requirements related to operational risks.

Pillar 2 of Basel III (supervisory review and assessment) assesses the additional capital requirement of risks not or only partly covered under Pillar 1 with a so-called advanced measurement approach, with the involvement of supervisory regulatory agencies. The Bank Group's lead regulatory agency, the National Bank of Hungary determines and reviews capital requirements for the entire group.

Pillar 3 of Basel III relates to market discipline, and its purpose is to enhance the transparency of companies by obliging them to disclose specific, pre-defined details of their risks as well as of their capital and risk management procedures under Basel III.

According to the capital adequacy regulations, the consolidated capital adequacy ratio are as follows (in 2017 according to the Hungarian accounting standards):

data in HUF M

Basel III capital adequacy	**2017 HAS**	**2018 IFRS**
Equity		
Share capital	19 396	19 396
Reserves	119 285	134 777
Accumulated other comprehensive income	-	(121)
Intangible assets	(9 605)	(12 929)
AVA prudent valuation	(5)	(60)
Deductible deferred tax receivables	-	(65)
Tier 1 capital	129 071	140 998
	-	-
Tier 2 supplementary capital elements	-	-
Regulatory capital	129 071	140 998
Risk Weighted Assets (RWA)	670 790	818 513
Operational Risk (OR)	102 430	98 707
Market Risk (MR)	186	95
Credit valuation adjustment	1 046	1 149
Total risk weighted assets	774 452	918 464
Capital adequacy ratio	16.67%	15.35%

The Bank immediately recognised the effects of IFRS 9 impairment in its Tier 1 capital determined for regulatory purposes, not availing itself of the option of recognising the effects of IFRS 9 impairment in the Tier 1 capital over a period of several years.

5 FOOTNOTES TO BALANCE SHEET

5.1 Cash and cash equivalents

data in HUF M

	31.12.2018	31.12.2017	01.01.2017
1-day interbank deposits	11 000	9 499	19 655
1-day deposits NBH	-	39 826	65 110
Interbank money transport	-	-	-
Bank accounts	-	-	-
Securities with a term of less than 3 months upon recognition	-	20 892	-
Settlements with central bank (NBH single account)	6 337	5 976	4 993
Loans from associates		-	-
Cash	16 057	14 851	12 577
Nostro	25 630	7 565	10 661
Impairment (stage1)	(1)		
Total	**59 023**	**98 609**	**112 996**

5.2 Derivative assets

The Bank only enters into derivative OTC transactions, and measures them through profit/loss on a mandatory basis.

The Bank's open derivative transactions were as follows on 31 December 2018:

data in HUF M

Type of derivative transaction	Face value asset side	Face value liability side	Asset FMV	Liability FMV	Net position	Derivative financial assets	Derivative financial liabilities	Remaining term (years) weighted with face value
Interet rate swap	465 546	465 546	466 255	(466 623)	(368)	2 518	(2 886)	2.6
CIRS	13 959	(14 453)	14 908	(15 281)	(373)	-	(373)	7.7
Foreign exchange forward	12 212	(12 243)	12 260	(12 248)	12	42	(30)	0.5
Foreign exchange swap	12 877	(12 934)	12 874	(12 937)	(63)	53	(116)	0.1
Total	504 594	425 916	506 297	(507 089)	(792)	2 613	(3 405)	

In 2018 the Group entered into HUF-denominated interest rate swap transactions (monetary policy interest rate swap, MIRS) with the National Bank of Hungary (NBH), as part of which it receives interest at a rate which is the equivalent of the 6-month BUBOR every six months and pays fixed interest annually to the NBH. Upon the conclusion of MIRS transactions, the Group did not pay the NBH a fee. The fixed interest payable in MIRS transactions was more favourable at the time of their conclusion than the fixed interest payable in interest rate swap transactions with similar parameters available on the market. As a result, the initial fair value of these transactions was higher than their transaction price (HUF 0). The Group accounted for this gain (HUF 2,513 million) immediately upon the initial recognition of the MIRS transactions in the net income statement in the "Profit or loss of held-for-trading financial instruments" line.

The Bank's open derivative transactions were as follows on 31 December 2017:

data in HUF M

Type of derivative transaction	Face value asset side	Face value liability side	Asset FMV	Liability FMV	Net position	Derivative financial assets	Derivative financial liabilities	Remaining term (years) weighted with face value
Interest rate swap	283 548	(283 548)	284 872	(285 568)	(696)	1 202	(1 898)	2.2
CIRS	17 312	(17 265)	21 406	(20 841)	565	565	-	8.7
Foreign exchange forward	5 456	(5 486)	5 461	(5 484)	(23)	12	(35)	0.3
Foreign exchange swap	18 406	(18 310)	18 406	(18 313)	93	93	-	0.1
Total	324 722	(324 609)	330 145	(330 206)	(61)	1 872	(1 933)	

5.3 Securities

data in HUF M

	Rating	Valuation hierarchy	31.12.2018
Held-for-trading securities			**151**
Government bonds	Baa3	Level1	151
Treasury bills			
Securities valued at fair value through profit or loss on a mandatory basis*			**5 295**
Funds	N/A	Level1	3 872
Stock exchange shares	N/A	Level1	1 423
Securities valued at fair value through other comprehensive income			**43 250**
Government bonds	Baa3	Level1	26 524
Mortgage debentures	Ba3	Level2	16 680
Treasury bills			
Compensation warrants	Baa3	Level2	46
Securities valued at amortised cost value			**258 787**
Government bonds	Baa3	Level1	225 182
Mortgage debentures			
Treasury bills			
Credit institution bonds	Baa3	Level2	33 605
			307 483

"Funds" solely represent securities purchased in open-end investment funds. The Group purchased the investment units held in the year-end portfolio in money market funds on the trading day preceding the reporting date for liquidity management purposes.

The interest income of FVTPL* securities are recognised in the line "Profit or loss of financial instruments valued at fair value through profit or loss" (see section 6.5).

While in 2017 the Bank entered into small amount of repurchase transactions, in 2018 the Bank did not enter into repurchase transactions at all.

data in HUF M

	Rating	31.12.2017	01.01.2017
Government securities		**172 215**	**161 160**
Treasury bills - Held to maturity (HTM)			
Treasury bills - Available for sale (AFS)	Baa3	25 892	-
Treasury bills - Held for trading			
Government securities - Held to maturity (HTM)	Baa3	88 721	78 647
Government securities - Available for sale (AFS)	Baa3	57 602	82 513
Government securities - Held for trading			
Valuation difference of government securities		**853**	**724**
Debt-securities, including fixed-interest securities		**54 750**	**20 467**
MFB bonds held for trading			
MFB bonds for investment	Baa3	35 911	20 447
Compensation warrants	Baa3	20	20
Mortgage debentures held for trading	B1	18 819	-
Shares and other variable income securities		**2 537**	**2 385**
Shares and other variable income securities	N/A	2 537	2 385
Total securities		**230 355**	**184 736**
Treasury bills - available for sale (AFS) *	*Baa3*	(20 892)	-
Balance sheet securities		**209 463**	**184 736**

* The Group regards securities with a term of less than 3 months at the time of their purchase as cash and cash equivalents, and therefore recognises them in the cash and cash equivalents balance sheet line.

