STATEMENT

on the consolidated annual financial statements of 2016

and on the Report of the Management

Pursuant to Ministry of Finance Decree no. 24/2008 (VIII.15.)

and Act CXX of 2001 on the Capital Market

STATEMENT
on the consolidated annual financial statements of 2016
and on the Report of the Management
Pursuant to Ministry of Finance Decree no. 24/2008 (VIII.15.)

MKB Bank Zrt (hereinafter: Bank) declares concerning its consolidated annual financial statements – accepted by the Annual General Meeting of the Bank on March 20, 2017 and audited by an independent auditor - the following statement:

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

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

Budapest, 20 March 2017.

MKB Bank Zrt.

dr. Balog Ádám
Chief Executive Officer

Sándor Benedek
Deputy Chief Executive Officer

MKB Bank Zrt.
Group

10 011 922 641 911 401
statistic code

Consolidated Financial Statements

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

Budapest, 10 March, 2017

December 31, 2016

Deloitte.

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Registered by the Capital Court of Registration
Company Registration Number: 01-09-071057

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of MKB Bank Zrt.

Opinion

We have audited the consolidated financial statements of MKB Bank Zrt. and its subsidiaries (the „Group") for the year 2016 which comprise the consolidated statement of financial position as at December 31, 2016 - which shows a total assets of HUF 2,101,616 million -, and the related consolidated statement of recognized income, consolidated statement of comprehensive income - which shows a profit for the year of HUF 9,496 million -, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and consolidated notes to the financial statements including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the MKB Bank Zrt. and its subsidiaries as at December 31, 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for the opinion

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

We are independent of the Group in compliance with the Hungarian ethical requirements pertaining to our audit of the consolidated financial statements, and we have fulfilled our other ethical responsibilities in accordance with the same ethical requirements.

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

Key Audit Matters

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

Key audit matter	Related audit procedures
Impairment of the loan receivables	
(See Sections 4. i, 11. and 30. of the Notes to the Financial Statements for the details) The net value of loans to customers in an amount of HUF 858,072 million comprise 41% of the total assets (gross book value of HUF 969,803 million), the relevant impairment charge recorded in the current year was HUF 10,302 million. The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of both the application of portfolio based collective impairment models, and determination of individual specific impairment of loans. The most significant assumptions applied in provisioning calculation are the followings: - historical loss data, - valuation of collaterals, - estimated time to realize the collaterals, - probability of default, - estimate that future cash-flows expected to be realized. Based on the significance of the above described circumstances the calculation of impairment of loans was identified as a key audit matter.	The relevant audit procedures performed by us included the followings: - evaluating internal controls relating to monitoring of loans and calculating and recording of impairment, - evaluating of specific loan impairments with random sample based on risk profiles, including the review of consideration and valuation of collaterals and estimations of expected future cash-flows, - evaluating the appropriateness of collective provisioning models, and review of the assumptions and management estimates applied and parameters, including comparison with historic data, and recalculation of impairment charge with the involvement of our experts, - review of subsequent events (sold receivables), and analysis of the possible effect on the year audited, - evaluating of impairment triggers related to the non-impaired portfolio, - evaluating the appropriateness of related disclosures.

Key audit matter	Related audit procedures
Capital adequacy	
(See Sections 6. i, of the Notes to the Financial Statements for the details) HUF 125,408 million equity has been recorded in the consolidated statement of financial position. For the purpose of maintaining solvency and the ability to fulfil liabilities - must have a solvency margin complying at all times with the amount of the risk of the financial and investment activities performed thereby, and must continuously maintain at least 8 percent capital adequacy ratio. On balance sheet date the amount of regulatory capital is HUF 112,764 million, the capital adequacy ratio is 12.04%. Accordingly, the capital adequacy is considered to be a key audit matter.	We evaluated the solvency capital calculation process, the capital requirement calculation methodology, and we performed regulatory capital recalculation as well. Furthermore with random sample we verified the appropriateness of the classification of certain risk exposures and the associated weighting. Regarding credit risk and operating risk we checked the process of capital requirement calculation, and controls applied during the process. With the involvement of expert we also evaluated the appropriate application of the of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013, and disclosures.

Key audit matter	Related audit procedures
EU commitment compliance	
(See Section 1. of the Notes to the Financial Statements the details) During the reorganisation process between December 18, 2014 and June 29, 2016 ordered by National Bank of Hungary, Restructuring plan has been prepared and this has been approved by the European Commission. This plan comprises several commitments ("EU commitments"). The fulfilment of commitments is monitored periodically by a Monitoring Trustee nominated by the European Commission. Based on the significance of the above described circumstances the compliance with EU commitments is identified as a key audit matter.	Based on the review of the documents, reports prepared by the Bank we checked if the Bank complies with the reporting requirements, to the Monitoring Trustee. We evaluated the commitments which could have the most significant impact to the Consolidated Financial Statements including consistency other information received during the audit and performing further substantive procedures.

Other information

Other information comprises the information included in the „Statement of corporate governance", "Management's discussion and analysis" and the consolidated business report of MKB Bank Zrt. and its subsidiaries for 2016, but does not include the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information and for the preparation of the consolidated business report in accordance with the relevant provisions of the Act C of 2000 on Accounting (hereinafter: "the Accounting Act") and other regulations. Our opinion on the consolidated financial statements provided in the section of our report entitled "Opinion" does not apply to the other information.

Our responsibility in connection with our audit of the consolidated financial statements is to read the other information identified above 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.

Furthermore, in accordance with the Accounting Act, our responsibilities regarding the consolidated business report also include reviewing the consolidated business report to assess whether the consolidated business report was prepared in accordance with the relevant provisions of the Accounting Act and other regulations, if any, including the assessment whether the consolidated business report complies with the requirements of Section 95/B (2) e) and f) of the Accounting Act. Furthermore, in accordance with the Accounting Act we shall make a statement whether the information referred to in Section 95/B (2) a)-d), g) and h) has been provided in the consolidated business report.

In our opinion, the consolidated business report of MKB Bank Zrt. and its subsidiaries for 2016 corresponds to the consolidated financial statements of MKB Bank Zrt. and its subsidiaries for 2016 and

the consolidated business report was prepared in accordance with the provisions of the Accounting Act. The information referred to in Section 95/B (2) a)-d), g) and h) of the Accounting Act has been provided.

As the Group is not subject to additional requirements under any other regulation in connection with the consolidated business report, our opinion on the consolidated business report does not include an opinion under Section 156 (5) h) of the Accounting Act.

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

Responsibilities of management and those charged with governance for the consolidated financial statements

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

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

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

The auditor's responsibilities for the audit of the consolidated financial statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify the opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

The engagement partners on the audit resulting in this independent auditor's report are the signatories of the report.

Budapest, March 10, 2017

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

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

Registration number of statutory registered auditor: 007239

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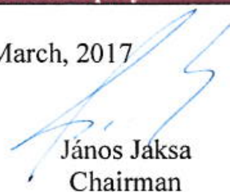
MKB Bank Zrt.
Consolidated Statement of Financial Position as at December 31, 2016

	Note	2016	2015
Assets			
Cash reserves	**7**	97 914	41 494
Loans and advances to banks	**8**	67 039	51 740
Financial assets measured at FVTPL	**9**	75 210	93 569
Investments in securities	**10**	924 137	859 741
Loans and advances to customers	**11**	858 072	802 954
Non-current assets held for sale and discontinued operations	**40**	309	32 635
Other assets	**12**	28 081	20 857
Deferred tax assets	**25**	3 320	2 567
Investments in jointly controlled entities and associates	**13**	1 651	1 529
Intangibles, property and equipment	**14**	45 883	47 012
Total assets		**2 101 616**	**1 954 098**
Liabilities			
Amounts due to other banks	**15**	376 262	324 651
Deposits and current accounts	**16**	1 519 868	1 379 168
Financial liabilities measured at FVTPL	**17**	29 983	20 751
Other liabilities and provisions	**19**	37 197	35 018
Deferred tax liabilities	**25**	6	900
Issued debt securities	**20**	12 892	85 625
Total liabilities		**1 976 208**	**1 846 113**
Equity			
Share capital	**22**	100 000	225 490
Treasury Shares		(5 550)	-
Reserves	**23**	25 368	(117 505)
Total equity attributable to equity holders of the Bank		**119 818**	**107 985**
Non-controlling interests	**24**	5 590	-
Total equity		**125 408**	**107 985**
Total liabilities and equity		**2 101 616**	**1 954 098**

Budapest, 10 March, 2017



János Jáksa
Chairman

dr. Ádám Balog
Chief Executive Officer

MKB Bank Zrt.
Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended December 31, 2016

	Note	2016	2015
Statement of profit or loss			
Interest income	**26**	62 476	73 971
Interest expense	**27**	23 804	31 642
Net interest income		**38 672**	**42 329**
Net income from commissions and fees	**28**	28 664	26 732
Other operating expense, net	**29**	(6 286)	(594)
Impairments and provisions for losses	**30**	15 236	94 458
Operating expenses	**31**	38 283	52 910
Share of jointly controlled and associated companies' profit		273	728
Profit /(Loss) before taxation		**7 804**	**(78 173)**
Income tax expense / (credit)	**32**	(1 692)	(1 771)
PROFIT/(LOSS) FOR THE YEAR		**9 496**	**(76 402)**
Other comprehensive income:			
Items that may be reclassified subsequently to profit or loss:			
Revaluation on AFS financial assets	**10**	7 889	(3 313)
Exchange differences on translating foreign operations		2	(4)
Other comprehensive income for the year net of tax		**7 891**	**(3 317)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**17 387**	**(79 718)**
Profit / (Loss) attributable to:			
Shareholders of the bank		**9 496**	**(75 868)**
Non-controlling interests		**-**	**(534)**
Total comprehensive income attributable to:			
Shareholders of the bank		**17 387**	**(79 184)**
Non-controlling interests		**-**	**(534)**
Net income available to ordinary shareholders		9 496	(75 868)
Average number of ordinary shares outstanding *(thousands)*		137 602	225 490
Earnings per Ordinary Share *(in HUF)*	**33**		
Basic		69	(336)
Diluted		69	(336)
Earnings per Ordinary Share from continuing operation *(in HUF)*	**33**		
Basic		69	(336)
Diluted		69	(336)

Budapest, 10 March, 2017

János Jaksa
Chairman

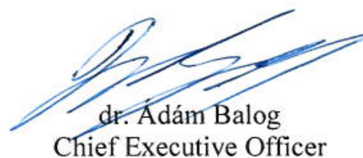
dr. Ádám Balog
Chief Executive Officer

MKB Bank Zrt.
Consolidated Statement of Changes in Equity for the year ended December 31, 2016

	Note	Share capital	Treasury shares	Share premium	Translation of foreign operations	Retained earnings	Revaluation on AFS financial assets	Non-controlling interests	Total equity
At 1 January 2015		**225 490**	**-**	**222 886**	**6**	**(260 221)**	**2 021**	**(1 398)**	**188 784**
Dividend for the year 2014		-	-	-	-	-	-	(136)	**(136)**
Profit/ (loss) for the year		-	-	-	-	(75 868)	-	(534)	**(76 402)**
Other comprehensive income for the year		-	-	-	(4)	-	(3 313)	-	**(3 317)**
First / (final) consolidation of subsidiaries		-	-	-	-	-	-	-	-
Change in non-controlling interests during the period		-	-	-	-	(3 012)	-	2 068	**(944)**
At 31 December 2015		**225 490**	**-**	**222 886**	**2**	**(339 101)**	**(1 292)**	**-**	**107 985**
Dividend for the year 2015		-	-	-	-	-	-	-	-
Profit/(loss) for the year		-	-	-	-	9 496	-	-	**9 496**
Other comprehensive income for the year		-	-	-	2	-	7 889	-	**7 891**
First / (final) consolidation of subsidiaries		-	-	-	(4)	-	-	5 590	**5 586**
Decrease of share capital		(125 490)	-	(201 157)	-	326 647	-	-	-
Acquisition of treasury Shares (ESOP)	1	-	(5 550)	-	-	-	-	-	**(5 550)**
At 31 December 2016		**100 000**	**(5 550)**	**21 729**	**-**	**(2 958)**	**6 597**	**5 590**	**125 408**

Budapest, 10 March, 2017

János Jaksa
Chairman



dr. Ádám Balog
Chief Executive Officer

MKB Bank Zrt.
Consolidated Statement of Cash Flows for the year ended December 31, 2016

	Note	2016	2015
Cash flows from operating activities			
Loss before taxation		**7 804**	**(78 173)**
Adjustments for:			
Depreciation, amortisation and impairment	14	5 407	14 008
Impairment on other assets	12	(44)	1 010
Provisions for off-BS items and settlement for customers	19	1 420	1 783
Impairment on financial assets (loans and advaces)	8, 11	8 346	36 764
Change in post acquisition reserve of jointly controlled entities and associates and due to first consolidation	13, Change in Equity	-	2 193
Deferred tax movement	32	(1 647)	(2 423)
Net Interest income		(44 197)	(34 018)
Dividends on available for sale securities		(12)	(58)
Revaluation of issued securities		(1 402)	17
Revaluation and other result of AFS securities		10 668	
Foreign Exchange movement	8, 11, 14, 19, Change in Equity	(306)	(4 353)
Cash flows from operating activities		(13 963)	(63 250)
Change in loans and advances to banks (gross amounts)	8	(15 256)	12 798
Change in loans and advances to customers (gross amounts) without spin-off	11	(63 156)	92 632
Change in loans and advances to customers (gross amounts) due to spin-off	11	-	213 098
Change in loans and advances to customers - correction due to Consideration received from spin-off	11	-	(95 894)
Change in trading assets	9	18 358	(52 169)
Change in other assets (gross amounts)	12	(7 180)	180
Change in amounts due to banks (short term)	15	63 383	95 368
Change in current and deposit accounts	16	140 700	85 497
Change in other liabilities and provisions (without provision charge of the year)	19	733	(36 122)
Change in trading liabilities	17, 18, Change in Equity	9 232	(14 319)
Interest received		58 637	56 124
Interest paid		(14 440)	(22 106)
Dividends received		12	58
Income tax		1 692	1 771
		192 715	336 916
Net cash (used in)/generated by operating activities		**178 752**	**273 666**
Cash flow from investing activities			
Investment in group companies	23, Change in Equity	(82)	(1 433)
Disposals of group companies	40	-	1 002
Purchase of property and equipment	14	(2 195)	(2 239)
Disposals of property and equipment	14	1 539	12 197
Purchase of intangible assets	14	(3 623)	(2 448)
Disposals of intangible assets	14	1	-
Consideration received from spin-off	11	-	95 894
Purchase of AFS securities	10	(849 883)	(1 639 408)
Disposals of AFS securities	10	838 160	1 137 270
Change in HTM securities (without impairment)	10	(55 453)	(51 827)
Net cash (used in)/ generated by investing activities		**(71 536)**	**(450 991)**
Cash flow from financing activities			
Change in issued securities	20	(71 331)	(69 530)
Change in amounts due to banks (Borrowings)	15	(11 771)	30 321
Dividends paid to NCI	Change in equity	-	(136)
Net cash (used in)/ generated by financing activites		**(83 102)**	**(39 345)**
Net increase of cash and cash equivalents		**24 114**	**(216 670)**
Cash reserves at 1 January	7	**41 494**	**286 586**
FX change on cash reserve		(21)	(136)
Non-current assets held for sale and discontinued operations	40	32 327	(28 286)
Cash reserves at December 31	7	**97 914**	**41 494**

Budapest, 10 March, 2017

János Jaksa
Chairman

dr. Ádám Balog
Chief Executive Officer

Notes to the Financial Statements

(from page 8 to page 105)

1 General information

MKB Bank Zrt. ("MKB" or "the Bank") is a commercial bank domiciled in Hungary, organised under the laws of Hungary and registered under the Hungarian Banking Act CCXXXVII of 2013. The address of MKB is Váci u. 38., HU-1056 Budapest, Hungary.
The consolidated financial statements of the Bank as at and for the year ended 31 December 2016 comprise the Bank and its subsidiaries (together referred to as the "Group"). The Group conducts its financial services businesses through domestic non-banking subsidiaries.[1]

The Hungarian government acquired 100% direct ownership in MKB Bank Zrt. on 29 September, 2014. The Prime Minister's Office was assigned to exercise the ownership rights and obligations of the Hungarian government. On 18th December 2014, the Financial Stability Board of the National Bank of Hungary ordered the reorganization of MKB Bank based on the Act XXXVII. of 2014 (Act on Resolution). The ownership rights were exercised by the National Bank of Hungary under the reorganization process and NBH together with MKB Bank started restructuring measures aiming at improving profitability. The reorganization of MKB Group has been carried out in compliance with EU directives[2] in each case. On 23 November, 2015 the National Bank of Hungary launched the reorganisation plan, which was approved by the European Commission on 16 December, 2015. The commitments included in the plan have to be fullfilled by 31 December 2019, and the process of the completion is controlled regularly by the independent Monitoring Trustee. The effective and successful reorganization was managed by the four resolution commissioners assigned by and acting under official and professional control of NBH: the commissioners were exercising the powers of the board of directors and also the general meeting as defined in the statutes of the Bank. On 23 July, 2015 – continuing the reorganization procedure – the reorganizational commissioners were recalled, and through the appointment of the new Chief Executive Officer and election as Chairman of the board, the board of directors is capable of exercising its full powers.

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

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

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

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

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

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

2 Compliance with International Financial Reporting Standards

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

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

These financial statements are presented in Hungarian Forint (HUF), rounded to the nearest million, except if indicated otherwise. These financial statements were authorised for issue by the Board of Directors on 10 March, 2017.

3 Basis of measurement

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

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

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

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

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 35.

4 Summary of significant accounting policies

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by the Group in preparing and presenting the consolidated financial statements. The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

a, Financial statement presentation

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

b, Consolidation

Subsidiaries

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

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

Fund management

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

Transactions eliminated on consolidation

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

c, Investments in jointly controlled entities and associated companies

Jointly controlled entities

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

Associates

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

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

d, Intangible assets

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

Goodwill

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

Goodwill is not amortised but annually tested for impairment.