5.4 Loans and advances to banks

data in HUF M

Breakdown of loans and advances to banks	**31.12.2018**	**31.12.2017**	**01.01.2017**
Interbank placements	2 975	4 976	29 955
Margin coverage	4 213	4 020	3 023
Other	7	-	269
NBH 1-12-month deposits	-	2 750	38 335
NBH separated deposits	6	6	6
Loans and advances to banks	**7 201**	**11 752**	**71 588**

5.5 Loans and advances to customers

data in HUF M

31.12.2018

Description	Gross portfolio	Impairment Allowance	Net portfolio
Unsecured retail loans	87 920	11 313	76 607
Secured retail loans	276 265	36 438	239 827
Corporate loans and leases	514 005	13 866	500 139
Other receivables	5 984	-	5 984
Receivables valued at amortised cost value	**884 174**	**61 617**	**822 557**
Loans valued at fair value through profit or loss on a mandatory basis	3 851	-	3 851
Total loans and advances to customers	**888 025**	**61 617**	**826 408**

31.12.2017

Description	Gross portfolio	Impairment Allowance	Net portfolio
Unsecured retail loans	81 703	17 210	64 493
Secured retail loans	253 814	49 594	204 220
Corporate loans and leases	412 368	14 837	397 531
Other receivables	3 058	-	3 058
Total	**750 943**	**81 641**	**669 302**

01.01.2017

Description	Gross portfolio	Impairment Allowance	Net portfolio
Unsecured retail loans	73 691	18 261	55 430
Secured retail loans	245 898	60 906	184 992
Corporate loans and leases	366 711	18 319	348 392
Other receivables	1 648	-	1 648
Total	**687 948**	**97 486**	**590 462**

The Group recognises the loans denominated in HUF and EUR and provided for small and medium-sized enterprises (SMEs) as part of the Growth Credit Programme (GCP) among loans and advances to customers. The interest on loans provided for SMEs as part of GCP is fixed, maximum 2.5%. At the disbursement of the loans, this interest rate was more favourable than market interest rates, and therefore a difference arose between the face and the fair value of the loans upon recognition. The Group did not immediately account for this difference in the net income as it considers that the assessment of the fair value of loans to SMEs takes account of material non-observable input data (default risk of SME customers). Instead, the Group adjusted the value of GCP loans on initial recognition to be equal with the disbursed amount (minus or plus any transactions fees and charges which may form part of the effective interest).

Other receivables line includes non-banking customer receivables, advances paid and receivables from investment services in 2018, as well as receivables from investment services before 2018.

See further information on loans and impairment in Chapter 4.1 Credit risk.

Loans valued at fair value

Loans valued at fair value were only recognised according to the IFRS 9 rules in 2018; statements under AA from periods before 2018 did not include credit portfolios valued at fair value. Fair value hierarchy of the loans is Level 3. The interest income of these loans and any other changes in fair value are accounted for in the line "Profit or loss of financial instruments valued at fair value through profit or loss" (see paragraph 6.5). For further information on the valuation of loans at fair value see paragraphs 2.3.1.2 "S", 6.5 and 7.7. The Group accounts for any fair value changes in loans valued at fair value in the net income.

Loans valued at fair value through profit or loss changed as follows during 2018:

data in HUF M

Description	Level 3
Gross portfolio Opening	3 726
Of which fair value difference	*(4)*
Change in fair value difference of gross portfolio	(213)
Gross portfolio disbursement	772
Gross portfolio interest income	191
Gross portfolio repayment	(625)
Gross portfolio derecognition profit/loss	-
Reclassification to gross portfolio	-
Reclassification from gross portfolio	-
Gross portfolio Closing	**3 851**
Of which fair value difference	*(217)*

Regarding the contents of the above loans, see also comments attached to table 3.2.2.

Macro-hedged loans

The Bank reduces the interest risk of fixed-interest loans with interest swaps. At the end of 2018, a fixed-interest credit portfolio and an interest swap portfolio worth HUF 48.9 billion were matched in a hedging relationship. Fair value differences of the hedging interest swaps are stated in the "Derivatives" balance sheet (see paragraph 5.2).

31.12.2018

data in HUF M

	Face value of interest rate swaps	Fair value difference of IRSs in hedge relationships
Assets	25 891	480
Liabilities	22 965	(299)
	48 856	181

In 2018 the Bank accounted for a net loss of HUF 255 million on interest swaps in hedging relationships. In 2018 during the terms of hedging relationships, the Bank accounted for a profit of

HUF 11 million on changes in interest risks related to the hedged fixed-interest-bearing loans which are stated in the balance sheet line “Loans and advances to customers”. An unamortised sum of HUF 335 million arising from closed hedging relationships is recorded in the balance sheet line “Other assets” (paragraph 5.9).

data in HUF M

	Fix-interest loans	Interest rate swaps	Net profit/loss
Positive fair value change	1 966	1 873	
Negative fair value change	(1 955)	(2 128)	
	11	**(255)**	**(244)**

See net profit/loss effect in paragraph 6.5.

Details of lease receivables

data in HUF M

	31.12.2018	31.12.2017
Gross lease receivables		
Within 1 year	62 146	48 812
Within 1-5 years	120 171	102 914
Beyond 5 years	8 437	5 121
Total	**190 754**	**156 847**
Present value of minimum lease payment		
Within 1 year	55 635	43 251
Within 1-5 years	111 249	95 713
Beyond 5 years	7 900	4 879
Total	**174 784**	**143 843**
Unearned revenues	15 970	13 004
Non-guaranteed residual value	17 063	12 568

The Group as lessor only has finance leases, though from a legal point of view it is engaged in both operating and finance lease activities (open-end and closed end finance leases).

- Closed-end finance lease: During the term, ownership of the asset remains with the Lessor. At the end of the term, upon the payment of the last lease fee, the Lessee automatically acquires title to the leased asset.
- Open-end finance lease: During the term, ownership of the asset remains with the Lessor; however, at the end of the term the Lessee is free to decide whether to exercise its pre-

emptive right and to acquire title to the leased asset through the payment of the residual value, or to exercise the right of appointing a buyer and the leased asset is sold at the residual value directly to a third party, or to return the leased asset to the Lessor.