For the purpose of impairment testing, goodwill is allocated to one or more of the Group's cash-generating units, that are expected to benefit from the synergies of the business combination, irrespective whether other assets or liabilities are assigned to them. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the present value of the expected future cash flows from a cash-generating unit with the carrying amount of its net assets, including

attributable goodwill. Goodwill is stated at cost less accumulated impairment losses. Impairment losses recognized for goodwill are charged to the statement of comprehensive income and are not reversed in a subsequent period.

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

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

Other intangible assets

Intangible assets that have a finite useful life are measured initially at costs and subsequently carried at costs less any accumulated amortisation and any accumulated impairment losses. Intangible assets are amortised over their estimated useful lives not exceeding 15 years from the date when the asset is available for use, applying the straight-line method.

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

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

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

e, Property, plant and equipment

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

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

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

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

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

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

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

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

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

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

The estimated useful lives of investment properties are as follows:

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

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

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

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

f, Cash reserve

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

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

g, Determination of fair value

All financial instruments measured at Fair Value through Profit or Loss are recognised initially at fair value, other financial assets and liabilities are recognized at fair value plus transaction cost that are directly attributable to the acquisition or issue of financial asset or financial liability. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the initial fair value will be based on other

observable current market transactions in the same instrument, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading gain or loss on inception of the financial instrument. When unavailable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the statement of comprehensive income but is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Group enters into an offsetting transaction.

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

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

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

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

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

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

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

h, Loans and advances to banks and customers

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

i, Impairment of loans and advances

At the end of each reporting period the Group assesses whether there is objective evidence that loans and advances are impaired. Loans and advances are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.
Objective evidence that loans and advances are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.
Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the statement of comprehensive income. The carrying amount of impaired loans at the end of the reporting period is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

Individually assessed loans and advances

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

Collectively assessed loans and advances

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

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

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

Write-off of loans and advances

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

Reversals of impairment

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

Assets acquired in exchange for loans

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

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

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

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

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

Long-term deposit

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

Structured Bonds

MKB issues structured bonds for its retail and institutional clients since 2008. In these bonds there are embedded derivatives (options) that have to be separated under IAS 39.11 unless the hybrid instruments are measured at fair value. The Group eliminated its interest and foreign currency risk arising from the above mentioned options by entering into offsetting option transactions. To eliminate valuation inconsistencies, these structured bonds are designated at fair value to profit or loss in their entirety and as a consequence the embedded derivatives are not separated.

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

k, Investments in securities

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

Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in equity in the ‘Revaluation reserve’ (Note 23) until the securities are either sold or impaired. When available-for sale securities are sold, cumulative gains or losses previously recognised in equity are recognised in the statement of comprehensive income as “Other operating income / (expense), net”.

At the end of each reporting period an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. This usually arises when circumstances are such that an adverse effect on future cash flows from the asset or group of assets can be reliably estimated. If an available-for-sale security is impaired, the cumulative loss (measured as the difference between the asset's acquisition cost (net of any principal repayments and amortisation) and its current fair value, less any impairment loss on that asset previously recognised in the statement of comprehensive income) is removed from equity and included in the statement of comprehensive income.
When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in provisions attributable to time value are reflected as a component of interest income.

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

l, Derivatives

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

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

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

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

m, Hedge accounting

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

- at the inception there is a formal documentation of the hedging relationship that includes among others the identification of the hedging instrument and the specific hedged item, the nature of risk being hedged.

- a high level of hedge effectiveness is expected at the inception and the hedge is actually effective throughout the hedge period,
- hedge effectiveness can be reliably measured.

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

Fair value hedge

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

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

Hedge effectiveness testing

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

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

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

n, Derecognition of financial assets and liabilities

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

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

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

o, Offsetting financial assets and financial liabilities

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

p, Finance and operating leases

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

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

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

q, Deposits, debt securities issued and subordinated liabilities

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

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

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

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

r, Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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

s, Income tax

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

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

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

assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the end of the reporting period.

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

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

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

t, Interest income and expense

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

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

Interest income is recognised on available-for-sale securities using the effective interest rate method, calculated over the asset’s expected life. Dividends are recognised in the statement of comprehensive income when the right to receive payment has been established.

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

u, Fees and commission

Fee and commission income is accounted for as follows:

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

v, Other operating income / (expense), net

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

w, Dividends

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

x, Segment reporting

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

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

Segment revenue, segment expense, segment assets and segment liabilities are determined as those that are directly attributable or can be allocated to a segment on a reasonable basis, including factors such as the nature of items, the conducted activities and the relative autonomy of the unit. The Group allocates segment revenue and segment expense through an inter-segment pricing process. These allocations are conducted on arm’s length terms and conditions. Please find further details on segment reporting in Note 39.

y, Foreign currencies

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

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities

denominated in foreign currencies at the end of the reporting period are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments.

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

z, Financial guarantees

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

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

aa, Share capital

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

ab, Treasury shares

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

ac, Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders

and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares. For further information about basic and diluted EPS, please see Note 33.

ad, New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2016, and have not been applied in preparing these consolidated financial statements:

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

  On 24 July 2014 the International Accounting Standards Board issued IFRS 9 Financial instruments, as a replacement of IAS 39 Financial instruments: Recognition and Measurement. The Standard includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. The version of IFRS 9 issued in 2014 supersedes all previous versions. IFRS 9 does not replace the requirements for portfolio fair value hedge accounting for interest rate risk (often referred to as the 'macro hedge accounting' requirements) since this phase of the project was separated from the IFRS 9 project due to the longer term nature of the macro hedging project.

  After the adoption by the EU the Group has started a project for the preparation of implementing IFRS 9 standard. The impact on the group financial statement will be estimated in course of the project.

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

  On 30 January 2014 the International Accounting Standards Board issued IFRS 14 Regulatory Deferral Accounts, with the objective to specify the financial reporting requirements for "regulatory deferral account balances" that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation. IFRS 14 is designed as a limited scope Standard to provide an interim, short-term solution for rate-regulated entities that have not yet adopted International Financial Reporting Standards (IFRS).

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

- **IAS 12 (Amendment) "Income taxes"** - Recognition of Deferred Tax Assets for Unrealised Losses (effective for annual periods beginning on or after 1 January 2017, with earlier application permitted),

  The International Accounting Standards Board (the Board) issued amendments to IAS 12 Income Taxes at 19 January 2016. The amendments, Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12), clarify how to account for deferred tax assets related to debt instruments measured at fair value. IAS 12 provides requirements on the recognition and measurement of current or deferred tax liabilities or assets. The amendments issued clarify the requirements on recognition of deferred tax assets for unrealised losses to address diversity in practice. The amendments to the Standard follow on from a recommendation by the International Financial Reporting Interpretations Committee.

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

- **IAS 7 (Amendment) "Statement of Cash Flows"** Disclosure initiative (effective for annual periods beginning on or after 1 January 2017),

  Disclosure Initiative issued by IASB on 29 January 2016. The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

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

- **IFRS 15 "Revenue from Contracts with Customers"** (effective for annual periods beginning on or after 1 January 2018, with earlier application permitted)

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

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

- **IFRS 10 (Amendment) „Consolidated Financial Statements", IAS 28 (Amendment) „Investments in Associates and Joint Ventures" –** Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (effective for annual periods beginning on or after 1 January 2016, effective date was deferred indefinitely until the research project on the equity method has been concluded)

  On 18 December 2014 the International Accounting Standards Board issued amendments to International Financial Reporting Standard (IFRS) 10 Consolidated Financial Statements, International Financial Reporting Standard (IFRS) 12 and International Accounting Standard (IAS) 28 Investments in Associates and Joint Ventures. The amendments introduce clarifications to the requirements when accounting for investment entities.

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

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

  The International Accounting Standards Board (IASB) issued IFRS 16 Leases in January 2016. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, ie the customer ('lessee') and the supplier ('lessor'). At its October 2015, the IASB decided to require an entity to apply the new Leases Standard for annual periods beginning on or after 1 January 2019 and to permit early application if the entity also applies IFRS 15 Revenue from Contracts with Customers at or before the date of early application. The aim of the standard is to ensure that assets and liabilities arising under leases are recognised in the statement of the financial position.
  IFRS 16 replaces the previous leases Standard, IAS 17 Leases, and related Interpretations. (IFRIC 4)

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

- **IFRS 2 (Amendment) "Share-based payment"** Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018, with earlier application permitted)

  The amendments provide requirements on the accounting for: (a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; (b) share-based payment transactions with a net settlement feature for withholding tax obligations; and (c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

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

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

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

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

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

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

- **Annual improvements to IFRS Standards 2014-2016 Cycle**, issued on 8 December 2016 (the amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after 1 January 2018, the amendment to IFRS 12 for annual periods beginning on or after 1 January 2017)

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

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

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

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

On 8 December 2016 the International Accounting Standards Board issued IFRIC 22 Foreign Currency Transactions and Advance Considerations. IFRIC 22 clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency.
The adoption of the above presented interpretations would have no significant impact on the financial statements.

5 Group of consolidation

The Bank has performed an analysis in order to examine, whether as an investor it controls its investees, and to what extent the control exists. This control determines the disclosure of the investees as a subsidiary, joint arrangement (joint operation or joint venture) or as an associate in the consolidated financial statements of the Group.
The conclusions were prepared in accordance with the International Financial Reporting Standards and the Accounting policies (4.a Financial statement presentation, 4.b Consolidation, 4.c Investments in jointly controlled entities and associated companies).

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

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

- the net revenues are less than HUF 500 million, and
- the share capital is less than HUF 500 million.

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

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

In case one of the subsidiaries of the exempted subsidiaries is to be consolidated based on the above thresholds, then the previously exempted subsidiary must be consolidated as well.
Furthermore the Bank can exempt from the group of consolidation the subsidiary, jointly controlled entity and associated company, if:

- the headquarter is situated in a country, where the legal system does not allow the submission of the necessary data and information,
- the consolidation would lead to misleading results (particularly, in case the duration of the control or the participation is foreseen to be less than one year),
- MKB's ability to control the investee is restricted legally or contractually,
- without these entities, the consolidated financial statements of the Group provide a true and fair view about the financial position and performance of the Bank and other subsidiaries. In case there are more subsidiaries compliance with this requisite, then they must be examined together, whether the exemption of these entities distort the true and fair value about the parent company and other subsidiaries, namely the sum of the total assets and contingent liabilities individually and collectively are less than 2% of the total assets of the parent company.

- Financial service companies and auxiliaries with total assets less than EUR 10 million, and are below the thresholds related to net revenues and share capital, are not considered material.
- In case the entities do not reach the minimum of the defined conditions individually, but they exceed those collectively, they cannot be considered negligible, the Bank does not exempt them from the group of consolidation.

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

5.1

2016

Company	Percentage of equity owned	Percentage of voting rights	Country of incorporation	Brief description of activities
Euro - Immat Üzemeltetési Kft.	100,00%	100,00%	Hungary	Intangible assets, license maintenance
Exter-Adósságkezelő Kft.	100,00%	100,00%	Hungary	Wholesale trade
Extercom Vagyonkezelő Kft.	100,00%	100,00%	Hungary	Property investments
MKB Befektetési Alapkezelő Zrt.	100,00%	100,00%	Hungary	Investment fund management activity
MKB-Euroleasing Autóhitel Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities
MKB-Euroleasing Autólízing Szolgáltató Zrt.	100,00%	100,00%	Hungary	Car finance activity
MKB Euroleasing Zrt.	100,00%	100,00%	Hungary	Holding of Euroleasing group
MKB Jelzálogbank Zrt.	99,00%	99,00%	Hungary	Mortgage loan refinancing
MKB Bank MRP Szervezet	37,50%	0,00%	Hungary	Special purpose entity for the Employee Share Program
MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft	100,00%	100,00%	Hungary	Other financial services
MKB Üzemeltetési Kft.	100,00%	100,00%	Hungary	Property operation and maintenance
Retail Prod Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities

2015

Company	Percentage of equity owned	Percentage of voting rights	Country of incorporation	Brief description of activities
Euro - Immat Üzemeltetési Kft.	100,00%	100,00%	Hungary	Intangible assets, license maintenance
Exter-Adósságkezelő Kft.	100,00%	100,00%	Hungary	Wholesale trade
Extercom Vagyonkezelő Kft.	100,00%	100,00%	Hungary	Property investments
MKB Befektetési Alapkezelő Zrt.	100,00%	100,00%	Hungary	Investment fund management activity
MKB-Euroleasing Autóhitel Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities
MKB-Euroleasing Autólízing Szolgáltató Zrt.	100,00%	100,00%	Hungary	Car finance activity
MKB-Euroleasing Zrt.	100,00%	100,00%	Hungary	Holding of Euroleasing group
MKB-Euroleasing Autópark Zrt.	50,00%	50,00%	Hungary	Car fleet management
MKB Autopark OOD	50,00%	50,00%	Bulgaria	Car fleet management
MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft	100,00%	100,00%	Hungary	Other financial services
MKB Üzemeltetési Kft.	100,00%	100,00%	Hungary	Property operation and maintenance
Retail Prod Zrt.	100,00%	100,00%	Hungary	Car and consumer finance activities

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

a) Vehicle financing:

Euroleasing Group

MKB-Euroleasing Zrt.

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

MKB-Euroleasing Autóhitel Zrt.

In accordance with the above mentioned transaction of Euroleasing Group, the Bank has 74% direct ownership in MKB-Euroleasing Autóhitel Zrt. (hereinafter: Autóhitel), and furthermore 26% indirect ownership through MKB-Euroleasing Zrt. Therefore the Bank owns 100% of the voting rights. It influences directly the important decisions related to relevant activities and it takes part in the preparations of important regulations (accounting and risk policies). The new members of the Board of Directors and the Supervisory Board were delegated by MKB during year 2015. The Bank is exposed significantly to the variable returns from Autóhitel, as the financing of the company is solely ensured by the Bank, so its operation is directly depending on it. From September 2015, as MKB possesses all these rights, it can alone influence the relevant activities and affect the total returns. Based on these facts MKB concluded, that there exists control over Autóhitel according to IFRS 10, so it is consolidated as a subsidiary in the financial statements of the Group.

MKB-Euroleasing Autólízing Zrt.

MKB has no direct participation in MKB-Euroleasing Autólízing Zrt. (hereinafter: Autólízing), it has indirect ownership of 70% through MKB-Euroleasing Autóhitel Zrt., and 30% through MKB-Euroleasing Zrt. The Bank is significantly exposed to the variable returns of the company. The Bank appointed new members to the Supervisory Board and to the Board of Directors. Consequently the Bank is able to influence the important decisions related to the relevant activities and takes part in the preparations of important regulations (accounting and risk policies). Autólízing is financed solely by MKB, so its operation is directly depending on it. As a result of the power due to the 100% ownership through Autóhitel and MKB Euroleasing Zrt., as its subsidiary, the Bank is able to affect the total returns, therefore it controls its investee and consolidates Autólízing as a subsidiary.

Retail Prod Zrt.

In 2015 Retail Prod Zrt. became part of the Group of consolidation as a new car financing subsidiary of MKB-Euroleasing Zrt. MKB-Euroleasing Zrt. acquired 100% ownership and voting rights in the company, obtaining the shares in exchange of a consideration paid in cash in the amount of HUF 1,000. As a result of the acquisition of Retail Prod Zrt. HUF 604 million gain was recognized, disclosed in Other operating income / (expense), net in the financial statements for 2015. In order to cover the risks and potential liabilities in the portfolio of the acquiree, the Group recognized provision for contingent liabilities identified. At the end of the reporting period the balance of the provision amounted to HUF 412 million.

b) Workout activity related to lending

Exter-Adósságkezelő Kft.
Extercom Kft.

MKB owns 100% of the shares of the above two entities, resulting that they are exposed fully to the variable returns of the companies. Based on the voting rights of 100%, the Bank is entitled to appoint officers, so has power over the relevant activities. Financing is provided fully by MKB. Based on these facts the Bank is able to affect the variable returns. Consequently the above entities are disclosed as subsidiaries in the financial statements of the Group.

c) Managing

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

MKB Üzemeltetési Kft.
Euro - Immat Üzemeltetési Kft.

Management of investment funds
MKB Befektetési Alapkezelő Zrt.

Issuance of SZÉP card, support of health and pension funds:
MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft.

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

d) Specialized credit institutions

MKB Jelzálogbank Zrt.

In order to comply with the laws and take advantages of the business opportunities originating from the new regulations, MKB Bank Zrt. decided to establish a new mortgage bank. MKB Jelzálogbank Zrt. was registered during 2016 with HUF 4 billion total equity, the main shareholder is MKB Bank Zrt. with 99 % participation, while Gránit Bank Zrt. holds 1% of the shares. The main role of the specialized credit institution is to refinance the mortgage loans granted by commercial banks through the financing obtained by issuing mortgage bonds. The operating permission of the new credit institution is expected to be obtained during 2017, it had been in process during the preparation of the financial statements for 2016. As MKB owns 99% of the shares, it is exposed fully to the variable returns of the entity. Based on the same percentage of the voting rights, the Bank is entitled to appoint chief executives, so has power over the relevant activities. Based on these facts, the Bank is able to affect the variable returns. Consequently MKB Jelzálogbank Zrt. is disclosed as a subsidiary in the financial statements of the Group.

e) Employee Share Ownership Programme

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

f) Other entities sold or deconsolidated during the financial year

On 16 December, 2015 the Bank signed an agreement about selling its 50% participations in MKB-Euroleasing Autópark Zrt. and MKB Autopark OOD. The transaction was closed on 30 June, 2016.

g) Non-consolidated entities

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

- Erzsébet-Utalvány Plusz Kft.
- Füred Service Üzemeltetési Kft.
- Exter-Estate Kft.
- Medister Kft.
- Exter-Reál Kft.
- Exter-Immo Zrt.
- MKB Consulting Kft.
- MKB Életbiztosító Zrt.
- MKB Általános Biztosító Zrt.
- Euroleasing Kft.
- I.C.E. Kft.
- Trend Zrt.
- Garantiqa Hitelgarancia Zrt.
- Kisvállalkozásfejlesztő Pénzügyi Zrt.
- Pannonhalmi Apátsági Pincészet Kft
- SWIFT
- Quantum Leap Kft.
- Budapesti Értéktőzsde Zrt.
- Core-Solutions Kft.
- MKB Inkubátor Kft.
- MKB Kockázati Tőkealapkezelő Kft.

6 Risk management

a, Introduction and overview

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

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

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

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

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

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

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

- participations risk:
  The participations risk is defined as the risk related to the following events:
  - Potential losses from providing equity / equity akin financial products or subordinated loan capital; This involves potential losses realised during the sale of participation or loss occurring as a result of a participation's bankruptcy, the (partial) write-off of the participations (also including write-off settled on business or company value or goodwill value), i.e. loss suffered on the book value of the investment
  - Potential losses from a possible commitment/liability extended in addition to equity investment (i.e. profit/loss transfer agreements), letters of comfort, capital contribution commitments, additional funding obligations)
  - Potential losses originating from other risks associated with the participation such as reputation risk, operational risk, exchange rate risk.

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

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

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

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

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

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

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

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

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

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

b, Risk management governance

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

Committees	Main responsibilities
Supervisory Board	- Control on the highest level of the harmonized and prudent operation of the Bank and the credit institutions, financial enterprises and investment companies under its controlling influence; -Management of the Bank and steers the company's internal audit organization; - Analyzing of the regular and ad-hoc reports prepared by the Board of Directors.
Risk Committee	- In the frame of continuous monitoring of the MKB Bank's risk strategy and risk taking appetite, previously comment the Risk Strategy, the Remuneration policy and the Quarterly Risk Report.
Board of Directors	- As the company's operative managing body it carries out management-related tasks and ensures the keeping of the company's business books in compliance with the regulations; - Tasks related to the shares and dividend.; - Tasks related to the company's organization and scope of activities ; - Tasks related to strategic planning (preparation of the business policy and financial plan, and approval of the risk strategy); - Approves the policies related to risk assumptions; - Evaluation of regular and ad-hoc risk reports.
Credit Committee	- Permanent body with the highest delegated decision-making authority under the Board of Directors. - Make decisions on credits case-by-case according to the Risk Decision Competence Regulation, except of the customers handled by Restructuring and Debt management Directorate
Restructuring and Debt Management Committee	- Organization with the highest level risk decision authority regarding the customers handled by Restructuring and Debt management Directorate - Decision-making competency for credit decisions on deals handled by the Directorate according to the Risk Decision Competence Regulation; - Authority regarding decision making in terms of debt-to-asset and debt-to-equity conversation as it is determined in the Risk Decision Competence Regulation Assumption
ALCO	- The asset and liability management and management of the Group's liquidity, funding, capital adequacy and market risks; - Elaboration of policies in principle for the management of liquidity risk, interest rate risk, exchange rate risk (foreign exchange and securities), capital adequacy risk, and the submission of this policy to the Board of Directors at MKB and Group level, including: ▪ measurement guidelines and limit system for the above risks. ▪ competence and decision-making mechanism ▪ guideline for managing limit excess
Product Committee	- Leading role in forming the principles connecting to the product management processes and pricing policy in compliance with the market policy and risk assessment strategy of the Bank; - Establishing the proper marges of foreign exchange and interest rate, deposit and credit marges and regularly monitors their accomplishment; - Observing regularly the performance of the annual market business plan during the execution, whether the pricing of products, services, and the order of granting preferential conditions adequately support the Bank's business, profitability targets, to initiate the modification thereof, if necessary
Managing Committee	- Highest level operational decision preparation and decision making body; - It operates as the supporting organisation to the general director in decision preparation of general executive cases. In affairs relating to operation of the MKB Group or the organisation of the company, or cases relevant to compliance and protection against money laundering, and supervision it operates as decision making body.

c, Credit risk

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

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

Credit risk management

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

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

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

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

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

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

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

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

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

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

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

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

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

6.1

2016	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Individually impaired						
Non-default	-	-	41 537	-	-	253
Default	-	-	162 003	-	-	1 787
Total individually impaired gross amount	-	-	203 540	-	-	2 040
Total individually impaired allowance for impairment	-	-	(100 086)	-	-	(1 842)
Total individually impaired carrying amount	**-**	**-**	**103 454**	**-**	**-**	**198**
Collectively impaired						
Non-default	-	16 289	721 580	-	-	247 887
Default	-	-	4 344	-	-	667
Total collectively impaired gross amount	-	16 289	725 924	-	-	248 554
Total collectively impaired allowance for impairment	-	(50)	(11 645)	-	-	(5 278)
Total collectively impaired carrying amount	**-**	**16 239**	**714 279**	**-**	**-**	**243 276**
Past due but not impaired						
Non-default	-	-	1	-	-	-
Default	-	-	217	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**218**	**-**	**-**	**-**
Past due comprises:						
up to 30 days	-	-	-	-	-	-
30 to 90 days	-	-	-	-	-	-
over 90 days	-	-	218	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**218**	**-**	**-**	**-**
Neither past due nor impaired						
Non-default	97 914	50 757	36 552	923 590	14 372	219 470
Default	-	-	3 569	-	-	822
Total neither past due nor impaired carrying amount	**97 914**	**50 757**	**40 121**	**923 590**	**14 372**	**220 292**
Total gross amount	**97 914**	**67 046**	**969 803**	**923 590**	**14 372**	**470 886**
Total allowance for impairment	**-**	**(50)**	**(111 731)**	**-**	**-**	**(7 120)**
Total carrying amount	**97 914**	**66 996**	**858 072**	**923 590**	**14 372**	**463 766**

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

2015	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Individually impaired						
Non-default	-	-	58 293	-	-	35
Default	-	-	223 344	-	-	13 435
Total individually impaired gross amount	-	-	281 637	-	-	13 470
Total individually impaired allowance for impairment	-	-	(155 458)	-	-	(3 440)
Total individually impaired carrying amount	**-**	**-**	**126 179**	**-**	**-**	**10 030**
Collectively impaired						
Non-default	-	39 951	443 410	-	-	298 075
Default	-	-	8 212	-	-	196
Total collectively impaired gross amount	-	39 951	451 622	-	-	298 271
Total collectively impaired allowance for impairment	-	(50)	(4 271)	-	-	(2 879)
Total collectively impaired carrying amount	**-**	**39 901**	**447 351**	**-**	**-**	**295 392**
Past due but not impaired						
Non-default	-	-	85	-	-	-
Default	-	-	185	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**270**	**-**	**-**	**-**
Past due comprises:						
up to 30 days	-	-	45	-	-	-
30 to 90 days	-	-	0	-	-	-
over 90 days	-	-	225	-	-	-
Total past due but not impaired carrying amount	**-**	**-**	**270**	**-**	**-**	**-**
Neither past due nor impaired						
Non-default	41 494	11 840	212 229	859 741	20 013	125 302
Default	-	-	16 925	-	-	901
Total neither past due nor impaired carrying amount	**41 494**	**11 840**	**229 154**	**859 741**	**20 013**	**126 203**
Total gross amount	**41 494**	**51 791**	**962 683**	**859 741**	**20 013**	**437 945**
Total allowance for impairment	**-**	**(50)**	**(159 729)**	**-**	**-**	**(6 320)**
Total carrying amount	**41 494**	**51 741**	**802 954**	**859 741**	**20 013**	**431 625**

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

Offsetting of financial assets and liabilities

This disclosure represents the financial instruments that are set off or that are subject to an enforceable master netting agreement or similar agreement, irrespective whether they are set off.
As of 31 December, 2016 the Group had no enforceable master netting agreement or similar agreement which should be set off in accordance with IAS 32.42.
The below table presents all the amounts that could potentially have been subject to an enforceable master netting agreement or similar agreement that are recognized financial instruments. As these agreements and the amounts related to them as financial collateral do not meet some or all of the offsetting criteria in IAS 32.42., the Bank does not apply offsetting to either of them. This is because the agreements constitute rights for set-off enforceable only following the event of a default, insolvency or bankruptcy of the Group or counterparties. In addition the Group or the counterparties do not intend to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

The similar agreements include derivative clearing agreements, global master repurchase agreements. Similar Financial instruments include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements. Financial instruments such as loans and deposits are not disclosed in the tables below unless they are offset in the statement of financial positions.
The group receives and gives collateral in the form of cash and marketable securities in respect of following transactions:

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

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

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

6.2

31 December 2016 Offsetting financial assets	IAS 32.42			similar netting arrangement			Net amount of financial assets after offsetting/ similar agreement /collaterals 12/2015
	Gross carrying amount before offsetting	Gross amounts of offsetting	recognised net carrying amount set off	Carrying amounts of accompanied liabilities	Received collaterals	Carrying amounts + receivabl. collaterals	
	debit	credit		credit	credit		
Derivatives							
Financial assets measured at FVTPL	5 042	-	5 042	772	506	1 278	3 764
Receivables concerning repos							
Loans and advances to customers	1 951	-	1 951	-	2 229	2 229	(278)
Financial assets under netting agreements	**6 993**	**-**	**6 993**	**772**	**2 735**	**3 507**	**3 486**

31 December 2016 Offsetting financial liabilities	IAS 32.42			similar netting arrangement			Net amount of financial liabilities after offsetting/ similar agreement /collaterals 12/2015
	Gross carrying amount before offsetting	Gross amounts of offsetting	recognised net carrying amount set off	Carrying amounts of accompanied assets	Pledged collaterals	Carrying amounts + pledged collaterals	
	credit	debit		debit	debit		
Derivatives							
Financial liabilities measured at FVTPL	10 628	-	10 628	771	8 080	8 851	1 777
Liabilities concerning repos							
Deposit and current accounts	2 470	-	2 470	-	2 482	2 482	(12)
Financial liabilities under netting agreements	**13 098**	**-**	**13 098**	**771**	**10 562**	**11 333**	**1 765**

31 December 2015 Offsetting financial assets	IAS 32.42			similar netting arrangement			Net amount of financial assets after offsetting/ similar agreement /collaterals 12/2014
	Gross carrying amount before offsetting	Gross amounts of offsetting	recognised net carrying amount set off	Carrying amounts of accompanied liabilities	Received collaterals	Carrying amounts + receivabl. collaterals	
	debit	credit		credit	credit		
Derivatives							
Financial assets measured at FVTPL	8 181	-	8 181	2 950	977	3 927	4 254
Receivables concerning repos							
Loans and advances to customers	3 997	-	3 997	-	3 946	3 946	51
Financial assets under netting agreements	**12 178**	**-**	**12 178**	**2 950**	**4 923**	**7 873**	**4 305**

31 December 2015 Offsetting financial liabilities	IAS 32.42			similar netting arrangement			Net amount of financial liabilities after offsetting/ similar agreement /collaterals 12/2014
	Gross carrying amount before offsetting	Gross amounts of offsetting	recognised net carrying amount set off	Carrying amounts of accompanied assets	Pledged collaterals	Carrying amounts + pledged collaterals	
	credit	debit		debit	debit		
Derivatives							
Financial liabilities measured at FVTPL	11 848	-	11 848	2 950	8 196	11 146	702
Liabilities concerning repos							
Deposit and current accounts	2 363	-	2 363	-	2 400	2 400	(37)
Financial liabilities under netting agreements	**14 211**	**-**	**14 211**	**2 950**	**10 596**	**13 546**	**665**

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

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

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

6.3

31 December 2016 **Line item of Statement of Financial Position**	Net amount after offsetting	Carrying amount in the statement of financial position	Financial assets not in scope of offsetting disclosure
Financial assets measured at FVTPL	5 042	75 210	70 168
Loans and advances to customers	1 951	858 072	856 121

31 December 2016 **Line item of Statement of Financial Position**	Net amount after offsetting	Carrying amount in the statement of financial position	Financial liabilities not in scope of offsetting disclosure
Financial liabilities measured at FVTPL	10 628	29 983	19 355
Deposits and current accounts	2 470	1 519 868	1 517 399

31 December 2015 **Line item of Statement of Financial Position**	Net amount after offsetting	Carrying amount in the statement of financial position	Financial assets not in scope of offsetting disclosure
Financial assets measured at FVTPL	8 181	93 569	85 388
Loans and advances to customers	3 997	829 890	825 893

31 December 2015 **Line item of Statement of Financial Position**	Net amount after offsetting	Carrying amount in the statement of financial position	Financial liabilities not in scope of offsetting disclosure
Financial liabilities measured at FVTPL	11 848	20 751	8 904
Deposits and current accounts	2 363	1 379 168	1 376 805

Credit (deal) classification system

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

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

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

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

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

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

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

Individually allocated impairment and provision

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

Cash-flow calculations for items in normal care management, are not mandatory to be performed in cases if no predefined Impairment Trigger occurred, and a current limit review proposal or monitoring report not older than three months is available
Individually assessed impairment allowances and provisions are only reversed when there is reasonable and objective evidence of a reduction in the established loss estimate.

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

Collectively allocated impairment and provision

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

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

Homogeneous groups of loans (group assessment)

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

In case of retail exposures collectively assessed provision is allocated for the following portfolios on monthly basis:
- on performing loans Incurred Loss (ICL) is calculated, and
- on non-performing loans Specific Loan Loss Provision (SLLP) is accumulated.

Collectively assessed provision for wholesale customers

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

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

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

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

Past due but not impaired loans

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

Write-off policy

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

Collateral structure

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

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

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

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

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

6.4

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

2015	Loans and advances to Corporates	Guarantees and contingencies	Letter of credit	Undrawn credit
Cash deposit	13 247	8 777	11	455
Debt securities issued by				
Central governments	262	1 938	-	-
Companies	5 068	139	6	448
Mortgage				
Building (incl. plot)	434 511	4 785	6 063	10 928
Other (ship, patent, chattel, goods stock, lien on assets over total assets, etc.)	40 430	2 203	89	3 108
Guarantees from				
Central governments	96 432	47 039	-	29 980
Other banks	1 346	1 088	-	0
Companies	13 007	4 070	-	889
Others	66 713	20	10	16 532
Total collateral	**671 016**	**70 059**	**6 179**	**62 340**

Valuation methods

The aim of collateral valuation is to conduct advisable and stable evaluation of value, taking into consideration the fluctuation of market prices.
The basis of the collateral valuation is provided by the collateral value (reflecting the value that can be realized on its own, independently from the course of business)

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

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

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

The Bank applies 3 main revaluation methods:

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

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

The Group obtained assets by taking possession of collateral held as security, or calling upon other credit enhancements, as follows:

6.5

	2016	2015
Non-financial assets		
Inventories	18	57
Total assets obtained	**18**	**57**

The management and processes related to assets obtained are regulated in Debt to Asset Policy.

Concentrations

The Group monitors concentrations of credit risk by sector and by risk classification. An analysis of gross exposures' concentrations of credit risk by sector and by risk classification at the end of the reporting periods is shown below:

6.6

2016	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Category I - without country risk	-	13 154	11 809	-	739	3 137
Category II - with low to medium country risk	-	4 590	29 486	-	2 341	3 770
Category III - with medium to high country risk	-	584	4 600	-	5	112
Total exposure	**-**	**18 328**	**45 895**	**-**	**3 085**	**7 019**

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

2015	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Category I - without country risk	-	12 050	29 441	287	2 152	3 369
Category II - with low to medium country risk	-	4 744	29 458	355	1 285	4 589
Category III - with medium to high country risk	-	153	10 564	-	-	68
Total exposure	**-**	**16 947**	**69 463**	**642**	**3 437**	**8 026**

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

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

6.7

2016	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Sovereign	64 322	40 429	6 203	901 925	783	64 737
Private	-	-	342 739	-	166	8 043
Financial institution	-	23 625	37 850	6 151	5 329	27 944
Real estate	-	-	120 156	-	4 730	3 964
Other	33 592	2 992	462 854	16 061	3 364	368 174
Total exposure	**97 914**	**67 046**	**969 802**	**924 137**	**14 372**	**472 862**

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

2015	Cash reserves	Loans and advances to banks	Loans and advances to customers	Investment in debt securities*	Positive fair values of derivative financial instruments	OFF B/S exposures
Sovereign	11 585	31 775	1 569	849 280	5 829	63 147
Private	-	-	352 619	-	90	95
Financial institution	-	20 016	94 955	-	6 208	14 303
Real estate	-	-	181 252	-	5 024	2 104
Other	29 909	-	332 288	10 461	2 862	357 080
Total exposure	**41 494**	**51 791**	**962 683**	**859 741**	**20 013**	**436 729**

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

d, Liquidity risk

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

Management of liquidity risk

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

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

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

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

Contractual maturity of liabilities

6.8

2016	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(376 262)	(386 511)	(163 229)	(3 236)	(7 626)	(129 297)	(83 123)
Deposits and current accounts	(1 519 868)	(1 498 905)	(1 294 518)	(115 649)	(43 419)	(44 654)	(665)
Issued debt securities	(12 892)	(12 702)	-	-	(1 739)	(10 963)	-
Financial liabilities measured at FVTPL							
Trading: outflow	-	(388 479)	(141 873)	(107 427)	(84 878)	(33 664)	(20 637)
Trading: inflow	-	364 165	132 961	98 817	70 052	38 574	23 761
Loan commitments	-	(236 124)	(3 693)	(17 496)	(120 846)	(63 440)	(30 649)
Loans and advances	925 111	-	-	-	-	-	-

2015	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(324 650)	(337 508)	(62 812)	(42 140)	(50 239)	(131 831)	(50 486)
Deposits and current accounts	(1 379 168)	(1 363 602)	(1 069 797)	(188 117)	(69 510)	(36 175)	(3)
Issued debt securities	(85 625)	(84 006)	(15 850)	(20 535)	(34 639)	(12 982)	-
Financial liabilities measured at FVTPL							
Trading: outflow	-	(380 390)	(120 851)	(59 792)	(168 909)	(24 170)	(6 668)
Trading: inflow	-	365 922	116 225	57 125	162 405	23 626	6 541
Loan commitments	-	(227 059)	(7 231)	(11 998)	(142 691)	(59 899)	(5 240)
Loans and advances	881 631	-	-	-	-	-	-