Lease transactions are denominated in HUF and EUR. The term of the portfolio ranges between 12 and 120 months; weighted average term: 53 months.

The Company's lease agreements do not include lease (rental) fees that are subject to performance indicators on the lessee's part.

5.6 Investments in subsidiaries, joint ventures and associates

At present, the Bank has investments in the following three subsidiaries which constitute the Bank Group together with the Bank. See detailed introduction of subsidiaries in Chapter 1.2.

The Bank itself established all its subsidiaries holding 100% stakes in each, no initial goodwill was generated, and the cost value of the investments is fully eliminated in the consolidated books.

data in HUF M

Name	Vote %	Equity	Share capital	Current-year comprehensive income	Total assets
Budapest Lízing Zrt	100%	10 117	62	1 697	120 375
Budapest Alapkezelő Zrt	100%	4 179	500	2 686	4 349
Budapest Eszközfinanszírozó Zrt	100%	2 140	11	(39)	5 756

5.7 Property, plant, equipment and intangible assets

The gross value and amortisation of the Bank's tangible assets were as follows during 2017 and 2018:

Data in HUF M

Changes during 2017	Properties	IT equipment	Other	Total
Cost value				
Opening balance on 1 January	**9 465**	**5 417**	**7 067**	**21 949**
Purchase and own production	461	561	1 061	2 083
Reclassification	(7)	5	2	-
Sales, derecognitions	(99)	(208)	(801)	(1 108)
Balance at the end of reporting period	**9 820**	**5 775**	**7 329**	**22 924**
Depreciation				
Opening balance on 1 January	**4 059**	**4 015**	**4 661**	**12 735**
Depreciation	573	719	680	1 972
Sales, derecognitions	(49)	(203)	(621)	(873)
Reclassifications	3	(2)	(1)	-
Balance at the end of reporting period	**4 586**	**4 529**	**4 719**	**13 834**
Book value				
Net opening balance on 1 January	**5 406**	**1 402**	**2 406**	**9 214**
Net balance at the end of period	**5 234**	**1 246**	**2 610**	**9 090**

Changes during 2018	Properties	IT equipment	Other	Total
Cost value				
Opening balance on 1 January	**9 820**	**5 775**	**7 329**	**22 924**
Purchase and own production	591	912	1 248	2 751
Reclassification	-	(1)	1	-
Sales, derecognitions	(2)	(153)	(832)	(987)
Balance at the end of reporting period	**10 409**	**6 533**	**7 746**	**24 688**
Depreciation				
Opening balance on 1 January	**4 586**	**4 529**	**4 719**	**13 834**
Depreciation	530	776	749	2 055
Sales, derecognitions	(1)	(147)	(663)	(811)
Reclassifications	-	(1)	1	-
Balance at the end of reporting period	**5 115**	**5 157**	**4 806**	**15 078**
Book value				
Net opening balance on 1 January	**5 234**	**1 246**	**2 610**	**9 090**
Net balance at the end of period	**5 294**	**1 376**	**2 940**	**9 610**

The Bank has no self-constructed assets or properties; no expenses incurred for this purpose. At the end of 2018, the Bank had contractual obligations worth of HUF 172 million for the purchase of property, plant and equipment.

Intangible assets include software and rights representing assets.

31.12.2018 data in HUF M

	Software	Rights representing assets	Total
Gross	35 161	164	35 325
Accumulated amortisation	(22 237)	(159)	(22 396)
	12 924	**5**	**12 929**

31.12.2017

	Software	Rights representing assets	Total
Gross	29 849	159	30 008
Accumulated amortisation	(18 440)	(159)	(18 599)
Net value	**11 409**	**0**	**11 409**

01.01.2017

	Software	Rights representing assets	Total
Gross	25 729	159	25 888
Accumulated amortisation	(16 239)	(159)	(16 398)
Net value	**9 490**	**0**	**9 490**

In 2017 and 2018 the Bank did not account for expenditures for research and development purposes. At the end of 2018, the Bank had contractual obligations worth HUF 2,094 million for the procurement of software. There is no collateral or any other restriction on the Bank's properties, plants, equipment and intangible assets restricting its ownership rights.

5.8 Tax receivables and tax liabilities

The Bank Group's individual subsidiaries closed their financial years with individual tax receivable or tax liability positions which were not netted in the consolidated balance sheet. The net tax positions changed as shown in the movements table below, also with regard to the deferred tax effect of the IFRS 9 transition on 1 January 2018.

data in HUF M

	31.12.2018	01.01.2018	31.12.2017	01.01.2017
Development of deferred tax portfolio				
Deferred tax receivables(+) / liabilities(-) portfolio				
Opening	296	652	726	726
Current-year change	(64)	-	(74)	-
Closing	232	652	652	726
Effect of IFRS 9 transition (accounted for in retained earnings)	-	(356)	-	-
Closing	232	296	652	726
Deferred tax from securities valued at fair value through OCI				
Opening	(115)	(77)	(65)	(65)
Created in current-year	186	-	(12)	-
Reclassification to current-year profit/loss	(58)	-	-	-
Closing	13	(77)	(77)	(65)
Effect of IFRS 9 transition	-	(38)	-	-
Closing	13	(115)	(77)	(65)
Total deferred tax	**245**	**181**	**575**	**661**
Deferred tax receivables(+) / liabilities(-)	245	181	575	661
Actual income tax receivables(+) / liabilities(-)	865	827	827	1 805
Balance sheet net tax receivables	**1 110**	**1 008**	**1 402**	**2 466**
Balance sheet tax receivables(+)	1 111	1 009	1 424	2 480
Balance sheet tax liabilities(-)	(1)	(1)	(22)	(14)
Balance sheet net tax receivables	**1 110**	**1 008**	**1 402**	**2 466**

See summary of transition effects in paragraphs 3.1.5 and 3.2.1.

5.9 Other assets

data in HUF M

	31.12.2018	31.12.2017	01.01.2017
Tax and tax-type items	1 476	1 485	2 326
Deferral of revenues	1 193	5 281	4 990
Deferral of costs and expenditures	764	526	357
Euronet settlement account	1 973	2 052	2 020
Card settlement accounts	745	1 184	325
Inventories	67	46	146
Impairment of inventories	(33)	(30)	(121)
Clearing accounts	189	18	14
Settlement account related to retail housing loans	490	308	126
Settlements with customers and suppliers	-	714	305
Finance lease settlement accounts	1 401	3 210	797
Other assets	1 816	2 992	3 126
Other impairment	(295)	(232)	(448)
Change in fair value of secured items during portfolio hedging transactions relating to interest rate risks	335	-	-
Investments in other enterprises	236	240	241
	10 357	**17 794**	**14 204**

In compliance with the regulatory reports to NBH, settlements with customers and suppliers were transferred to the line “Loans and advances to customers -other receivables” in 2018.