The above table shows the undiscounted cash flows on the Group's financial liabilities and loan commitments on the basis of their earliest possible maturity. The Gross nominal inflow / (outflow) disclosed in the previous table is the contractual, undiscounted cash flow on the financial liability or commitment. The disclosure for derivatives shows a gross inflow and outflow amount for derivatives (e.g., forward exchange contracts and currency swaps).
The Group's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and loan commitments are not all expected to be drawn down immediately. Due to the significant difference between the expected and the contractual cash-flows, the Group's risk management department use both analyses to manage liquidity risk. The expected, undiscounted cash-flows on the Group's financial liabilities were as follows:

Expected maturity of liabilities

6.9

2016	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(376 262)	(386 511)	(163 229)	(3 236)	(7 626)	(129 297)	(83 123)
Deposits and current accounts	(1 519 868)	(1 502 095)	(107 796)	(14 501)	(4 951)	(11 682)	(1 363 165)
Issued debt securities	(12 892)	(12 702)	-	-	(1 739)	(10 963)	-
Financial liabilities measured at FVTPL							
Trading: outflow	-	(388 479)	(141 873)	(107 427)	(84 878)	(33 664)	(20 637)
Trading: inflow	-	364 165	132 961	98 817	70 052	38 574	23 761
Loan commitments	-	(37 780)	(12 987)	(24 793)	-	-	-
Loans and advances	925 111	-	-	-	-	-	-

2015	Carrying amount	Gross nominal inflow/(outflow)	up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	5 years and over
Non-derivative liabilities							
Amounts due to other banks	(324 650)	(337 508)	(62 812)	(42 140)	(50 239)	(131 831)	(50 486)
Deposits and current accounts	(1 379 168)	(1 368 576)	(99 520)	(20 863)	(8 244)	(8 333)	(1 231 616)
Issued debt securities	(85 625)	(84 006)	(15 850)	(20 535)	(34 639)	(12 982)	-
Financial liabilities measured at FVTPL							
Trading: outflow	-	(380 390)	(120 851)	(59 792)	(168 909)	(24 170)	(6 668)
Trading: inflow	-	365 922	116 225	57 125	162 405	23 626	6 541
Loan commitments	-	(35 194)	(11 353)	(23 841)	-	-	-
Loans and advances	881 631	-	-	-	-	-	-

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

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

6.10

	2016		2015	
	Up to 1 year	Over 1 year	Up to 1 year	Over 1 year
Loans and advances to banks	60 658	6 388	51 244	546
Loans and advances to customers	121 683	848 119	97 477	865 206
Financial assets measured at FVTPL	48 012	27 198	70 621	22 948
Investments in AFS securities	152 963	420 428	30 316	777 598

The table above represents the gross amounts expected to be recovered or settled within the time category. Impairment on loans and advances to customers amounted to HUF 111,731 million (2015: HUF 159,729 million).

e, Market risk

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

Management of market risks

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

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

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

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

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

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

Exposure to market risks – trading portfolios

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

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

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

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

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

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

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

6.11

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

2015	Average	Maximum	Minimum	Stress (15%)
Foreign currency risk	72	629	4	130
Interest rate risk	28	56	14	-
Overall market risk of trading book	**100**	**685**	**18**	**130**
Credit spread risk of trading book	66	147	5	-

Important notes in connection with the table above:

- MKB applies historical and parametric VaR for general market risk:
  - Historical VaR: (1 day holding period; 99% confidence level, number of observation: 250 business days)

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

A potential adverse 15% change in the fx rates (HUF appreciation for long position and HUF depreciation for short position) would cause HUF 513 million losses based on the end of year fx open position.

Exposure to interest rate risk – non-trading portfolios

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

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

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

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

6.12

As at 31 December 2016

Fixed rate instruments	in HUF millions
Financial assets	851 067
Financial liabilities	(1 060 946)
Total fixed rate instruments	**(209 879)**

Variable rate instruments	Denominated in				
	HUF	CHF	EUR	USD	Other currencies
Financial assets	656 984	26 478	217 906	2 881	3 729
Financial liabilities	(625 795)	(5 428)	(240 219)	(67 210)	(8 284)
Total variable rate financial instruments	**31 189**	**21 050**	**(22 313)**	**(64 329)**	**(4 555)**

As at 31 December 2015

Fixed rate instruments	in HUF millions
Financial assets	780 925
Financial liabilities	(961 580)
Total fixed rate instruments	**(180 655)**

Variable rate instruments	Denominated in				
	HUF	CHF	EUR	USD	Other currencies
Financial assets	867 664	34 764	270 413	1 538	4 178
Financial liabilities	(572 919)	(14 827)	(248 778)	(56 294)	(7 676)
Total variable rate financial instruments	**294 745**	**19 937**	**21 635**	**(54 756)**	**(3 498)**

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

6.13

As at 31 December 2016

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

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

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

As at 31 December 2015

2015	Effect on equity	Effect on P/L
HUF		
200 bp increase	(10 632)	(5 601)
200 bp decrease	7 506	(5 672)
CHF		
200 bp increase	(9)	(400)
200 bp decrease	-	(642)
EUR		
200 bp increase	(1 885)	(2 802)
200 bp decrease	36	(2 056)
USD		
200 bp increase	292	(563)
200 bp decrease	(310)	329
Other currencies		
200 bp increase	26	39
200 bp decrease	(13)	(56)

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

2015			
			in HUF millions
FCY	Yield curve stress + 200 Bp	Yield curve stress - 200 Bp	Adverse case
EUR	(1 885)	36	(1 885)
USD	292	(310)	(310)
CHF	(9)	-	(9)
GBP	12	(5)	(5)
JPY	1	-	-
Others	(10 619)	7 498	(10 619)
Total	(12 208)	7 219	(12 828)

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

6.14

Effect of credit risk changes of liabilities measured at Fair Value Through Profit or Loss	2016	2015
Changes during the reporting period	248	408
Changes cumulatively (since designation of the financial liabilities)	(386)	(634)
Difference between the financial liability's carrying amount and the amount contractually required to pay at maturity	151	(331)

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

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

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

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

Exposure to other market risks – non-trading portfolios

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

6.15

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

2015	In functional currencies	In foreign currencies				Total
		USD	EUR	CHF	Other	
Financial assets except for derivatives	1 555 731	12 699	327 578	48 340	9 993	1 954 341
Financial liabilities except for derivatives	1 374 388	143 770	392 460	18 481	25 242	1 954 341
Net derivative and spot instruments (short) / long position	(181 173)	131 213	64 252	(29 829)	15 537	-
Total net currency positions	**170**	**142**	**(630)**	**30**	**288**	**-**

f, Encumbered assets

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

6.16

	2016		2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets of the reporting institution				
Loans on demand	49 192	49 192	40 622	40 622
Debt securities	288 494	288 149	208 976	208 976
Total encumbered assets	**337 686**	**337 341**	**249 598**	**249 598**

6.17

		Non-encumbered	
	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance	Nominal value of collateral received or own debt securities issued non available for encumbrance
31 December 2016			
Collateral received by the reporting institution			
Loans on demand	-	2 336	-
Other collateral received	-	-	419 969
Collateral received and own debt securities issued	**-**	**2 336**	**419 969**
31 December 2015			
Collateral received by the reporting institution			
Loans on demand	-	817	-
Other collateral received	-	-	548 074
Collateral received and own debt securities issued	**-**	**817**	**548 074**

6.18

	2016		2015	
	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	*289 501*	*337 686*	*216 152*	*249 598*
Derivatives	24 842	49 936	11 074	41 074
Deposits	264 659	287 750	205 078	208 524
Repurchase agreements	2 471	2 485	2 364	2 362
Collateralised deposits other than repurchase agreements	262 188	285 265	202 714	206 162
Total Sources of encumbrance	**289 501**	**337 686**	**216 152**	**249 598**

At the end of 2016 the total size of encumbered assets was 16,07% of the total balance sheet. The majority of MKB Group's encumbered assets is belonging to MKB Bank. The main sources and types of encumbrance were arising from having secured refinancing and money market deposits as well as collateralized derivative transactions. Encumbrance due to repo transactions, collateral requirement of used clearing systems and central counterparties was not significant. MKB did not have covered bond issues or securitization.
One of the two significant secured refinancing facilities was participating in the „Funding for Growth Scheme" refinancing loan program of National Bank of Hungary. The other significant secured liability item is connected to the refinancing loan facility of the European Investment Bank. Secured money market deposits were provided by the National Bank of Hungary which supported to active liquidity management of the bank in line with the self-financing program of the National Bank of Hungary. The majority of collateralized derivative transactions were concluded to hedge on balance sheet fx position.

g, Credit spread risk

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

Managing and monitoring credit spread risk

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

Risk measurement

Similar to the general interest rate risk measurement the Group establishes the credit spread risk figures based on the present value of the future cash flows.
The applied credit spread stress test values are revised regularly, but at least semi-annually. The length of liquidation periods used for the calculations are matched to the required liquidation time of the products.

h, Operational risks

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

Procedure

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

Risk measurement

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

Risk management and monitoring

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

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

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

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

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

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

Risk management methods and tools

Loss data collection

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

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

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

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

The Bank performed a comprehensive scenario analysis in 2016 in order to explore and analyse the rare events having significant loss potential.
The scenario analysis is to be performed on yearly basis and will be extended to all relevant MKB group members.

Business Continuity Planning

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

Membership of the Hungarian Interbank Operational Risk Database (HunOR)

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

i, Capital management

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

Capital allocation

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

Basel III

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

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

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

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

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

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

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

The capital requirement is limited by a complex limit system, which contains the limits of the material risk types by institutions and business lines.
6.19

	2016 Basel III IFRS	2015 Basel III IFRS
Share capital	100 000	225 490
Outstanding share capital	*100 000*	*225 490*
Reserves	21 899	(117 400)
Intangible assets	(8 446)	(6 904)
AVA - additional valuation adjustments	(689)	(957)
Additional Tier 1	**-**	**-**
Tier 1: Net core capital	**112 764**	**100 229**
Subordinated debt	-	-
Tier 2: Supplementary capital	**-**	**-**
Regulatory capital	**112 764**	**100 229**
Risk-weighted assets (RWA)	758 269	754 539
Large loan limit	-	212
Operational risk (OR)	165 167	126 892
Market risk positions (MR)	13 368	6 530
Total risk weighted assets	**936 804**	**888 173**
Regulatory capital / Total assets	5,37%	5,13%
Tier1 ratio	**12,04%**	**11,28%**
Capital adequacy ratio	**12,04%**	**11,28%**

The table above contains the MKB Bank’s consolidated capital adequacy ratio. Unconsolidated capital adequacy ratio is 14.62% based on HAS.

At December 31, 2016, as an actual figure of tier1 capital the Group was HUF 112.8 billion based on Basel III IFRS under Supervisory Regulation. The increase of regulatory capital - by HUF 12.5 billion – is derived from the increase of profit and revaluation reserve, which was compensated by the increase of deduction of intangible assets and the core capital deduction due to contribution to ESOP program (HUF 3.33 billion).

Risk-weighted assets including operational and market risk increased by 5.5% from HUF 888.2 billion in 2015 to HUF 936.8 besides approximately 0.7% strengthening of domestic currency. The main part of the decrease derived from the increasing operational risk capital requirement due to accounting standard change and increasing business volumes.

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

Planning and limitation of capital requirements

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

j, Forborn assets

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

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

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

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

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

Besides the Group's internal forbearance initiatives, the home protection measures in the retail clientele launched by the Hungarian government, and set by legal regulations also result in forborn assets. Such assets include the preferential buffer account facility ("árfolyamgát") granted pursuant to the act LXXV of 2011 on FX loans and the related original FX loan.

Such exposures and associated credit risks are managed, monitored and reported distinctly by specific restructuring and debt management units of the Group on the basis of guidelines and procedure rules set by internal regulations incorporating also both legal and supervisory requirements. When the conditions of forbearance cease to exist and the following cure period expires, respective assets are returned to normal treatments both from business and risk management perspectives.
To revert to normal treatment regarding Corporate customers, additional criteria is that the customer performs its amended contractual obligations duly through a specified period (180 days or 360 days) and its risk position shows significant improvement. Forborn assets are recorded separately, and the amended terms and conditions of the contract are also indicated in the accounting records. Recognition, derecognition and subsequent valuation of these assets are carried out according to the general rules of accounting as specified by the relevant IFRSs.
The detailed requirements of risk classification and impairment valuation of forborn exposures are included in the accounting policies, and other internal regulations on the valuation of assets and liabilities, as well as in impairment and provisioning policies. Based on these internal guidelines, forbearance measures are always regarded as impairment triggers and, as a consequence, individual impairment assessment should be performed for such exposures where the general methodologies and principles of assessment are to be applied. On the results of such risk assessments, impairment losses and the reversals of previously charged impairments are accounted for according to the common rules defined by IAS 39.

In the first six months of 2015 there were significant modifications regarding the retail loan portfolio affected by act XXXVIII of 2014 (Uniformity decision), act XL of 2014 (Settlement act) and act LXXVII of 2014 (the HUF conversion act), hereby compared to the previous financial year there were no changes in forbearance policies and practices applied by the Group.

6.20

	Balance at 31.12.2016	Balance at 31.12.2015
Corporate Banking		
Forbearence loans and advances based on actual restructured status	28 994	33 383
Allowances for impairment	(20 204)	(20 314)
Carrying amount	8 790	13 069
Retail and Private Banking		
Forbearence loans and advances based on actual restructured status	50 862	58 340
Provision	(16 350)	(5 851)
Carrying amount	34 512	52 489
Total carrying amount	**43 302**	**65 558**

7 Cash reserves

7.1

	2016	2015
Cash and balances with Central Banks	97 914	41 494
Cash reserves	**97 914**	**41 494**

The Group is required to maintain a minimum reserve with the National Bank of Hungary (NBH) equivalent to 1% (2015: 2%) of certain deposits. The balance of the minimum reserve, in line with the prescription of NBH, is based on the balance at the end of November of these deposit accounts and amounted to HUF 11,560 million as at 31 December 2016 (2015: HUF 25,167 million). At 31 December 2016, cash on hand amounted to HUF 13,217 million (2015: HUF 14,000 million).

8 Loans and advances to banks

8.1

	2016	2015
Current and clearing accounts	63 629	49 100
Loans and advances	3 417	2 690
Less collective allowances for impairment	(7)	(50)
Loans and advances to banks	**67 039**	**51 740**
Collective allowances for impairment		
Balance at 1 January	**(50)**	**(35)**
Impairment loss for the year:		
Charge for the year	(3)	(10)
Reversal	45	28
Effect of foreign currency movements	1	-
Reclassification	-	(33)
Balance at 31 December	**(7)**	**(50)**

9 Financial assets measured at FVTPL

9.1

	2016			2015		
	Cost	Fair value adjustment	Book value	Cost	Fair value adjustment	Book value
Debt and equity instruments						
Government Treasury bills	44 361	917	45 278	65 330	1 186	66 516
Government bonds	14 878	76	14 954	6 165	42	6 207
Hungarian corporate sector bonds	390	10	400	523	5	528
Hungarian equities	168	38	206	274	30	304
Total debt and equity instruments	**59 797**	**1 041**	**60 838**	**72 292**	**1 263**	**73 555**
Derivative instruments by type						
FX-based derivatives instruments	-	3 176	3 176	-	5 417	5 417
Index-based derivative instruments	-	9	9	-	1	1
Interest-based derivative instruments	-	10 200	10 200	-	13 157	13 157
Options	1 472	(485)	987	2 213	(775)	1 438
Total derivative instruments	**1 472**	**12 900**	**14 372**	**2 213**	**17 800**	**20 013**
Total financial assets measured at FVTPL	**61 269**	**13 941**	**75 210**	**74 505**	**19 063**	**93 568**

10 Investments in securities

10.1

	2016	2015
Available-for-sale		
Hungarian Government bonds	566 624	730 698
Hungarian corporate sector bonds	6 220	77 215
Hungarian equities	33	33
Foreign equities	547	-
Less specific allowances for impairment	(33)	(33)
Held-to-maturity		
Hungarian Government bonds	283 569	47 543
Hungarian corporate sector bonds	67 177	4 285
Less specific allowances for impairment	-	-
Investment in securities	**924 137**	**859 741**
Specific allowances for impairment		
Balance at 1 January	(33)	(33)
Impairment loss for the year:		
Utilisation	-	-
Balance at 31 December	**(33)**	**(33)**

At 31 December 2016, HUF 384,281 million (2015: HUF 249,337 million) from the total amount of Investments in securities were pledged as collateral for stock exchange, for NBH related to Funding for Growth Scheme and credit card transactions in the ordinary course of business.

The total revaluation effect excluding deferred taxes in equity comprises HUF 6,606 million gain (2015: HUF 1,768 million loss) and HUF 3 million deferred tax asset and HUF 12 million deferred tax liability (2015: HUF 476 million deferred tax asset and NIL deferred tax liability) is disclosed.

In 2016, HUF 16,236 million (2015: HUF 5,481 million) gain was recognized in the income statement relating to AFS securities, which is a reclassification from other comprehensive income into profit or loss.

Related to the Held-to-maturity investments HUF 4,549 million (2015: HUF 774 million) interest income was recognized in the Statement of profit or loss during the year.

In 2015 there was a remarkable reclassification between Cash reserves and Investments in securities. The reason was that during this period there were changes in the liquidity management means provided to the credit institutions by NBH.