Repossessed assets – primarily in connection with lease activities – are carried in the inventories:

data in HUF M

	31.12.2018	31.12.2017	01.01.2017
Gross value of repossessed assets	49	39	125
Impairment of repossessed assets	(33)	(28)	(119)
Gross value of other inventories	18	7	21
Impairment of other inventories	-	(2)	(2)
	34	**16**	**25**

Impairment accounted for in respect of assets repossessed in 2018	(10)
Impairment accounted for in respect of assets repossessed in 2017	-

Investments in other enterprises on 31 December 2018.

data in HUF M

Name of enterprise	Head office	Purchase value	Voting %
Garantiqa Hitelgarancia Zrt	H-1082 Budapest, Kisfaludy utca 32	190	2.42%
Kisvállalkozás-fejlesztő Pénzügyi Zrt	H-1052 Budapest, Szép u. 2	50	1.14%
Swift	Avenue Adele 1 B 1310 La Hulpe Belgium	7	0.02%

5.10 Deposits from banks

data in HUF M

	31.12.2018	31.12.2017	01.01.2017
Refinancing funding - NBH	61 075	92 956	114 082
Refinancing funding - Other banks	47 896	28 518	31 902
Refinancing funding - Mortgage banks	34 187	20 940	3 655
Interbank funding	3 652	18 007	1 400
Deposits from MFB	16 109	-	242
Deposits from other banks	469	193	2
	163 388	**160 614**	**151 283**

Pledged assets supplied by the Bank as collateral amounted to HUF 83,176 million of securities and HUF 16,877 million of receivables on 31 December 2018.

The Company recognises the refinancing funding received from the NBH with 0% interest as part of the Growth Credit Programme (GCP) in deposit to banks.

5.11 Deposits from customers

data in HUF M

	31.12.2018	31.12.2017	01.01.2017
Retail deposits	276 401	228 078	216 012
Corporate deposits	546 496	442 279	458 022
Deposits frominvestment funds	39 163	14 350	795
Investment services settlement accounts	20 095	11 901	8 499
Suppliers	6 402	-	-
Other customers	3 516	2 880	932
	892 073	**699 488**	**684 260**

In compliance with the regulatory reports to NBH, suppliers payables were transferred to the line “Deposits from customer” from “Other liabilities” in 2018.

5.12 Provisions

On 31 December 2018 the following provisions were accounted for the off-balance-sheet contingent liabilities:

data in HUF M

	Gross	Provisions
Contingent liabilities		
Undrawn lines of credit and guarantees	343 770	953
Other contingent liabilities (including lawsuits)	1 393	1 292
Total contingent liabilities	**345 163**	**2 245**

The following table represents the portfolio of provisions as at 1 January 2018.

data in HUF M

	Gross	Provisions
Contingent liabilities		
Undrawn lines of credit and guarantees	286 948	871
Other contingent liabilities (including lawsuits)	1 865	1 739
Total contingent liabilities	**288 813**	**2 610**

Amounts stated as “gross” represent the maximum available credit line or the maximum amount payable by the Group in connection with financial guarantee contracts. In the case of other contingent liabilities, the “gross” amount is the estimated maximum amount payable by the Group.

The Bank rates and creates provisions for its few litigations of significant amounts individually. The Bank makes provisions in the amount of the expected loss for litigations where the likelihood of a negative outcome is more than 50%. Litigations take typically several years to conclude.

5.13 Other liabilities

data in HUF M

Breakdown of other liabilities

	31.12.2018	31.12.2017	01.01.2017
Monthly accruals of costs	2 095	1 950	2 074
Credit card overpayments	3 096	3 375	2 662
Clearing accounts	5 742	3 019	2 970
Settlements with customers and suppliers	-	5 353	6 155
Tax and tax-type items	2 073	1 947	1 937
Card settlement accounts	901	6	4
Other	7 664	8 882	8 415
	21 571	**24 532**	**24 217**

In compliance with the regulatory reports to NBH, settlement with customers and suppliers were transferred to the line “Deposits from customer-other customer” in 2018.

5.14 Share capital

There was no change in the share capital in 2018.

data in HUF M

Description	Face value (HUF)	Number of shares	Value (HUF M)
Opening balance 01.01.2018	1000	19 395 945	19 396
Subject-year change	-	-	-
Closing balance 31.12.2018	1000	19 395 945	19 396

The Bank’s issued capital consists of ordinary registered shares each with face value of HUF 1,000, 100% of which are held by Corvinus Nemzetközi Befektetési Zrt (see Chapter 1.1)

Description	Share type	Face value (HUF)	Number of shares	Value (HUF M)
Ordinary shares	registered	1 000	19 395 945	19 396

5.15 Reserves

The accumulated other comprehensive income in 2018 was generated in relation to securities:

	data in HUF M **2018**
Opening valuation difference of securities valued at fair value through other comprehensive income	1 168
Effect of interim purchases and exchange rate changes	(2 056)
Derecognition due to maturity	(5)
Net amount transferred to profit/loss due to sale	646
Effect of deferred tax	127
Accumulated other comprehensive income closing	**(120)**

6 FOOTNOTES TO PROFIT AND LOSS ACCOUNT

6.1 Net interest income

data in HUF M

Interest income	31.12.2018	31.12.2017
Cash and cash equivalents	97	81
Securities valued at fair value through comprehensive income	773	3 142
Securities valued at amortised cost value	2 984	2 714
Loans and advances to banks valued at amortised cost value	1 012	373
Loans and advances to customers valued at amortised cost value	28 809	30 500
Interest income related to leases	2 947	2 665
Default interest income	1 246	680
Interest income	**37 868**	**40 155**

Interest expense	31.12.2018	31.12.2017
Deposits from banks valued at amortised cost value	(448)	(349)
Deposits from customers valued at amortised cost value	(457)	(556)
Interest expense	**(905)**	**(905)**
Net interest income	**36 963**	**39 250**

The above interest income and expenses were accounted for with the effective interest rate method, see paragraph 2.2 D. In case of FVTPL financial assets where interest is calculated differently, interest income and expense are not stated in the interest income and expense line, but in the line ”net income/(loss) from financial instruments valued at FVTPL.