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

As at 31 December 2016, the carrying amount, the fair value and the amortized cost of all investments in debt instruments (included either in cash reserves or investments in securities), other than those classified as FVTPL are as follows:

10.2

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

2015	Carrying amount	Fair value	Amortized cost
Investments in debt instruments classified as:			
Held-to-maturity investments	51 827	51 748	51 827
AFS financial assets	807 914	807 914	809 682
Total	**859 741**	**859 662**	**861 509**

11 Loans and advances to customers

Loans and advances to customers at amortised cost

11.1

2016	Gross amount	Specific allowances for impairment	Collective allowances for impairment	Carrying amount
Core business				
Wholesale				
Refinanced loan	52 172	(947)	(515)	50 710
Funding for Growth Scheme	81 963	(429)	(965)	80 569
Factoring	24 661	(284)	(1 175)	23 202
Overdraft	44 156	(2 397)	(367)	41 392
Széchenyi Loans	20 567	(458)	(221)	19 888
Other	214 589	(28 565)	(2 888)	183 136
Total Wholesale	***438 108***	***(33 080)***	***(6 131)***	***398 897***
Retail				
Residental mortgage				
HUF	*259 940*	*(37 436)*	*(3 380)*	*219 124*
Foreign currency	*4 849*	*(2 016)*	*(71)*	*2 762*
Credit card	2 672	(145)	(67)	2 460
Overdraft	2 107	(580)	(54)	1 473
Personal loan	1 281	(100)	(34)	1 147
Car finance	97 631	(5 560)	(346)	91 725
Other	59 688	(5 513)	(79)	54 096
Total Retail	***428 168***	***(51 350)***	***(4 031)***	***372 787***
Total Core business	**866 276**	**(84 430)**	**(10 162)**	**771 684**
Non-core business				
CRE	***103 527***	***(15 656)***	***(1 483)***	***86 388***
Total	**969 803**	**(100 086)**	**(11 645)**	**858 072**

2015	Gross amount	Specific allowances for impairment	Collective allowances for impairment	Carrying amount
Core business				
Wholesale				
Refinancing	45 348	(1 052)	(364)	43 932
Funding for Growth Scheme	100 366	(798)	(1 341)	98 227
Factoring	18 535	(328)	(172)	18 035
Overdraft	28 793	(2 125)	(284)	26 384
Széchenyi Loans	16 960	(435)	(75)	16 450
Other	125 906	(20 846)	(933)	104 127
Total Wholesale	***335 908***	***(25 584)***	***(3 169)***	***307 155***
Retail				
Residental mortgage				
HUF	*294 068*	*(39 633)*	*(45)*	*254 390*
Foreign currency	*5 704*	*(1 687)*	*-*	*4 017*
Credit card	2 911	(210)	-	2 701
Overdraft	2 176	(650)	-	1 526
Personal loan	1 504	(351)	-	1 153
Car finance	56 050	(8 597)	(175)	47 278
Other	24 171	(7 744)	(33)	16 394
Total Retail	***386 584***	***(58 872)***	***(253)***	***327 459***
Total Core business	**722 492**	**(84 456)**	**(3 422)**	**634 614**
Non-core business				
CRE	***240 191***	***(71 002)***	***(849)***	***168 340***
Total	**962 683**	**(155 458)**	**(4 271)**	**802 954**

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

Spin off

In 2015, the previous owner's priority was to separate and sell those bad debts due for years, which did not match into the Bank's long-term strategy in consideration the possibilities offered by relevant legislation, simultaneously complying with the rules of EU. To reach this purpose the Bank assigned necessary internal resources and used external experts as well.
The project aiming at the separation of the portfolio was approved by the resolution of the previous owner on 12 March 2015, and was completed succesfully on 21 December 2015. In course of this transaction receivables in the net amount of HUF 114.9 billion were transferred to MSZVK Magyar Szanálási Vagyonkezelő Zrt., founded by the Szanálási Alap. The losses realised on this transaction amounted to HUF 26.3 billion.
In addition to the receivables, the investments held by the Bank in MKB Pénzügyi Zrt. and Resideal Zrt. were also transferred, resulting in HUF 46.5 million loss in the consolidated financial statements for 2015. This loss was however increased by the impairment losses accounted for the real estates by Resideal Zrt. in the amount of HUF 5 billion prior to the transfer.

CRE (previously SCU) remaining portfolio

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

According to the EU commitments forming part of the Restructuring Plan approved by the European Commission, the gross volume of the remaining CRE (i.e. Commercial Real Estate previously SCU) portfolio has to be reduced below HUF 60 billion by the end of 2019. The main measures for dismantling the portfolio are: collection of scheduled repayment; refinancing by other financial institution; completion of legal procedures. In case of available favorable offers, asset sales can be considered as well.
On 31 December, 2016 the balance of the CRE portfolio amounted to HUF 86,389 million. (See Note 11.1)

Asset realization strategy

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

Effects of the Act on Consumer Loan Contracts of Financial Institutions

Settlement

Based on the requirements of the act XXXVIII of 2014, which objective was to settle disputes on the Curia's civil law uniformity decision on consumer loan contracts and the act XL of 2014 enacting the method of regulations on the settlement and other related directions, repayment obligation arose at MKB Group if the consumer loan contract commenced after May 1st, 2004 and before July 26th 2014 and have not been terminated before July 26th, 2009 and if the Bank has charged foreign currency exchange rate spread (margin) on the client or applied unilateral commission or interest increase. The repayment obligation covers those

consumer loan contracts as well, which expired before July 26th, 2009, however the Group is aware of the fact, that its claims against the consumers have not barred yet, or the consumers can prove, that the claims previously transferred by the Group are due to a credit management company, which is not obliged to the settlement.

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

The repayment obligation of the Group has been carried out during 2015, except for the claims assigned to credit management companies – in this case the clients could apply for the settlement by December 31st, 2015. The credit management companies may request the Group to refund the settlement made to the clients without any statutory deadline. As of December 31st, 2015 the Group maintained HUF 956 million provision for the expected future claims and litigations.

In 2015, the Group accounted for HUF 47,697 million losses in Other expenses related to the settlement made, and HUF 45,303 million of those provisions were released that were set aside for such losses in 2014. As of December 31, 2015 the balance of the provision by the Group for possible future settlement obligations amounted to HUF 1,216 million.

By the end of the reporting period the deadline for submitting settlement claims expired, so the Bank does not have any settlement obligations remained. However in case of receivables sold and non-consumer loan agreements the release of the provision requires further legal and business considerations, as a result of this on December 31st, 2016 HUF 1,000 million provision is maintained by the Group.

Conversion of foreign currency denominated mortgage and other loans

On December 31st, 2014, the net carrying amount of the mortgage and other loans denominated in foreign currency amounted to HUF 318,312 million in the statement of financial position of the Group. These loans were converted to domestic currency at a fixed rate on February 1st, 2015 based on the act of LXXVII of 2014, and later during the reporting year according to the act CXLV of 2015. Based on the requirements of the act CXLV of 2015 on the conversion of foreign currency consumer contracts, 6 thousand contracts of the Group were affected by the conversion of other consumer loans in 2015.
The Group did not account for a significant exchange rate difference related to the conversion as a result of the derivative transactions entered.

In line with International Financial Reporting Standards, the Group derecognized the foreign currency denominated loans and initially recognized the loans after conversion denominated in domestic currency at fair value in the books. In case of the loans impaired prior to the conversion, the fair value of the converted loans reflected the net recovery expectation of the Group, which amounted to the net carrying amount prior to the conversion. As a result of the settlement and conversion, in 2015 the volume of the loans concerned by these transactions at the Bank decreased by HUF 107 billion, of which HUF 49 billion reduction was driven by the impairment taken into account for the initial value of the converted loans.

Conversion of foreign currency denominated mortgage and other loans – apart from few cases – was finished in 2015.

Allowances for impairment

11.2

	2016	2015
Specific allowances for impairment on loans and advances to customers		
Balance at 1 January	155 458	288 604
Impairment loss for the year:		
Charge for the year	26 166	48 911
Reversal	(23 876)	(8 299)
First consolidation as subsidiary	-	1 816
Disposal from deconsolidation	-	(411)
Utilisation	(56 012)	(160 245)
Effect of foreign currency movements	(294)	(1 605)
Unwinding of discount	(1 356)	(3 562)
Reclassification	-	(123)
Disposal of Non-current assets held for sale and discontinued operations	-	(9 628)
Balance at 31 December	**100 086**	**155 458**
Collective allowances for impairment on loans and advances to customers		
Balance at 1 January	4 271	5 785
Impairment loss for the year:		
Charge for the year	11 339	2 219
Reversal	(3 327)	(2 487)
First consolidation as subsidiary	-	18
Utilisation	(24)	(1 194)
Effect of foreign currency movements	(56)	(37)
Unwinding of discount	(558)	-
Reclassification	-	(33)
Balance at 31 December	**11 645**	**4 271**

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

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

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

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

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

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

11.3

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

Sectors 2015	Gross amount	Specific allowances for impairment	Collective allowances for impairment	Carrying amount
Sovereign	1 523	(85)	(1)	1 437
Private	583 594	(78 717)	(1 804)	503 073
Financial institution	21 933	(166)	(168)	21 599
Real estate	88 081	(38 371)	(817)	48 893
Other	267 552	(38 119)	(1 481)	227 952
Loans and advances to customers	**962 683**	**(155 458)**	**(4 271)**	**802 954**

At 31 December 2016 there were no loans designated as hedged item in a fair value hedge relationship.

Finance lease receivables

As part of its financing activities, the Group enters into finance lease transactions as a lessor. At December 31, 2016 and 2015, the reconciliation of the Group's gross investment in the lease, and the net present value of minimum lease payments receivable by relevant remaining maturity periods are as follows:

11.4

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

2015	up to 1 year	1 year to 5 years	over 5 years	Total
Gross investment in the lease	23 094	36 835	809	60 738
Unearned finance income	(3 495)	(4 105)	(59)	(7 659)
Present value of minimum lease payments	19 599	32 730	750	53 079
Finance leases as per balance sheet date	**19 599**	**32 730**	**750**	**53 079**

In 2016, HUF -116 million contingent rents were recognized in finance income (2015: HUF 100 million), and unguaranteed residual value amounted to HUF 4 869 million (2015: HUF 2 702 million). At 31 December 31 2016, no accumulated allowance for uncollectible minimum lease payments were recognised (2015: 0 million).

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

12 Other assets

12.1

	2016	2015
Prepayments and other debtors	27 079	19 855
Inventory	626	658
Corporate income tax refundable	31	24
Other taxes refundable	514	533
Specific allowances for impairment	(169)	(213)
Other assets	**28 081**	**20 857**

Specific allowances for impairment		
Balance at 1 January	(213)	(867)
Impairment loss for the year:		
Charge for the year	(27)	(1 012)
Reversal	71	2
Utilization	-	107
Effect of foreign currency movements	-	(4)
Disposal due to deconsolidation	-	1 684
Reclassification	-	(123)
Balance at 31 December	**(169)**	**(213)**

13 Investments in jointly controlled entities and associates

13.1

	2016	2015
Cost	1 651	1 529
Investments in jointly controlled entities and associates	**1 651**	**1 529**

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

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

14 Intangibles, property and equipment

14.1

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

2015	Intangible assets	Freehold property	Investment property	Equipment	Total
Cost					
Balance at 1 January	44 522	49 432	15 850	28 019	137 823
First consolidation as subsidiary	48	96	-	103	247
Additions – including internally developed	2 448	1 040	118	941	4 547
Other additions	951	26	-	115	1 092
Disposals	(639)	(787)	(3 237)	(3 881)	(8 544)
Disposal due to deconsolidation	(4)	(2 546)	(12 731)	(18)	(15 299)
Balance at 31 December	**47 326**	**47 261**	**-**	**25 279**	**119 866**
Depreciation and impairment losses					
Balance at 1 January	34 405	12 122	2 107	20 659	69 293
First consolidation as subsidiary	48	5	-	54	107
Depreciation and amortization for the year	2 162	1 558	314	1 775	5 809
Impairment loss	3 496	463	3 862	378	8 199
Disposals	(639)	(568)	(174)	(3 637)	(5 018)
Disposal due to deconsolidation	-	(492)	(6 109)	(8)	(6 609)
Balance at 31 December	**40 423**	**13 095**	**-**	**19 336**	**72 854**
Carrying amounts					
At 1 January	10 117	37 310	13 743	7 360	68 530
At 31 December	**6 903**	**34 166**	**-**	**5 943**	**47 012**

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

Investment properties of the Group were disposed in the course of the spin off process by the end of 2015. Prior to the transfer, impairment loss had been recognised on them in the amount of HUF 3,862 million.

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

In 2016, no Non-cancellable operating leases are disclosed, as the properties rented previously were transferred in course of the spin-off by the end of 2015.

During 2015 and 2016, the main part of the increase in intangible assets was the additional investments in, and developments of such assets. In 2016, the most significant component of these investments and developments was the costs related to the on-going Core system replacement process at the Bank. In addition, the Group disclosed several other items here concerning capitalisations of functional developments of other IT systems.

15 Amounts due to other banks

15.1

	2016	2015
Due on demand	4 608	4 915
Money market deposits	160 846	97 156
Borrowings	210 808	222 580
Amounts due to other banks	**376 262**	**324 651**

16 Deposits and current accounts

16.1

	2016	2015
From corporate clients	988 805	834 800
From retail clients	531 063	544 368
Deposits and current accounts	**1 519 868**	**1 379 168**

As at 31 December 2016, from the amount of current and deposit accounts, HUF 8,688 million (2015: HUF 21,388 million) has been measured as a fair value through profit or loss.

Finance leases as a lessee

As part of its business activities, the Group enters into finance lease transactions as a lessee. At 31 December 2016 and 2015, the reconciliation of the Group's future minimum lease payments at the end of the reporting period and their present value by relevant remaining maturity periods was the following:

16.2

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

2015	up to 1 year	1 year to 5 years	over 5 years	Total
Future minimum lease payments	1 375	6 864	20 612	28 851
Unpaid finance expense	(1 296)	(6 465)	(10 417)	(18 178)
Present value of minimum lease payments	**79**	**399**	**10 195**	**10 673**
Finance leases as a lessee	**79**	**399**	**10 195**	**10 673**

In 2016, no contingent rents were recognized in finance income (2015: HUF NIL). The net carrying amount of the leased office (IT) equipment amounted to HUF 255 million at the end of the reporting period (2015: HUF 313 million), and the net carrying amount of the lands and buildings used by the reporting entity was HUF 5,300 million (2015: HUF 5,696 million). In case of the building the contractual maturity is 25 years, with no residual value. The IT tools are leased for 5 years as per contract, which equals to the useful life of the assets.

17 Financial liabilities measured at FVTPL

17.1

	2016			2015		
	Cost	Unrealised result	Book value	Cost	Unrealised result	Book value
Derivative instruments by type						
FX-based derivatives instruments	-	2 867	2 867	-	7 816	7 816
Index-based derivative instruments	-	10	10	-	2	2
Interest-based derivative instruments	-	26 623	26 623	-	12 530	12 530
Options	134	349	483	245	158	403
Total derivative instruments	**134**	**29 849**	**29 983**	**245**	**20 506**	**20 751**
Financial liabilities measured at FVTPL	**134**	**29 849**	**29 983**	**245**	**20 506**	**20 751**

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

18 Derivative liabilities held for risk management

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

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

Other derivatives held for risk management

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

19 Other liabilities and provisions

19.1

	2016	2015
Accruals and other creditors	27 560	26 681
Corporate income tax payable	19	-
Other taxes payable	2 498	2 017
Provision for contingencies and commitments	6 120	5 104
Provision for settlement of FX consumer loans	1 000	1 216
Other liabilities and provisions	**37 197**	**35 018**

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

Provision for contingencies and commitments

19.2

	2016	2015
Balance at 1 January	6 320	46 999
Provisions made during the year	4 115	3 528
Provisions used during the year	(210)	(45 310)
Provisions reversed during the year	(3 080)	(1 745)
Effect of foreign currency movements	(25)	2 848
Balance at 31 December	**7 120**	**6 320**

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

Operating lease as a lessee

The Group leases some of its branches in the form of operating lease. At 31 December 2016 and 2015, the total amount of future minimum lease payments under non-cancellable operating leases by relevant remaining period was the following:

19.3

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

2015	up to 1 year	1 year to 5 years	over 5 years	Total
Minimum lease payments	1 131	3 558	3 565	8 254
Non-cancellable operating leases	**1 131**	**3 558**	**3 565**	**8 254**

In 2016, lease were recognised as an expense in the period amounted to HUF 1 281 million (2015: HUF 1 307 million). Furthermore no contingent rents (2015: 0 million) and no sublease payments were recognised.
The leasing contracts remaining maturity ranges from 1 year to 10 years. Most of the leasing agreements are EUR based. Bank branches, warehouses and archives are operated in the leased property.
The contingent rents are yearly increased by inflation rates of Eurostadt. Most of the leasing contracts were extend as a right of option.

20 Issued debt securities

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

20.1

Interest	Balance at 1 January	Issued debt securities	Repurchased debt securities	Repaid debt securities	Revaluation result	Balance at 31 December
31 December 2016						
Fixed rate	42 767	-	5 613	(46 831)	97	1 646
Structured	23 045	-	17	(11 935)	82	11 209
Floating rate	18 195	-	4 581	(22 776)	-	-
Accrued interest	1 618	-	-	-	-	37
Total	**85 625**	**-**	**10 211**	**(81 542)**	**179**	**12 892**
31 December 2015						
Fixed rate	57 684	1 745	(2 635)	(14 688)	661	42 767
Structured	23 248	9 640	128	(9 208)	(763)	23 045
Floating rate	72 713	-	(2 430)	(52 082)	(6)	18 195
Accrued interest	1 493	-	-	-	-	1 618
Total	**155 138**	**11 385**	**(4 937)**	**(75 978)**	**(108)**	**85 625**

The Group uses fair value option revaluation through profit or loss for structured bonds, as they are related to assets, which share the same risk that give rise to opposite changes in fair value. At 31 December 2016 the carrying amount of FVTPL own issued bonds amounted to HUF 11,227 million (2015: HUF 23,141 million).

21 Subordinated debt

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

At 31 December 2016 the Group had no subordinated debt obligations (2015: NIL).

On 25 July, 2016 the MKB Bank’s General Meeting authorized the Board of Director to negotiate and take the reasonable steps for involvement of subordinated debt at most in amount of HUF 50 billion.

22 Share capital

The Bank’s authorised, issued, called up and fully paid share capital comprises 100,000,000 (2015: 225,489,994) ordinary shares of HUF 1,000 (2015: HUF 1,000) each. All issued shares rank pari passu in the event of a winding up.

On 25 July, 2016 the extraordinary General Meeting made a decision to reduce the Share capital of the Bank from HUF 225.49 billion to HUF 100 billion. This action was the result of the commitment required by the authorities and assigned to the new owners in course of the resolution process in order to meet respective legal requirements. The capital reduction was carried out in the form of a reclassification between the elements of the Equity (see Consolidated Statement of Changes in Equity).

23 Reserves

Currency translation reserve

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

Share premium

Share premium comprises of premiums on share capital issuances.

Retained Earnings

Retained earnings comprise the accumulated profit after taxes earned in the course of the operating life of an entity of the Group less any dividend payment. There is no available Retained Earnings for distribution for the parent of the holding company.

Based on the contract signed on 12 June 2015 by MKB Bank Zrt. and the former co-owners of Euroleasing Group, the Bank obtained 100% direct ownership in MKB-Euroleasing Zrt. - controlled previously 50%-, and through this company indirectly also in the car financing entities of the Group (MKB-Euroleasing Autóhitel Zrt. and MKB-Euroleasing Autólízing Zrt.). At the same time MKB-Euroleasing Zrt. sold the investments held in car dealer companies. The transactions were closed on 8 September 2015.
According to IFRS 3 International Financial Reporting Standard, this transaction is not considered as an acquisition, therefore it is disclosed as buyout of the non-controlling interest in the Financial Statements of the Group for 2015: the payments made in addition to this buyout decreased Retained earnings in the amount of HUF 2,876 million, while the balance of non-controlling interest of HUF – 1,932 million was disposed. The transaction resulted in HUF 945 million reduction in the consolidated Equity of the Group.

General reserve

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

The Group discloses general reserve as part of retained earnings. In 2016 MKB recognized additional general reserve of HUF 1 014 million (2015: NIL).

Revaluation reserves

AFS financial assets' revaluation reserve includes the cumulative net change in the fair value of available-for-sale investments until the investment is derecognized or impaired.
The Group did not apply any reclassification adjustments relating to components of other comprehensive income.

24 Non-controlling interest

In September 2015, the Group acquired 100% ownership in MKB-Euroleasing Autóhitel Zrt. and MKB-Euroleasing Autólízing Zrt., resulting in NIL Non-controlling interest at the end of 2015.

For the year ended December 31, 2016 there are no material non-controlling interests related to non-wholly owned subsidiaries of the Group.

Non material non-controlling interest exists in case of MKB Jelzálogbank Zrt. where the main shareholder is MKB Bank Zrt. with a 99% participation, while Gránit Bank Zrt. holds 1% of the shares.
The Group discloses also a Non-controlling interest of HUF 5,550 million related to the special purpose entity for the Employee Share Ownership Program (ESOP). This amount represents the contribution of the participating members.

25 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

25.1

	2016			2015		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Intangibles, property and equipment	0	495	(495)	2	546	(544)
Investments in subs., jointly contr. entities and associates	117	0	117	146	-	146
Available-for-sale securities	3	201	(198)	1 038	-	1 038
Loans and advances to customers	656	151	505	586	248	338
Allowances for loan losses	67	629	(562)	32	1 331	(1 299)
Amounts due to customers	468	-	468	976	-	976
Issued debt securities	-	8	(8)	-	122	(122)
Provisions (included general risk reserve)	213	244	(31)	407	-	407
Derivatives	162	50	112	513	312	201
Other items	232	17	215	601	91	510
Tax loss carry-forwards	3 191	-	3 191	1 013	-	1 013
Offsetting	(1 789)	(1 789)	-	(2 747)	(2 747)	-
Non-current assets held for sale and discontinued operation	-	-	-	-	997	(997)
Net tax assets / liabilities	3 320	**6**	**3 314**	2 567	**900**	**1 667**

26 Interest income

26.1

	2016	2015
Cash reserves	338	2 075
Loans and advances to banks	49	73
Loans and advances to customers	32 226	45 683
Derivatives	9 110	12 480
Investments in securities	20 753	13 661
Interest income	**62 476**	**73 971**

Included within various captions under interest income for the year ended 31 December 2016 is a total of HUF 1,914 million (2015: 3,543 million) accrued on impaired financial assets.

27 Interest expense

27.1

	2016	2015
Amounts due to other banks	2 649	1 798
Deposits from customers	9 224	14 365
Issued debt securities	1 029	4 089
Other fees and commisions similar to interest expenses	29	105
Derivatives	10 873	11 285
Interest expense	**23 804**	**31 642**

Included within net interest income there is HUF 4,526 million interest income and HUF 7,112 million expense from derivatives held in a qualifying fair value hedging relationship. These derivatives were designated as fair value hedges to hedge changes in the fair value of certain investments in securities during the reporting year.

The only components of interest income and expense reported above that relate to financial assets or liabilities carried at fair value through profit or loss are the income and expense on derivative assets and liabilities held for risk management purposes.

28 Net income from commissions and fees

28.1

	2016	2015
Commission and fee income	**37 406**	**35 030**
Payment and account services	19 152	19 100
Credit related fees	1 639	1 585
Card services	2 377	2 450
Brokerage fees and other securities business	10 646	8 316
Other commission and fee income	3 592	3 579
Commission and fee expense	**8 742**	**8 298**
Payment and account services	2 837	2 960
Credit related fees	1 090	1 664
Card services	1 436	1 214
Brokerage fees and other securities business	1 229	654
Other commission and fee expense	2 150	1 806
Net income from commissions and fees	**28 664**	**26 732**

Brokerage fees include fees from trust management and other securities services in the amount of HUF 2,151 million (2015: HUF 1,975 million). For further information on the Group's fund management activity, please see Note 38.

29 Other operating income / (expense), net

29.1

	2016	2015
Gain on trading securities	2 579	1 631
Gain / (loss) on sale of available-for-sale securities	9 361	3 493
Net loss on assets held for sale	-	(46)
Net gain on trading derivative transactions	6 111	18 738
Gains and losses on fair value hedges		-
Gains and losses on hedging instruments	*(11 174)*	-
Gains and losses on underlyying transactions	*9 124*	-
Fair Value results from FVTPL revaluation (FVO)	(486)	(164)
Net income from collaterals held in possession	(2)	(2)
Expenses relating to bank levies	(6 257)	(13 641)
Transaction duty	(11 020)	(10 823)
Other taxes	(3 063)	(2 365)
Other	(1 459)	2 585
Other operating income / (expense), net	**(6 286)**	**(594)**

The result from fair value revaluation of structured bonds designated at fair value through profit or loss was HUF 95 million loss (2015: 872 million gain), and it amounted to HUF 430 million gain regarding long term deposits designated at fair value (2015: 1,046 million gain). Net gain on assets held for sale in 2015 included the result of the spin-off of Resideal Zrt. and MKB Pénzügyi Zrt.

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

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

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

Financial institutions operating on 1 January, 2016 shall be liable to pay this tax in the whole amount also in 2016 according to the Act. The financial plans are calculated with remaining, but decreasing rate of banking tax. In the following years, instead of the 2009 annual accounts, as a rolling tax base, the total asset data from the previous second year shall be taken into account.
In 2016, the credit institutions providing also investment and supplementary services were levied an additional banking tax concerning these services.

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

30 Impairments and provisions for losses

30.1

	Note	2016	2015
Impairment loss on			
Loans and advances to banks	**8**	(42)	(18)
Loans and advances to customers	**11**	10 302	40 343
Other assets	**12**	(44)	1 010
Realised loss on sale of loans		3 600	47 706
Impairment loss on investment properties	**14**	-	3 862
Non-current assets held for sale and discontinued operations		-	(228)
Provision on			
Guarantees and contingencies	**19**	1 420	1 783
Impairments and provisions for losses		**15 236**	**94 458**

In 2015, the losses arising from derecognition contained the effect of spin off in the amount HUF 26,336 million. For further information about spin off, please see Note 11.

31 Operating expenses

31.1

	2016	2015
General and administration expenses	3 062	4 238
Legal and advisory services	2 507	5 249
Wages and salaries	12 642	15 389
Termination benefits	427	888
Compulsory social security obligations	4 270	4 748
Occupancy costs	9 511	15 705
Marketing and public relations	1 087	1 009
Communication and data processing	4 777	5 684
Operating expenses	**38 283**	**52 910**

In 2016, the Group's average statistical employee number was 1,996 (2015: 2,080).
Occupancy costs significantly decreased due to the impairment on Intangible assets in 2015, which amounted to HUF 3,495 million. Legal and advisory costs decreased as well mainly due to the expenses incurred last year in connection with the reorganization of the Group.
Expenses for Legal and advisory services contains HUF 110 million (2015: 143) audit fees.

32 Income tax

Income tax expense recognized in the Statement of Comprehensive Income

32.1

	2016	2015
Current tax expense	*440*	*119*
Hungarian corporation tax charge – on current year profit	440	119
Deferred tax expense/(income)	*(2 132)*	*(1 890)*
Origination (reversal) of temporary differences	(3 120)	(1 841)
Effect of changes in deferred tax rates	988	(50)
Income tax expense / (credit)	**(1 692)**	**(1 771)**

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

Reconciliation of effective tax rate

32.2

	2016		2015	
	%	HUF million	%	HUF million
Profit / Loss before income tax		12 765		(78 173)
Income tax using the domestic corporation tax rate	10,00%	1 277	10,00%	(7 817)
Effect of tax rates in foreign jurisdictions	0,00%	-	0,00%	-
Effect of changes in tax rates	8,78%	1 121	2,44%	(1 905)
Movement of unrecognized temporary differences	-30,68%	(3 917)	-2,92%	2 281
Unrecognized tax losses for the reporting period	1,35%	172	-7,73%	6 041
Tax Losses expiring in current year	-3,44%	(439)	-0,68%	534
Non-deductible expenses	36,26%	4 629	-1,68%	1 315
Tax exempt income	-13,82%	(1 764)	1,16%	(909)
Re-assessment of unrecognised tax losses/interest carryforwards	-20,43%	(2 608)	0,00%	-
Other tax effects	-1,27%	(163)	1,68%	(1 311)
Income tax	**-13,26%**	**(1 692)**	**2,26%**	**(1 771)**

MKB used a prudent approach concerning tax losses. Workout companies were not allowed to recognize any deferred tax assets above the limit of deferred tax liability in their books and the relating tax income and other companies used their available plan figures for calculation the upper limit. In 2011 legal base of tax loss changed and due to this fact, tax losses can be used at maximum the 50% of the tax base in the future. Based on this calculation, deferred tax asset on balance sheet items and on tax loss carry forwards totalled at HUF 5,109 million (2015: 5,313 million) before offsetting (see Note 25).

At 31 December 2016, the Group had unused tax losses amounting to HUF 375,918 million (2015: HUF 379,490 million) with the following maturity:

32.3

	2016	2015
Maturity between 1 and 5 years	66 222	63 684
Mature between 5 and 10 years	309 696	315 806
Tax loss carryforwards	**375 918**	**379 490**

The Group has HUF 343,962 million (2015: HUF 368,323 million) tax losses carried forward, on which no deferred tax asset was recognised.
In 2015, the rules of utilization of tax losses carried forward have changed in Hungary: tax losses arising in 2015 and in following years, can be utilized solely in the next five years after the tax year in which it was generated.

In 2016, the Group booked HUF 3 million deferred tax asset and HUF 12 million deferred tax liability (2015: HUF 476 million deferred tax asset) directly against equity relating to AFS securities' revaluation.

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

32.4

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

2015 P/L-effective effects on deferred tax assets (DTA) and deferred tax liabilities (DTL)	Opening balance DTA/DTL	First consolidation as subsidiary	Tax Rate change	P/L-effective movement of DTA/DTL	P/L-neutral movement of DTA/DTL	Closing balance DTA/DTL
Deferred Tax Assets - due to deductible temporary differences						
Assets						
Provision for losses on loans and advances	1 516	-	1 302	(2 786)	-	32
Financial assets measured at FVTPL	381	-	327	(195)	-	513
Investments accounted for using the equity method	219	-	78	411	476	1 184
Property, plant and equipment and investment property	16	-	14	(28)	-	2
Intangible Assets	271	-	232	(7)	-	496
Other Assets	-	-	-	105	-	105
Liabilities						
Amounts due to other banks, Deposits and current accounts	-	-	-	976	-	976
Provisions	412	-	322	(327)	-	407
Other liabilities	730	-	627	(1 357)	-	-
Deferred Tax Assets - due to tax losses (total)	286	401	-	326	-	1 013
Subtotal DTA before netting	**3 831**	**401**	**2 902**	**(2 295)**	**476**	**5 315**
Deferred Tax Liabilities - due to deductible temporary differences						
Assets						
Loans and advances to bank, Loans and advances to customers, Receivables held for trading	(2 662)	(3)	(2 045)	4 462	-	(248)
Provision for losses on loans and advances	(370)	(331)	-	(630)	-	(1 331)
Investments accounted for using the equity method	-	(67)	-	67	-	-
Property, plant and equipment and investment property	(557)	-	-	11	-	(546)
Non-current assets or disposal groups as held vor Sale and assets from discontinued operations	-	-	-	(997)	-	(997)
Other Assets	(743)	-	(639)	1 375	-	(7)
Liabilities						
Amounts due to other banks, Deposits and current accounts , Liabilities categorised as held for trading (excluding liabilities from short sales)	(68)	-	(58)	126	-	-
Securitized liabilities	(48)	-	(41)	(33)	-	(122)
Financial liabilities measured at FVTPL	(81)	-	(69)	(162)	-	(312)
Subtotal DTL before netting	**(4 529)**	**(401)**	**(2 852)**	**4 136**	**-**	**(3 646)**
Netting of short-term DTA	(81)	-	(69)	(162)	-	(312)
Netting of short-term /DTL	81	-	69	162	-	312
Subtotal DTA after netting balance sheet positions	**3 750**	**401**	**2 833**	**(2 457)**	**476**	**5 003**
Netting of p/l-effective DTA with p/l-effective DTL (per earning reserves)	(3 692)	(401)	-	1 715	-	(2 436)
Netting of p/l-effective DTA with p/l-neutral DTL (per earning reserves)	(58)	-	-	-	-	-
Subtotal DTL after netting of balance sheet - positions	**(4 448)**	**(401)**	**(2 783)**	**4 298**	**-**	**(3 334)**
Netting of p/l-effective DTL with p/l-effective DTA (per earning reserves)	3 691	401	-	(1 658)	-	2 434
Subtotal DTA after netting completely with DTL	**-**	**-**	**2 833**	**(742)**	**476**	**2 567**
Subtotal DTL after netting completely with DTA	**(757)**	**-**	**(2 783)**	**2 640**	**-**	**(900)**

33 Earnings per share

The calculation of basic earnings per share at 31 December 2016 was based on the net income attributable to ordinary shareholders of HUF 9,496 million (2015: HUF -75,868 million) and a weighted average number of ordinary shares outstanding of 137,602 thousands (2015: 225,490 thousands)

$$\text{Earnings per Ordinary Share (in HUF)} = \frac{\text{Net income available to ordinary shareholders (in HUF million)}}{\text{Average number of ordinary shares outstanding (thousands)}} = \frac{\text{HUF 9,496 million}}{\text{137,602 thousands}} = \text{HUF 69}$$

The calculation of fully diluted earnings per share was based on the profit attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding after any adjustment for the effects of all dilutive potential ordinary shares. In 2016 and 2015 there

were no dilution factor that might cause an adjustment in the weighted average number of ordinary shares, therefore basic and diluted EPS were equivalent.

34 Contingencies and commitments

34.1

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

2015	Gross	Provision	Net
Contingencies			
Guarantees and similar obligations	114 804	(1 883)	112 921
Obligations from letters of credit and other short term trade related items	12 005	(94)	11 911
Other contingent liablities (including litigation)	82 835	(1 696)	81 139
Total contingencies	**209 644**	**(3 673)**	**205 971**
Commitments			
Undrawn commitments to extend credit	227 085	(1 431)	225 654
Total commitments	**227 085**	**(1 431)**	**225 654**

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

35 Use of estimates and judgements

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

These disclosures supplement the commentary on financial risk management (see Note 6).

Key sources of estimation uncertainty

Allowances for credit losses

Assets accounted for at amortised cost are evaluated for impairment on a basis described in accounting policy (see Note 4 i,).

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

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

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

Determining fair values

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

Critical accounting judgements in applying the Group's accounting policies

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

Valuation of financial instruments

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

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

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

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. Counterparty risk (CVA) and own credit risk (DVA) is also taken into account by calculation of fair value of derivative transactions except of the followings:

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

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

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

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

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

35.1

	Note	Quoted market prices in active markets	Valuation techniques - observable inputs	Total
31 December 2016				
Financial assets measured at FVTPL	**9**	14 999	60 211	75 210
Investments in securities	**10**	385 666	187 725	573 391
Deposit and current accounts	**16**	-	8 688	8 688
Financial liabilities measured at FVTPL	**17**	-	29 983	29 983
Issued debt securities	**20**	-	11 228	11 228
Total		400 665	297 835	698 500
31 December 2015				
Financial assets measured at FVTPL	**9**	4 564	89 005	93 569
Investments in securities	**10**	672 297	135 617	807 914
Deposit and current accounts	**16**	-	21 388	21 388
Financial liabilities measured at FVTPL	**17**	-	20 751	20 751
Issued debt securities	**20**	-	23 141	23 141
Total		676 861	289 902	966 763

The determination of fair value level and the transfers between levels are in line with accounting policy (see Note 4 g).
There were no transfers between fair value levels in the financial year ended on December 31, 2016.