6.2 Net commission and fee income

data in HUF M

Fee and commission income	**31.12.2018**	**31.12.2017**
Fee and commission income related to funds	4 552	4 523
Fee and commission income from current account and savings products	26 148	23 879
Fee and commission income from credit products	4 691	5 727
Customer conversion income (trade income)	4 552	3 816
Fee and commission income	**39 943**	**37 945**
Fee and commission expense	**31.12.2018**	**31.12.2017**
Trading and other commissions	(392)	(411)
Bank card and credit card commissions	(4 495)	(5 043)
Commissions related to account keeping and loans	(1 170)	(1 674)
Fee and commission expense	**(6 057)**	**(7 128)**
Net fee and commission income	**33 886**	**30 817**

6.3 Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)

data in HUF M

Description	**31.12.2018**	**31.12.2017**
Credit institutions FVTOCI - foreign exhange gains/losses	23	-
Credit institutions AC- foreign exhange gains/losses	-	(9)
Government bonds FVTOCI - foreign exhange gains/losses upon derecognition	(670)	(615)
Government bonds AC - foreign exhange gains/losses upon derecognition	(183)	(794)
Other shares - foreign exhange gains/losses upon derecognition	7	-
Sale of own receivables	2 700	363
Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)	1 877	(1 055)

See definitions and contents of the abbreviations in paragraphs 2.3.1.-3. Upon derecognition (typically in the event of sale), in every instance the Bank transfers the fair value differences accounted for in other comprehensive income to the current year profit/loss in this line.

Sale of receivable represent the net profit/loss of default loans sold on the collections market.

6.4 Net trading income/(losses)

data in HUF M

Description	31.12.2018	31.12.2017
Interest rate swap	1 312	(953)
CIRS	(781)	529
Foreign exchange swap	(625)	133
Foreign exchange forward	144	(25)
Total	**50**	**(316)**

The Bank enters into OTC derivative transactions valuing through profit or loss on a mandatory basis. Interest rate swaps also include the fair value effect of preferential-interest rate transactions concluded with the central bank ("MIRS") which the Bank recognised immediately upon deal conclusion.

As part of the Market Credit Programme ("NHP") launched by the NBH in 2016, the Bank concluded interest rate swap transactions (HIRS) amounting to HUF 95,990 million, with maturity in February 2019. As HIRS transactions are designed to improve lending activity and were offered by the NBH under preferential terms compared with the relevant market terms, the market value of HIRS transactions at the time of the conclusion of the contracts qualifies as a state subsidy under IAS 20. The Bank has fulfilled the criteria of increase in lending activity. The Bank accounted for the initial market value of HIRSs pro rata up to the end of the term as trading income (HUF 973 million in 2018). The balance of the initial deferred profit amounted to HUF 157 million as at 31 December 2018.

6.5 Net income /(loss) from financial instruments valued at FVTPL

data in HUF M

Description	31.12.2018	31.12.2017
Interest of non-trading financial assets valued at fair value through profit or loss on a mandatory basis	191	-
Fair value of non-trading financial assets valued at fair value through profit or loss on a mandatory basis	(301)	4
Net profit/loss of hedging transactions	(244)	324
Total	(354)	328

The fair value of financial assets arises from the fair value adjustments of HUF 213 million related to loans valued at fair value (see paragraph 5.5) and of HUF 88 million accounted for shares and funds quoted at stock exchange.

See further information on credit-related hedging transactions in Chapters 5.5 and 2.4.3.

6.6 Other operating income and expenses

data in HUF M

Detailed account of other operating income	31.12.2018	31.12.2017
Insurance	1 533	1 202
Other	490	765
Adjustments from previous year	2 695	2 054
Intermediary activities	483	204
Recharges	296	377
Other operating income	**5 497**	**4 602**

Detailed account of other operating expenses	31.12.2018	31.12.2017
Bank levy	(2 071)	(1 744)
Other	(987)	(1 409)
Damages, fines	(386)	(347)
Mandatory membership fees	(2 002)	(1 951)
Non-deductible VAT	(1 509)	(1 529)
Transaction duty	(12 076)	(10 940)
Other operating expenses	**(19 031)**	**(17 920)**
Net other profit/loss	**(13 534)**	**(13 318)**

6.7 Administrative expenses

data in HUF M

Personnel expenses	31.12.2018	31.12.2017
Salaries	(20 070)	(18 587)
Salary taxes	(4 941)	(5 012)
Other payments to personnel	(1 331)	(1 354)
Personnel expenses	**(26 342)**	**(24 953)**

Other administrative expenses	31.12.2018	31.12.2017
Facility management expenses	(4 230)	(3 861)
IT expenses	(3 653)	(3 244)
Marketing expenses	(2 433)	(2 095)
Communication expenses	(1 123)	(1 103)
Expert fees	(1 057)	(924)
Expenses of services used	(957)	(1 065)
Other adminstrative expenses	(2 241)	(1 582)
Other administrative expenses	**(15 694)**	**(13 874)**
Administrative expenses	**(42 036)**	**(38 827)**

Staff (number of persons)	2 952	2 911

6.8 Depreciation and amortisation

data in HUF M

Breakdown of depreciation of tangible assets	31.12.2018	31.12.2017
Properties	(530)	(573)
IT equipment	(776)	(719)
Other	(749)	(680)
Depreciation of tangible assets	**(2 055)**	**(1 972)**

Breakdown of depreciation of intangible assets	31.12.2018	31.12.2017
Intangible assets	(3 800)	(2 632)
Depreciation of intangible assets	**(3 800)**	**(2 632)**
Depreciation and amortisation	**(5 855)**	**(4 604)**

6.9 Net (impairment loss)/ reversal of impairment loss on financial assets & provision

data in HUF M

Description	31.12.2018
Impairment (loss) / release related to lending	1 187
Net effect of cancellations and write-offs of loans	943
Provisions (made) / released	370
Impairment for other financial instruments	(30)
Total	**2 470**

6.10 Income tax expense

data in HUF M

	31.12.2018	31.12.2017
Actual tax expenditures		
corporate tax	345	213
local trade tax	1 632	1 639
innovation contribution	236	236
	2 213	**2 088**
Adjustments accounted for actual tax expenditures of earlier periods		
corporate tax	147	241
local trade tax	(4)	-
innovation contribution	-	-
	143	**241**
Deferred tax expenditures(+) / revenues(-)		
Current-year	103	74
adjustment of earlier periods	-	-
	103	**74**
Deferred tax write-off(+) / reversal(-)		
write-off	-	-
reversal	-	-
	-	**-**
Deferred tax on accrued losses not recognised earlier	**(40)**	**-**
Income tax expense	**2 419**	**2 403**

Analysis of effective tax rate

➡ Consolidated Footnotes – Profit and Loss Account

data in HUF M

	31.12.2018	31.12.2017
Pofit before income tax (a)	14 958	16 842
Tax expected on the basis of pofit before income tax [*9%]	1 346	1 516
local trade tax effect (current year and previus year's)	1 628	1 639
innovation contribution effect (current year and previous year's)	235	236
previous year's corporate tax effect	147	241
previous year's deferred tax effect	-	-
effect of permanent differences	(504)	(498)
effect of deferred tax write-off, reversal	-	-
effect of accrued loss not recognised as deferred tax	(40)	-
tax relief effect	(496)	(857)
other effects (due to consolidation)	103	126
Income tax expense	**2 419**	**2 403**
Income tax expense recognised in profit and loss account (b)	**2 419**	**2 403**
Effective tax rate (on total income tax) [b/a]	**16.17%**	**14.27%**

7 OTHER INFORMATION

7.1 Financial indicators

		2018		2017	
Profitability ratios					
Profit margin	Profit for the year / Total revenues[1]	12 539 / 83 308	= 15.05%	14 439 / 82 702	= 17.46%
ROA	Profit for the year / Closing assets	12 539 / 1 236 735	= 1.01%	14 439 / 1 030 715	= 1.40%
ROE (1)	Profit for the year / Equity	12 539 / 154 052	= 8.14%	14 439 / 141 824	= 10.18%
ROE (2)	Profit for the year / Share capital	12 539 / 19 396	= 64.65%	14 439 / 19 396	= 74.44%
Capitalisation ratio:					
Capital leverage ratio	Total assets / Equity	1 236 735 / 154 052	= 8.03%	1 030 715 / 141 824	= 7.27%
Coverage ratio:					
Credit in % of deposits	Total loans and leases / Total deposits	833 609 / 1 055 461	= 78.98%	681 054 / 860 102	= 79.18%
Efficiency ratios:					
Income per capita	Profit for the year / Average staff	12 539 / 2 952	= 4.25	14 439 / 2 911	= 4.96
Costs/net revenues ratio	Costs[2] / Net revenues[3]	42 036 / 70 849	= 59.33%	38 827 / 70 067	= 55.41%

The values used for the calculation of indicators are stated in HUF million.
Comments:

1- Total revenue: interest income, dividend income, commission and fee income, other operating income.
2- Costs: payments to personnel, other administrative expenses.
3- Net revenues: net interest income, net commission and fee income.

7.2 Payments to members of Board of Directors and Supervisory Board for 2018 business year

Description	Persons receiving remuneration (persons)	Amount of remuneration (HUF M)
Board of Directors	7	24
Supervisory Board	6	14
Total	**13**	**38**

7.3 Loans provided for members of Board of Directors, Management and Supervisory Board

data in HUF M

Description	Disbursement	Amortisation	Outstaning debt on 31 December 2018	Material terms and conditions
1. Interest-free employer loans				long-term loan,
- Board of Directors	-	-	-	mortgage on property
- Supervisory Board	-	-	-	property collateral
1. Total:	**-**	**-**	**-**	
2. Preferential housing loans				long-term loan,
- Board of Directors	-	-	-	mortgage on property
- Supervisory Board	7.00	(3.17)	3.83	property collateral
2. Total:	**7**	**(3)**	**4**	
3. Mortgage loans				long-term loan,
- Board of Directors	25.00	(2.31)	22.70	mortgage on property
- Supervisory Board	-	-	-	property collateral
3. Total:	**25**	**(2)**	**23**	
4. Personal loans				
- Board of Directors		-		long-term loan,
- Supervisory Board	-	-	-	no collateral
4. Total:	**-**	**-**	**-**	
Grand total:	**32**	**(5)**	**27**	

Members of the Board of Directors and the Supervisory Board have total overdraft facilities worth of HUF 1,510,000 and credit card lines worth of HUF 3,000,000 to which the Bank's standard contractual terms and conditions apply.

7.4 Severance pay of executives in key positions

The following benefits were paid to executives in key positions following the termination of their employment:

data in HUF M

	31.12.2018	31.12.2017
Severance pay	103	211

7.5 Terms and conditions of loans provided for subsidiaries

Company	Currency	Term	Interest rate 2018
Budapest Lízing Zrt	HUF-EUR-USD	2-3 years	0.37% - 2.67%
Budapest Eszközfinanszírozási Zrt	HUF-EUR-USD	2-3 years	0.30% - 2.60%

Company	Currency	Term	Interest rate 2017
Budapest Lízing Zrt	HUF-EUR-USD	2-3 years	0.01% - 1.78%
Budapest Eszközfinanszírozó Zrt	HUF-EUR-USD	2-3 years	0.01% - 1.78%

7.6 Related parties

In 2017 and 2018 the Bank did not enter into business relations with its owner, the Corvinus Zrt.

7.7 Fair value hierarchy of financial instruments not valued at fair value

In the table below is included the fair value of financial assets, in the case of which the Management concluded that the book value is a good approximation of the fair value.

Financial instruments	Reasoning
Cash and cash equivalents	Quick turnover, low risk of change in fair value
Loans and advances to banks	Short term, variable interest
Deposits from customers	Mainly short term, also includes settlements with suppliers
Other assets	Short term
Other liabilities	Short term

data in HUF M

Description	31.12.2018			31.12.2017		
	Book value	Fair value	Level	Book value	Fair value	Level
Securities, of which:	258 787	262 285		124 632	126 152	
Securities valued at L1	*225 182*	*227 970*	L1	*88 721*	*89 280*	L1
Securities valued at L2	*33 605*	*34 315*	L2	*35 911*	*36 872*	L2
Loans and advances to customers	826 408	826 941	L3	669 302	669 009	L3

In case of securities, values are based on fair market prices for transactions with an active market.

The Bank uses the technique of discounted cash flow calculation for determining the fair value of Loans and advances to customers. Exceptions to this rule are sight receivables where the fair value equals to the book value, as well as non-performing transactions where the fair value is the net book value.

7.8 Future minimum payment of non-terminable operating leases

data in HUF M

Due date of future lease fees	Amount
Within 1 year	2 077
1 - 5 years	2 148
Beyond 5 years	24
Total	**4 249**

The Bank Group as lessor had no non-terminable operating lease receivables.

7.9 Subsequent events

In order to meet the commitment made to the European Bank for Reconstruction and Development, the Government requested the Minister of National Assets Management to start negotiations with the potential financial institutions for the purchase of the State's indirect majority stake in Budapest Bank for a consideration reaching or exceeding the purchase price paid by Corvinus Zrt.

8 BUSINESS REPORT OF THE MANAGEMENT

8.1 General introduction

Budapest Bank Group

Budapest Bank was established in 1987 as one of the very first domestic commercial banks. It is a key player of the Hungarian banking market, one of the eight domestic large banks. On 29 June 2015 the Bank Group was transferred to state ownership: Corvinus Nemzetközi Befektetési Zrt purchased a 100 per cent stake in Budapest Bank Zrt from GE Capital. The Bank Group's other members are the subsidiaries owned by the Bank 100 per cent: Budapest Alapkezelő Zrt, Budapest Lízing Zrt and Budapest Eszközfinanszírozó Zrt.