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

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

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

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

35.2

	Note	Interest	Foreign exchange rate	Other
31 December 2016				
Financial assets measured at FVTPL	**9**	70 890	4 575	-
Investments in securities	**10**	-	35 132	-
Deposit and current accounts	**16**	8 688	(5 540)	8 688
Financial liabilities measured at FVTPL	**17**	-	-	-
Issued debt securities	**20**	21 728	11 227	11 227
Total		**101 306**	**45 394**	**19 915**
31 December 2015				
Financial assets measured at FVTPL	**9**	90 389	8 001	1 332
Investments in securities	**10**	807 914	32 929	-
Deposit and current accounts	**16**	21 388	1 753	21 388
Financial liabilities measured at FVTPL	**17**	18 611	7 887	307
Issued debt securities	**20**	15 337	4 448	23 141
Total		**953 639**	**55 018**	**46 168**

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

36 Accounting classifications and fair values

The estimated fair values disclosed below are designated to approximate values at which these instruments could be exchanged in an arm's length transaction. However, many of the financial instruments have no active market and therefore, fair values are based on estimates using net present value and other valuation techniques (see Note 4 g, and Note 35), which are significantly affected by the assumptions used on the amount and timing of the estimated future cash flows and discount rates. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured.

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

36.1

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

2015	Note	Fair value through profit or loss	Loans and receivables	Available for sale	Held to maturity	Other amortised cost	Total carrying amount	Fair value
Financial assets								
Cash reserves	**7**	-	-	-	-	41 494	41 494	41 494
Loans and advances to banks	**8**	-	51 741	-	-	-	51 741	51 789
Measured at amortised cost		-	*51 741*	-	-	-	*51 741*	*51 789*
Financial assets measured at FVTPL	**9**	93 569	-	-	-	-	93 569	93 569
Investments in securities	**10**	-	-	807 914	51 827	-	859 741	859 662
Loans and advances to customers	**11**	-	802 954	-	-	-	802 954	796 251
Measured at amortised cost		-	*802 954*	-	-	-	*802 954*	*796 252*
Total		***93 569***	***854 695***	***807 914***	***51 827***	***41 494***	***1 849 499***	***1 842 765***
Financial liabilities								
Amounts due to other banks	**15**	-	-	-	-	324 650	324 650	335 957
Deposits and current accounts	**16**	21 388	-	-	-	1 357 780	1 379 168	1 365 364
Measured at fair value		*21 388*	-	-	-	-	*21 388*	*21 388*
Measured at amortised cost		-	-	-	-	*1 357 780*	*1 357 780*	*1 343 976*
Negative fair values of derivative financial instruments	**17**	20 751	-	-	-	-	20 751	20 751
Issued debt securities	**20**	23 141	-	-	-	62 484	85 625	87 241
Measured at fair value		*23 141*	-	-	-	-	*23 141*	*23 141*
Measured at amortised cost		-	-	-	-	*62 484*	*62 484*	*64 100*
Total		***65 280***	-	-	-	***1 744 914***	***1 810 194***	***1 809 313***

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

Cash reserves

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

Financial assets measured at FVTPL, Negative fair values of derivative financial instruments and Derivative assets and liabilities held for risk management

Fair values of Financial assets measured at FVTPL and Negative fair values of derivative financial instruments and Mikro hedge derivative assets and liabilities held for risk management that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using valuation techniques. For further information, please see Note 35.

Investments in securities

The fair values of instruments grouped into Investments in securities are based on quoted market prices, when available. If quoted market prices are not available, fair value is estimated using quoted market prices of similar securities. For further information, please refer to Note 10 and Note 35.

Loans and advances to banks and to customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by coupon rates. In general, contractual cash flows are discounted using a rate which is sum of the available interest rate which would have been offered if the customer applied for loan at the end of the reporting period plus the counterparty marge. The used interest rates are available in published Terms and Conditions as of 31 December, 2016 and the counterparty marge is available in the Bank's systems. The rediscounted cash flows are decreased using by the same impairment percentage as it was used for impairment purpose, and it is considered as fair value of the loan portfolio. Non-performing loans which are assessed for impairment individually are discounted with discount factors which are calculated as in case of performing loans, but that estimated cash flows of these loans are used for calculation, which was also used for impairment purpose. In the case of work-out loans where the bank expects cash flows only from sale of collaterals and therefore they are impaired to the net present value of this amount, the fair value is equal with the carrying amount. Concerning fair value estimation of FX loans see Note 11.

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

Amounts due to other banks and Current and deposit accounts

For the purposes of estimating fair value, Amounts due to other banks and Current and deposit accounts are grouped by residual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities plus MKB own credit risk. For determining own credit risk (DVA – Debit Value Adjustment) the bank uses the own PD and LGD used also for risk purposes which is also in line with the DVA

calculation method for negative fair value derivatives. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the end of the reporting period.

Issued debt securities and Subordinated debt

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

37 Related parties

During 2014, all of the MKB's shares were acquired by State of Hungary from Bayern LB. The new ultimate controlling party of the Group was the MSZKV Magyar Szanálási Vagyonkezelő ZRt.
By 30 June 2016, the market-based sales procedure of MKB Bank was closed, and the ownership rights are exercised by the new shareholders. (Further information about the owners, please see in 1. General information)

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

Transactions with related parties

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

37.1

	Non-consolidated subsidiaries		Jointly controlled entities		Associates		Key Management Personnel		Other related parties	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Assets										
Loans and advances to customers	1 913	1 518	-	25 062	324	335	29	42	-	44
Liabilities										
Current and deposit accounts	501	497	-	23	141	29	381	173	-	-
Other liabilities	-	-	-	12	-	-	-	-	-	-
Income statement										
Interest income	299	21	-	638	10	15	1	-	-	12
Interest expense	3	5	-	-	-	-	-	-	-	237
Other net income / (expense)	8	4	-	13	2	2	(804)	(813)	-	64
Contingencies and commitments										
Undrawn commitments to extend credit	713	494	-	1 743	55	56	-	-	-	13 877
Provision	1 241	1 221	-	209	9	3	-	-	-	108

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

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

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

Key management personnel compensation for the period comprised:

37.2

	2016	2015
Short-term employee benefits	804	420
Termination benefits	-	393
Total	**804**	**813**

22 December, 2014 four Reorganizational Commissioners took over control of the Bank, the former members of Board of Directors and Supervisory Board were recalled. Chairman and Chief Executive was Mr. András Sebők till 31 January, 2015.
Mr. Ádám Balog was appointed to take over the Chairman and Chief – Executive role of MKB Bank Zrt. from 23 July 2015. On 30 June, 2016, the National Bank of Hungary terminated the resolution process of MKB Bank, after the fulfilment of all objectives of the resolution. At this time – continuing the reorganization procedure – the reorganizational commissioners were recalled, and further the Board of Directors has been exercising the control of the Bank.

Key exposures to State of Hungary and local governments:

37.3

	Government		Local government	
	2016	2015	2016	2015
Loans and advances to customers	-	891	-	-
Bonds of public sector issuers	-	851 003	-	-
Current and deposit accounts	-	1 268	-	14 063
Undrawn commitments to extend credit	-	396	-	13 243
Guarantees	-	-	-	46 633

The exposures to State of Hungary and local governments have been purchased and issued by market terms. For 2016 no disclosure is required as exposures to government related parties, due to the change of the ownership of the Bank.

38 Funds management

The Group manages 20 close-ended (2015: 21) and 24 open-ended (2015: 31) investment fund via MKB Befektetési Alapkezelő Zrt, a fully owned and consolidated subsidiary. However, as the funds themselves are not controlled by the Group, they are not consolidated. For funds management services provided by the Group, funds should pay certain fees and commission that is presented as „Commission and fee income" (see Note 28). In 2016 and 2015, the volume of the funds, and transactions with the funds themselves were as follows:

38.1

	2016	2015
Managed funds (in HUF million)		
Open-ended funds	203 018	165 095
Close-ended funds	49 548	49 396
Commission and fee income from funds	2 151	7 096
Deposits from funds	73 017	65 706
Interest expense on deposits from funds	1 619	3 065

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

39 Segment information

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

Business segments

The business segments identified by the Group represent the organizational structure as reflected in its internal management reporting systems. The Group is organized into four business lines, each with its own distinct market and products. Each business line has its own set of objectives and targets broken down by operating units, which are consistent with the Group's overall strategic direction. As of 31 December 31 2016, the Group's business segments and their main products were:

Corporate Banking

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

Institutional Banking

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

Retail and Private Banking

The Group provides a wide range of deposit and savings instrument, credit and debit cards, portfolio management, and a limited number of loan products to high net worth individuals and entrepreneurs through 73 full-service branches and sub-branches (2015: 79 branches), ATMs, telephone and electronic channels.

Other

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

39.1

2016	Note	Corporate Banking	Institutional Banking	Retail and Private Banking	Other	Total
Assets						
Cash reserves	**7**	-	84 697	-	13 217	97 914
Loans and advances to banks	**8**	-	67 039	-	-	67 039
Financial assets measured at FVTPL	**9**	-	75 210	-	-	75 210
Investments in securities	**10**	707 054	217 083	-	-	924 137
Loans and advances to customers	**11**	463 734	1 258	393 080	-	858 072
Assets from Discontinued opeartion as held for sale	**40**	-	-	-	309	309
Other assets	**12**	-	-	-	28 081	28 081
Deferred tax assets	**25**	-	-	-	3 320	3 320
Investments in jointly controlled entities and associates	**13**	1 651	-	-	-	1 651
Intangibles, property and equipment	**14**	-	-	-	45 883	45 883
		1 172 439	**445 287**	**393 080**	**90 810**	**2 101 616**
Liabilities						
Amounts due to other banks	**15**	-	376 262	-	-	376 262
Deposit and current accounts	**16**	988 805	-	531 063	-	1 519 868
Negative fair values of derivative financial instruments	**17**	-	29 983	-	-	29 983
Other liabilities and provisions	**19**	2 545	788	320	33 544	37 197
Deferred tax liabilities	**25**	-	-	-	6	6
Issued debt securities	**20**	67	629	12 196	-	12 892
Shareholders' equity	**22,23,24**	(55 346)	-	-	180 754	125 408
		936 071	**407 662**	**543 579**	**214 304**	**2 101 616**
Income statement						
Gross revenue - external customers		21 529	32 358	46 207	(241)	99 853
Gross revenue - inter-segment		3 969	(3 630)	(339)	-	-
Interest and commission expenditure		(9 855)	(13 245)	(9 446)	-	(32 546)
Impairment and provisions for losses	**30**	(4 103)	47	(11 180)	-	(15 236)
Restructuring expenses		6	-	-	(6)	-
Operating costs	**31**	(16 498)	(1 420)	(20 302)	(63)	(38 283)
Expenses related to bank levies		-	-	-	(1 296)	(1 296)
Share of jointly controlled and associated companies' profit / (loss)		273	-	-	-	273
Profit / (Loss) before taxation		(6 212)	12 841	2 781	(1 606)	7 804
Segment result		**(6 212)**	**12 841**	**2 781**	**(1 606)**	**7 804**
Other information						
Capital expenditure		-	-	-	5 818	5 818
Depreciation and amortisation	**14**	3 237	-	1 739	-	4 976
Other non-cash expenses		415	36	511	1	963

2015	Note	Corporate Banking	Institutional Banking	Retail and Private Banking	Other	Total
Assets						
Cash reserves	**7**	-	27 494	-	14 000	41 494
Loans and advances to banks	**8**	-	51 740	-	-	51 740
Financial assets measured at FVTPL	**9**	-	93 569	-	-	93 569
Investments in securities	**10**	856 090	3 651	-	-	859 741
Loans and advances to customers	**11**	404 810	-	398 144	-	802 954
Non-current assets held for sale and discontinued operations	**40**	26 936	-	-	5 699	32 635
Other assets	**12**	-	-	-	20 857	20 857
Deferred tax assets	**25**	-	-	-	2 567	2 567
Investments in jointly controlled entities and associates	**13**	1 529	-	-	-	1 529
Intangibles, property and equipment	**14**	-	-	-	47 012	47 012
Total		**1 289 365**	**176 454**	**398 144**	**90 135**	**1 954 098**
Liabilities						
Amounts due to other banks	**15**	-	324 651	-	-	324 651
Deposit and current accounts	**16**	834 799	-	544 369	-	1 379 168
Financial liabilities measured at FVTPL	**17**	-	20 751	-	-	20 751
Other liabilities and provisions	**19**	13	667	1 365	32 973	35 018
Deferred tax liabilities	**25**	-	-	-	900	900
Issued debt securities	**20**	4 255	1 990	79 380	-	85 625
Shareholders' equity	**22, 23, 24**	-	-	-	107 985	107 985
Total		**839 067**	**348 059**	**625 114**	**141 858**	**1 954 098**
Income statement						
Gross revenue - external customers		39 338	42 293	47 196	(6 779)	122 048
Gross revenue - inter-segment		3 111	(877)	(2 234)	-	-
Interest and commission expenditure		(12 284)	(16 092)	(11 564)	-	(39 940)
Impairment and provisions for losses	**30**	(72 851)	-	(22 033)	426	(94 458)
Restructuring expenses		-	-	-	-	-
Operating costs	**31**	(11 786)	(4 869)	(31 367)	(4 888)	(52 910)
Expenses related to bank levies		-	-	-	(13 641)	(13 641)
Share of jointly controlled and associated companies' profit / (loss)		728	-	-	-	728
Profit / (Loss) before taxation		**(53 744)**	**20 455**	**(20 002)**	**(24 882)**	**(78 173)**
Segment result		**(53 744)**	**20 455**	**(20 002)**	**(24 882)**	**(78 173)**
Other information						
Capital expenditure		-	-	-	4 547	4 547
Depreciation and amortisation	**14**	3 516	-	2 293	-	5 809
Other non-cash expenses		166	69	442	65	742

During 2014 MKB Group ceased its foreign operations, in 2015 and 2016 conducted financial services only in Hungary. The Group had indirect interests in the Bulgarian car financing market, besides its domestic subsidiaries, however the shares were disposed on 30 June 2016. Consequently both revenues and non-current assets can be connected to domestic activities based on geographical location.

In presenting information on the basis of geographical areas, revenue is based on the geographical location of customers and assets are based on the geographical location of the assets.

Measurement of segment profit or loss

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

Calculation of intersegment revenue

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

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

40 Non-current assets held for sale and discontinued operations

For the year ended in December 2015, the table of non-current assets held for sale and discontinued operations, represented the Group's non-current assets held for sale in the amount of HUF 32,635 million, which consisted of more components:
On the one hand, the Group disclosed participations in MKB-Euroleasing Autópark Zrt. and MKB Autopark OOD as Non-current assets held for sale in the consolidated financial statements ended 31 December, 2015.
On the other hand the whole exposure of one of the Bank's customers was disclosed as loans and receivables held for sale in the amount of HUF 26,936 million as of December 31, 2015.
In addition one of the branches of the Bank (street Andrássy, Budapest) was closed in line with the cost cutting plans of the Group. For the year ended 31 December 2015, the own property was disclosed as non-current assets held for sale in the amount of HUF 133 million.

On 31 December, 2016, two of the branches of the Bank (street Andrássy and Alagút) are disclosed as non-current assets held for sale in the amount of HUF 285 million. These branches were closed and the management is committed for the sale of the properties. Furthermore related to the sale of the educational and leisure center in Balatonfüred, sailboats are also disclosed in this line in the amount of HUF 24 million. These assets are held for sale, the sale is continuous and is expected to be closed by the end of 2017.

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

40.1

	2016	2015
Assets		
Loans and advances to customers	-	26 936
Investments in jointly controlled entities and associates	-	5 566
Intangibles, property and equipment	309	133
Total assets	**309**	**32 635**

41 Government grants

The National Bank of Hungary (NBH) launched its three-pillar Funding for Growth Scheme (FGS) on 1 June 2013, primarily to stimulate lending to small and medium-sized enterprises. Under Pillar I and II of the FGS the NBH provided refinancing loans to credit institutions participating in the Scheme, at 0 per cent interest rate and with a maximum maturity of 10 years, which were lent further by the credit institutions to the SMEs with a capped interest margin.
Under Pillar I of the Scheme investment and current asset loans, EU subsidy financing, and loan refinancing denominated in Hungarian Forint could be carried out. Pillar II of the Scheme aimed to reduce the ratio of SME's foreign currency loans, allowing conversion of foreign currency loans to forint loans.

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

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

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

MKB Bank participated in all phases of the Scheme, and lent HUF 232,716 million loan to SME's since the beginning of the program, with an interest rate of 2.5% and EUR 35 million in course of the third phase.

The loans lent as part of FGS are measured at amortised cost at MKB Bank, however at initial recognition the difference between the carrying amount and the fair value of the loans and parallel of the NBH funds was deferred to Other assets (HUF 19,042 million) and to Other liabilities (HUF 15,467 million), which is amortised to Profit and loss during the term of the loans. This difference was driven by the gap between the market interest rate and the subsidized rate.
The fair value of the loans amounted to HUF 95,478 million as of 31 December 2016 (2015: HUF 101,266 million).

MKB Bank joined Market Loan Program - called PHP - on 19 January that is aimed at stimulating the banks' transition towards lending on market terms, and to continue to encourage banks to grant loans to SMEs. At the same time, the National Bank of Hungary also started to phase out the NHP III program.
MKB Bank undertook a HUF 25 billion growth in the net volume of SME lending for 2016 concerning PHP, therefore concluded HIRS transactions with NBH in a total amount of HUF 100 billion.

42 Share based compensation

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

Details of the share based compensation:

	Number of shares	Weighted average exercise price (HUF/share)
outstanding at the beginning of the period	0	0
granted during the period	33,823,499	164
forfeited during the period	449,152	164
exercised during the period	0	0
expired during the period	0	0
outstanding at the end of the period	32,866,989	164
exercisable at the end of the period	0	0

In order to determine the fair value of the share based compensation the Bank used Black-Scholes-Merton model with the following key parameters of risk-free rate of 2.25%, Volatility 25%. The estimate of the spot price is based on the transaction price related to the sale of the Bank's shares between MSZVK Magyar Szanálási Vagyonkezelő Zrt. and the new shareholders as disclosed in Note 1. General information. As the Bank's shares are not listed, the volatility is estimated based on historical volatility of share prices of the similar exchange listed banks in Hungary.