Managers of Budapest Bank

Name	Organisational unit	Position
Dr. Koppány Lélfai	Office of the Chief Executive	Chief Executive Officer and Chairman of the Board
Viktor Tóth	Office of the Chief Executive	Deputy Chief Executive Officer for Corporate and Retail Sale
András Puskás	Office of the Chief Executive	Deputy Chief Executive for Operations, Risk, and IT
Dr. Krisztián Németh	Legal and Compliance	Head of Legal and Compliance
Dr. Kornél Barna	Office of the Chief Executive	Head of Chief Executive's Cabinet
Ferenc Alföldi	IT	Head of IT
Frigyes Lasetzky	Operations	Head of Operations and Quality
Péter Nyulasi	Risk Management	Head of Risk Management
Imre Szabó	Internal Audit	Head of Internal Audit
Dr. Csaba Sándor	HR and Communications	Head of HR and Communications
Keresztyénné Katalin Deák	Finance	Head of Finance
László Somodi	Bank Security and Facility Management	Head of Bank Security and Facility Management

Bank's auditor: KPMG Hungária Kft and István Henye as registered chartered auditor. In addition to the annual audit, KPMG performed the following audit jobs during the course of 2018: mandatory compliance audit of mortgage loans offered for refinancing, and a statutory audit of the IFRS transition of the Bank's account as requested by the NHB.

8.2 Results of 2018 business year

Budapest Bank continued its self-financing business model in 2018. At the end of 2018, the deposit portfolio accounted for 72% of the Bank Group's total funding, while refinancing funding (including deposits from banks) accounted for 13%. While total assets increased 20%, deposits increased by 28%, and refinancing funding by 2%.

Other deposits are comprised of the Fund managers' deposit portfolios, the Investment services settlement accounts and NFA deposits (NFA: National Land Fund Management Organisation, which provides deposits temporarily for the Bank). Within corporate deposits, parallel with a decrease in BUBOR, the percentage of sight deposits increased further (from 81% to 84%).

The composition of refinancing funding has significantly restructured. The weight of the Growth Credit Programme ("NHP") as refinancing funds decreased (from 58% to 37%). This decrease was offset by a rise in mortgage debentures refinancing from 11% to 20% due to compliance with the Mortgage Funding Adequacy Ratio ("JMM ratio") and the EUR funding worth HUF 15 billion raised from MFB in the interest of stable compliance with the Foreign Exchange Funding Adequacy Ratio ("DMM ratio"). The ratio of Interbank and other refinancing sources did not change.

In 2018 the Bank Group's retail credit portfolio achieved a core growth: based on the gross credit portfolio, there was an 8% year-to-year increase. Within this, mortgage loans increased by 10%, unsecured loans by 5%, while the portfolio of automobile finance was 7% higher than the December 2017 closing portfolio. At the same time, the Bank launched loan sales and portfolio cleansing activities which achieved significant results in 2018.

The mortgage lending increased above the market growth rate: the new volume exceeded that of the previous year by 69%.
This is due to several reasons, including a review of the process of mortgage lending (as part of which credit assessment times were significantly reduced); a more intensive marketing activities compared with the year before; the Bank Group's unique, flagship, preferential-interest credit product (Egyenlítő Product), and the excellent position achieved with third-party sales partners.

Regarding credit card products, the Bank Group targeted an intensively growing market share: it issued almost 80,000 new credit cards. Strategic partnership cooperation with the store chains Tesco, Media Markt and Euronics played a key role in new issuances.
The new volume of personal loans increased by 50% compared with the year before. Expansion was supported – in addition to a sector-level increase – by intensive marketing activities and the reinforcement of credit replacement products.

The volume of new automobile loans increased by 34% on a year-to-year basis. Nearly 70% of the new volume originated in the corporate segment.

As a new strategic initiative launched in 2016, Budapest Bank Group takes part in the state land sale programme coordinated by the NFA. The Bank Group's role consists of two banking services provided on a market basis: as custodian it receives escrow funds from farmers who intend to submit bids, and later, in the capacity of intermediary, it manages the applications of awarded bidders for land loans provided by MFB Bank and handles the disbursement of loans. The Bank Group successfully closed the contract conclusion phase of the MFB-GCP Land Purchase Credit Programme in March 2017. In

2018 the Bank Group realised significant commission revenues in connection with the NFA programme.

Budapest Bank's corporate division, which primarily focuses on serving domestic small and medium-sized businesses, successfully took advantage of the period of economic prosperity, and despite extremely keen pricing and risk competition, increased its portfolio by almost 25%; both its gross corporate credit and lease portfolios increased by 25%. Besides the background of favourable macro-economic processes, the expansion of lending was supported by the nation-wide sales network and intensive sales activities.

The Bank Group also managed to improve its positions in transaction banking: in the field of newly opened accounts, the Bank Group achieved the second position among its competitors. Foreign currency conversion activities are assisted by the new arrangement that Treasury activities were transferred to the corporate division, and as a result, there is even closer cooperation between the two units.
The corporate strategy continues to focus on the SME segment accounting for almost 79% of its loan portfolio. In 2018 there was a minor increase in the percentage of the segment of large corporates (from 18% to 21%).

The Bank Group has taken part in the operation of MFB points created for the allocation of MFB EU funds since 2016. In 2018 the Group realised commission revenues in connection with the MFB points; at the same time, the MFB points provide further significant customer acquisition potential.

The Bank Group continues to make emphasis on technological innovations: the senior management created a Digital Strategy and appointed a digital manager. This year the Bank appeared on the market with several new digital services; the launch of Budapest Bank's Mobile Payment service was an important milestone in the implementation of its digital strategy. The goal of this service is to further improve the quality of customer experience, thereby enabling the Bank to positively distinguish itself on the market.

At the end of last year, Budapest Bank Group's network consisted of 96 branches. The branches located in the territory of Budapest qualify as establishments, while the branches operating outside of Budapest qualify as branch offices.
In accordance with the statutory regulations, a Works Council is operational at the Bank Group. Employment policy decisions are made at all times in agreement with the Works Council.

During the demerger process from GE, in addition to establish self-funding, another great challenge the Bank Group faced was the replacement of the various systems supplied by GE. The last major demerger project, the card system transition was successfully implemented in 2018.

8.3 Asset quality and portfolio

In 2018 the Bank Group's total assets increased significantly, from HUF 1,031 billion to HUF 1,237 billion. Liquid assets, low-risk government securities and loans to banks amounted to HUF 371 billion on 31 December 2018. This sum represents 30% of the total assets.

The net portfolio of loans provided for customers (lending) increased significantly and amounted to HUF 826 billion by the end of 2018. During 2018 the Bank Group continued to place the main business emphasis on the portfolio of small and medium-sized enterprises. Similar to the year before, the Bank achieved second place among large banks as regards the number of newly-opened SME accounts, by taking advantage of the cross-selling opportunities offered by MFB points. The Bank's corporate credit portfolio placed with small and medium-sized enterprises, calculated without impairment and including leases, amounted to HUF 514 billion which demonstrates the key role of this segment in the Bank's strategy.

The Bank's retail credit portfolio reached a significant level of HUF 368 billion, excluding impairment.

During 2018, the amount of allowances made for loan impairments decreased significantly, from HUF 81 billion to HUF 61 billion in consequence of the improving portfolio quality which, on the whole, represented a 6.9% allowance / gross receivables coverage ratio at the end of 2018.

The Bank made all the required impairment allowances and provisions.

8.4 Asset-liability structure and liquidity

The Bank's foreign currency-based placements and liabilities decreased significantly in 2015 due to the mandatory statutory forint conversion of mortgage and automobile loans.

19% of the total assets are denominated in foreign currency (20% in 2017); the majority of foreign currency assets are denominated in EUR, USD and CHF.

18% of the total liabilities (17% in 2017) are denominated in foreign exchange; the majority of foreign liabilities, too, are denominated in EUR, USD and CHF.

Due to the Bank's risk-avoiding business policy, foreign exchange fluctuations can affect the Bank only to a moderate degree in the absence of material open foreign exchange positions. The Bank did not have material open foreign exchange positions at the end of the year.

The Bank continues to have an outstandingly highly-liquid asset portfolio, and as a result, it is in a long-term interbank lending position on the Hungarian money market. Cash and equivalents, Loans to banks and securities account for some 30% of the total assets. Its total assets maturing within a year amounted to HUF 474 billion; by contrast, liabilities maturing within a year amounted to HUF 239 billion which represents a HUF 235 billion positive net asset surplus position in this segment.

By using a risk-avoiding pricing, the Bank managed interest rate risks, arising from the different repricing of assets and liabilities, at a pre-defined level. The Bank continuously monitors interest rate risks on a transactional level for the entire balance sheet, and assesses them with stress tests. Since 2016, in order to reduce the interest rate risks of the increasing portfolio of fixed-interest assets (both securities and individual loans), the Bank has concluded interest rate swap transactions.

On the whole, Budapest Bank maintained a very high level of liquidity, cash flow and interest rate management practice throughout the year.

8.5 Capital position

In 2015 there was a change of owners at Budapest Bank. Corvinus Nemzetközi Befektetési Zrt proceeding on behalf of the State became the 100% owner. The change of owners did not affect the Bank Group's stable capital position; its issued capital amounted to HUF 19,396 million. At the end of 2018, the Bank Group's equity, together with the current year profit of HUF 12,539 million, amounted to HUF 154,052 million.
The Bank has created a general reserve of HUF 4 962 million from its yearly profits as required under the Hungarian legal rules in recent years, and in 2018 it did not pay dividends to its owner which reinforced the Bank's capital position and business growth potential.
The Bank Group's capital adequacy ratio is 15.35% which is above the 10.36% prescribed by the central bank as a mandatory requirement.
In 2018 the Bank Group's Basel III and IFRS-based regulatory capital amounted to HUF 140,998 million (HUF 129,071 million in 2017) which complies with the relevant rules. The increase of the regulatory capital – HUF 11,928 million – is the net result of the rise of reserves (+ HUF 15,491 million), the deduction of increasing intangible assets (HUF 3,324 million) and the change in the valuation adjustment. During the course of capital management, the Group continuously tracks the development of the individual capital elements.
The portfolio of risk-weighted assets – including operational and market risks – increased from HUF 774,452 million at the end of 2017 by 19% to HUF 918,464 million. The rise in risk-weighted assets is mainly due to the increase in the Bank Group's lending activities. The fall in the operational risk capital requirement is due to the strengthening controlling of processes.

8.6 Profitability

Also in 2018 the Bank Group achieved an outstanding profit rate, above its business plan. The Bank Group's for the year is HUF 12,539 million which is a HUF 1.9 billion decrease compared with the year before. While the Bank's 2017 profit and loss statement below was prepared in the IFRS structure, its valuation principles were primarily based on the Hungarian Accounting Act, a few exceptions apart. For instance, already in 2017 leases qualifying as operating leases under the Hungarian regulations were reclassified as finance leases, and all finance leases were recalculated with the effective interest rate method in accordance with the IFRS transition rules. Therefore, while the structure of the enclosed profit and loss account and the contents of the individual lines were significantly different, as regards the total profit/loss, there was only a slight difference compared with the profit of HUF 14,600 million published last year on the basis of the Hungarian Accounting Act.

➡ Business Report of the Management

Profit and loss account (HUF M)	2018	2017	Delta	%
Net interest income	36 963	39 250	(2 287)	-5.8%
Net commission and fee income	33 886	30 817	3 069	10.0%
Profit/loss of financial instruments	3 064	(638)	3 702	-580.3%
Other revenues/expenditures, net	(13 534)	(13 318)	(216)	1.6%
Operating expenses	(47 891)	(43 431)	(4 460)	10.3%
Impairment	2 470	4 162	(1 692)	-40.7%
Income (profits) tax	(2 419)	(2 403)	(16)	0.7%
After-tax profit/loss	**12 539**	**14 439**	**(1 900)**	**-13.2%**

Primarily the following items were responsible for changes in the profit/loss lines:

- On a year-to-year basis, the Bank's net interest revenues decreased by HUF 2.2 billion primarily as a result of the continuously decreasing interest environment and the new IFRS rules that entered into force.

- The 10% increase in net commissions, too, is primarily due to the IFRS modifications. However, despite the different IFRS commission and interest calculation methods, the net interest and commission changes offset one another.

- The profit of financial instruments increased by HUF 3.7 billion during 2018 compared with the year before. This was due to more active Treasury activities, the net profit of the sale of bad loans arising from intense portfolio cleansing activities in 2018 and reclassifications under the IFRS rules into different profit/loss categories.

- The net other expenditures typically include non-profit-tax-type taxes (transaction duty, bank levy, non-deductible VAT, etc.) and membership fees; they did not change significantly.

- The increase of operating expenses was caused by higher salaries, marketing expenses and depreciation expenses.

- The improvement in portfolio quality which continued in 2018 contributed to a HUF 2.4 billion impairment loss release.

On the whole, not only the operations of the Bank Group were profitable in 2018, but also those of most of the subsidiaries. Budapest Lízing made HUF 1,697 million profit for the year, Budapest Alapkezelő achieved HUF 2,686 million profit for the year, while the loss of Bp. Eszközfinanszírozó amounted to HUF 46 million.