43 Events after the end of the reporting period

No significant events occurred at the Group after the end of the reporting period.

BUSINESS REPORT
to the consolidated 2016 financial statements of
MKB Bank Zrt. (Prepared under IFRS)

In 2016, the scope of activities of MKB Bank Zrt's subsidiaries and jointly controlled companies comprised the following sectors

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

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

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

On 16 December, 2015 the Bank signed an agreement about selling its participations in MKB-Euroleasing Autópark Zrt. and MKB Autopark OOD. The transaction was closed on 30 June, 2016.

MKB Group's profit after taxation for 2016 under IFRS amounted to HUF 9,496 million gain.

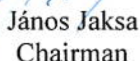
Consolidated shareholders' equity was HUF 125,408 million at 2016 year-end.

At December 31, 2016, MKB Group held repurchased own shares of HUF 5.5 billion in its portfolio (2015: NIL).

MKB Bank's corporate governance statement is attached in Enclosure 1.

In 2016, the Group accounted for HUF 412 million R&D costs.

Budapest, 10 March, 2017



János Jaksa
Chairman

dr. Ádám Balog
Chief Executive Officer

STATEMENT OF CORPORATE GOVERNANCE

The corporate governance system applied by MKB Bank Zrt. (hereinafter: the Company) is based on the effective Hungarian statutory regulations and the Articles of Association of the Company.

The Company was subject to a financial reorganisation procedure until 30 June 2016, which was closed upon the successful completion of a sales procedure closely monitored by the European Commission. In this Statement of Corporate Governance, the corporate governance structure for the period following the closure of the financial reorganisation procedure is presented. This corporate governance structure was in force also on 31 December 2016.

The Company is a private company limited by shares. Its supreme body is the General Meeting. At the General Meeting, each share entitles its holder to one vote. Furthermore, a Board of Directors and a Supervisory Board operate at the Company. The Board of Directors is the management body of the Company, which comprised three internal board members employed by the Company and four external board members on 31 December 2016. Approval of the By-laws of the Board of Directors and the Supervisory Board;

The Supervisory Board comprised four independent and three employee board members on 31 December 2016.

The detailed responsibilities and competence of the corporate bodies are set out in the Articles of Association, the Organisational and Operational Rules and the relevant legislation. The aforementioned regulations do not contain any deviations from the statutory provisions. The Bank complies the provisions of the referred regulations in its procedures.

A Management Committee chaired by the CEO and including the Deputy CEO for Strategy and Finance, the Deputy CEO for Retail and Digital Operations, the Deputy CEO for Business, the Deputy CEO for Operations and Legal, the Chief Risk Officer and the Executive Directorate for Risk Control operates at the Company. It also has decision preparation and decision-making powers in matters that do not fall within the competence of the General Meeting, the Board of Directors and the Supervisory Board.

There are the following committees at the Company, which the Company has a statutory responsibility to set up pursuant to Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises.

Audit Committee
Risk Committee
Remuneration Committee
Nomination Committee

According to its 2017 work schedule the Remuneration Committee will discuss in July 2017 the Nomination Policy comprising in consolidated structure the elements of the diversity policy applied in case of the Company's management bodies, the recruitment policy for the selection of members of the management bodies, as well as the diversity policy applicable for the selection of members of the management bodies.

During the selection of the members of the Company's management bodies the Company places special emphasis on selecting adequate managers, accordingly the present members of the Company's management bodies have great professional knowledge, wide ranging expertise both in the respect of the financial sector and other areas of the economy.

Main characteristics of the internal audit system of the Company:

The system of internal control functions within the organisation has been developed in accordance with the requirements set out in Recommendation No 5/2016 (6 June) of the Magyar Nemzeti Bank on 'the elaboration and operation of internal safeguards, the governing and controlling functions of financial institutions', and based on statutory and EU standards. Within the internal safeguards – in addition to internal governance – the system of internal control functions comprises the following main elements:

- Risk management
- Internal Audit System (within which: in-process control, management control, management information system and independent internal audit organisation)

- Compliance.

The units pursuing internal control functions are independent from each other within the organisation, and from the banking organisational units the activities of which are controlled by them.

The elements of the internal audit system aimed at in-process control, management control and the operation of the management information system, and the regulated operation thereof are secured by internal regulations, job descriptions and other IT-supported solutions (e.g. the self-control system operated in the branch network) forming an interlinking, hierarchical system. In addition, in accordance with the relevant provisions of the law, the Company shall also operate an independent internal audit unit, which is subordinated to the exclusive authority of the Supervisory Board and the Chairman and Chief Executive of the Company. The internal audit unit also performs group control tasks and in addition to its own directly performed audits, it also supervises the operation and tasks of the internal audit functions of other group members.

Brief presentation of the risk management system of the Company and the fundamental principles applied in the course of risk management:

The risk strategy and capital plan of the MKB Bank banking group is reviewed annually by the Risk Control Unit of MKB Bank with the involvement of the concerned units. Adapting to the current economic environment and in accordance with the Bank's business strategy and capital plan, the Risk Strategies incorporate the fundamental principles and objectives of the Bank's risk strategy in relation to each risk type and the defined risk appetite. The approval of the risk strategy belongs to the competency of the Board of Directors.

The concept that comprehensively concerns the risk assumption processes of the group has been formulated and is continuously fine-tuned in accordance with the fundamental regulatory requirements.

The major elements of the concept:
– Application of risk management principles at group level;
– Implementation of the Unified Segmentation categorisation applicable for the whole clientele of the group;
– Decision-making system that is dependent on customer quality and the level of risk assumption;
– Application of Basel II conform rating tools and analytic and behavioural scorecards in the interest of IRBF compliance, and the corresponding customer rating system, which suitably supports the decision-making activity of the managements of the bank;
– Internal, group level model validation methodology on an annual basis (rating and scoring tools, validation of the related processes);
– Monitoring process with IT support;

- Definition of a comprehensive criteria system to identify threatened loans as soon as possible, containing and considering the relevant indicators that facilitate the recognition of threatened loans; based on this, definition of the applicable deal management types, the related tasks, procedural rules;
- Provisioning system that is based on the Hungarian Accounting rules and IFRS;
- Pillar 1- and Pillar 2-based capital calculation system, which is based on the Hungarian Accounting Standards and the IFRS;
- Regular management reports, backtests (Risk Reports, Capital Management Reports, Rating Quality, Rating Monitoring Reports, etc.);
- Devising and monthly evaluation of a reviewed recovery plan.

The most important risk management principles contain final control enforced at the level of the Board of Directors, independent control separated from the risk assumption areas and adequate measuring, diversification, monitoring and reporting of the risks.
The efficient communication of risks and the risk appetite within the organisation, continuous developments in the interest of the recognition, measurement, monitoring of risks, making the risk processes of key importance up-to-date and user friendly, enhancing their performance and the employment of sufficiently qualified and trained workforce are the tokens of the efficient risk management function of the Company.

The Bank hereby declares that on 31 December 2016 it did not have any bonds listed on the stock exchange issued by the Bank, and that the additional information pertaining to the Bank in relation to Section 95/B can be found in Note No. 6 of the financial statements prepared under IFRS.

The Articles of Association of the Company are available for the public on the website of MKB Bank Zrt. (www.mkb.hu) and in the registry of the Metropolitan Court of Budapest as Court of Registration.

Annex

Governing bodies of MKB Bank Zrt. as at 31 December 2016

Supervisory Board:

Chairman
Dr Mihály Barcza
Partner at Oppenheim Law Firm

Members
Dr Ádám Lovászi-Tóth
Lawyer, Lovászi-Tóth Law Firm

Ferenc Smohay
Head of the Risk management division of ABT Treuhand Group

Tibor Lados
Director of Mátrai Erőmű Zrt./Mátra Power Plant Ltd.

János Nyemcsok
Executive Director of MKB Bank Zrt.

Ferenc Müller
Director of MKB Bank Zrt.

Albert Godena
Director of MKB Bank Zrt.

Board of Directors:

Chairman
János Jaksa
Chief Executive Officer of Minerva Tőkealap-kezelő Zrt./Minerva Capital Fund Management Plc.

Members
Imre Kardos
Deputy Chief Executive Officer of Minerva Tőkealap-kezelő Zrt./Minerva Capital Fund Management Plc.

Rakesh Kumar Aggarwal
Investor of Blue Robin Investments S.C.A.

Balázs Benczédi
Chief Executive of Pannónia CIG Alapkezelő Zrt./Pannónia CIG Fund Manager Ltd.

Dr Ádám Balog
Chief Executive Officer of MKB Bank Zrt.

Ildikó Katona
Deputy Chief Executive of MKB Bank Zrt.

Márk Hetényi
Deputy Chief Executive of MKB Bank Zrt.

MANAGEMENT'S DISCUSSION & ANALYSIS
(International Financial Reporting Standards, IFRS)

The following section of the Annual Report provides a discussion and analysis of the Group's financial condition and results of operations so as to help the reader to assess any changes in the financial condition and profits for the year 2016. The forthcoming analyses are based on figures reported in MKB Bank's consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU ("IFRS") as at, and for the financial year ended, December 31, 2016 and audited by Deloitte Könyvvizsgáló és Tanácsadó Kft. chartered accountants. On this basis, the discussion focuses on the performance of the Group as an entity. The consolidated financial statements prepared in accordance with IFRS are presented separately.

INTERNATIONAL ECONOMIC ENVIRONMENT

2016 was a volatile year globally: the beginning of the year saw a rough start to the year driven by the fear of the slow-down in Chinese economic growth. Later on, the willingness of investors' risk-taking has typically improved in the global money and capital markets, which was also supported by the measures taken by the main central banks (BoJ, ECB). The favourable changes in the macro-economic indicators somewhat reduced the recession fears and the forward-looking confidence indicators. After a fall-back at the start of the year, global macro figures improved during the spring. The second quarter of the year was characterized by optimism due to delayed interest rate hike expectations of the Fed and by the uncertainty about the referendum on Britain's membership of the EU (at the end of June). After the voting on 23 June, the role of the USD as a safe-haven currency has strengthened and the stock market uptrend has temporarily come to a halt.

Macro data published in the developed countries reflected stable economic growth in the second half of the year, and investor sentiment was determined by positive expectations related to central bank actions. Towards the year-end, the American presidential elections came into the focus, and after the victory of Donald Trump, optimism has increased about the expansion of the US economy, which at the same time led to the increase of inflation expectations and a jump in government bond yields. Before the Fed increased the interest rate the dollar had strengthened by 7% against the Euro. The weakening of the Euro was partly caused by the unsuccessful Italian constitutional referendum and the renewing problems of the Italian bank sector. In the meantime, the oil exporting countries announced measures to reduce output, which supported the year-end rise of oil prices; the price of crude oil almost doubled during 2016.

In addition to increasing the interest rate in December 2016, the Fed projected a higher interest rate course for the year of 2017, while the ECB announced the extension of its asset purchase program. While the year of 2016 started with the increasing fear of deflation, in 2017 inflation is expected to gain ground, which would also determine central banks' monetary policy decisions; they are expected to gradually withdraw from applying the zero interest policy.

Heading into 2017, the International Monetary Fund expects 3.4% growth of the world economy in 2017, which may be followed by 3.6% increase in 2018. While United States growth expectations improved compared to the projections of October 2016, emerging markets' growth outlook have somewhat diminished. For the Eurozone, 1.6% growth is expected for the year of 2017 and in 2018.

HUNGARIAN ECONOMIC ENVIRONMENT

In 2016 the economic growth was somewhat more moderated than in 2015. After a GDP growth of 3.1% in 2015, in 2016 the Hungarian economy showed an expansion of 2%. Regarding the production side, construction was a laggard in growth figures, while agriculture and services were the key factors. Within the construction sector various economic incentives (CSOK, VAT discount for housing) were already apparent in 2016, but the sector has not contributed substantively to the growth of economy. Due to the favourable weather in the spring and summer, agricultural harvest figures came to historical high or close to that, which also fuelled the economic growth. On the expenditure side, consumption was the catalyst of growth in 2016. The permanent expansion of retail consumption was supported by the historically high financial wealth, favourable income-related dynamics and increased lending to households. 2016 was characterised by the dynamic growth of employment and a tightening labour market. The unemployment rate declined at the end of 2016 to the lowest level in more than 10 years (to 4.5%). In addition, labour shortage had increasingly become a problem hindering growth, which affected all sectors of the economy. Growth in 2016 was also constrained by the lower amount of EU funds flowing into the country, in comparison to 2015. Tenders of EU funds for the 2014-2020 periods have increased substantially, however, due to delays in announcing the winning bids, the disbursements and the implementation of the projects would mostly take place in 2017 and beyond.

Hungary has finally said goodbye to its junk bond status during 2016, as all three credit rating agencies upgraded the country to investment grade. Fitch upgraded Hungary’s government bond rating to investment grade in May, while S&P announced a similarly positive move in September and Moody’s in November. Through these upgrades in 2016, Hungary has become a more attractive investment destination, and thanks to favourable financial conditions the government got more room for procyclical fiscal policy.

After two years concerning negative inflation, consumer prices have increased by an average of 0.4% in 2016 compared to the previous year.

Between March and May, NBH cut the key policy rate three times by 15 bps (total 45 bps), thus it declined to 0.90%. Regarding the monetary policy, the two-week NBH deposit was phased out at the end of April and the ceiling of three-month deposits was set as HUF 900 billion at the end of 2016.

In the course of 2016 the sentiment of the domestic money market was mainly determined by the international developments and a major swing was apparent in the HUF exchange rate at the beginning of the year and in the second half of April. At the start of autumn, HUF reached the year-high record versus the Euro (305) with positive expectations related to the credit rating agencies, but in November forint weakened again, partly because of the NBH’s non-conventional monetary policy and partly because of the turbulence in global markets after US elections. The yield curve became steeper during the year: while short term yields plunged below the 0.90% base rate permanently due to the unconventional steps taken by the NBH, the long term yields increased driven by international events. The yield of 5-year government bonds decreased by 87 bps to 1.86%, while the yield of the 10-year government bonds declined by 16 bps to 3.26% by the end of 2016.

HUNGARIAN BANKING SECTOR[3]

The Hungarian banking system reached the turning point of the period following the crisis: not only the complete bank system but also most of the banks, which earlier permanently generated loss, - closed a profitable year. The credit portfolio started to grow again in respect of most of the segments and products. Banks has significantly intensified their lending activity in retail unsecured credit, in particular in consumer loans, while the housing market has been further supported by state incentives, although its segmented boom has a favourable effect on housing loans. The decrease of the bank tax also contributed to the stable operation environment.

Financial institutions' lending activity has favourable characteristics. New disbursements of both corporate and retail loans have grown. In 2016 new volumes of households' mortgage backed loans grew by ~27%. According to the preliminary data total assets of credit institutions increased by 4% compared to the end of - 2015. Net corporate loans increased by 3.9%, while the credits of households stagnated; the securities portfolio grew by 10.7%. During the period, the rate of loans in default for longer than 90 days further improved: in the household sector it decreased from 17.6 % to 12.7 %, while in the sector of non-financial enterprises it dropped from 9.6 % to 5.4%. Financial institutions achieved a total of HUF 510.3 billion pre-tax profit (2015: HUF 34.3 billion), which represents a 15.4% average return on equity. From among the 111 institutions, 76 booked a profit of HUF 527.2 billion, while 35 booked HUF 17.0 billion loss during the year. There are, however, highly volatile and cyclic one-off profit items in the background of the significant improvement of profitability, such as provision release, the moderation of the bank tax and the VISA-transaction.

In 2017 we expect further strengthening of the banking system; the growth will be supported by intensifying retail consumption, improving trends of the labour market, increasing real wages, a low inflation level and the drawdown of EU funds. At the same time, however, as in the whole European banking system, the major challenge the domestic banks will have to face is the management of the effects of the permanently low interest environment, as due to the shrinking interest margins the banks' profitability will be under pressure. The impact of the low interest rate environment will be mitigated by the further recovering lending activity, however, the lower 0 percent limit of retail deposit interest rates and the ever-intensifying competition may further reduce the margins that can be achieved.

PERFORMANCE OF THE MKB GROUP IN YEAR

The **IFRS-based** total assets of the **MKB Group (consolidated),** increasing by 7.5%, amounted to HUF 2,101.6 billion at the end of 2016. As a result of the intensifying dynamics of new lending, customer loans, increasing by 6.9% reached HUF 858.1 billion, while the portfolio of customer funds, increasing by 10.2%, amounted to HUF 1,519.9 billion at the end of 2016. The profitability of MKB Group significantly improved in 2016: the Group achieved HUF 7.8 billion pre-tax profit after last year's HUF 78.2 billion losses. Such an extent of improvement was caused by the decrease of the allocation of provisions, 27.6% cutback on costs and the 7.2% growth in net fee and commission income. The Group's financial and business fundamentals are stable, including its capital strength, liquidity, self-financing ability, the evolution of its balance sheet structure and the performance of its business lines.

[3] Source: MNB, HAR, nonconsolidated, preliminary data

PERFORMANCE OF THE BUSINESS LINES OF MKB BANK[4]

DIGITALIZATION

The digitalization projects support the operation of both the corporate and retail business lines, which contribute to the moderation of costs, increase the efficiency of banking operations and may open new directions. In 2016 the Bank Transformation project had outstanding significance, whose purpose is to introduce the Flexcube banking system in addition to adopting the currently existing customer portfolios. In 2016 the process started with massive BPR (Business Process Reengineering), a gap analysis was prepared for the system, the specifications of the requested customisations have been completed and the developments have been delivered. The electronic filing system and biometric signature (DMS) projects have been launched, in which significant results were achieved in the course of 2016. The new software solutions support the product development and customer registration processes, make the bank's operation smoother, faster and more efficient Due to the development processMKB Bank's service quality and reliability may improve.

BRANCH NETWORK AND ALTERNATIVE SALES CHANNELS

MKB sales channel network has developed in harmony with the digitalization endeavours. In order to improve efficiency the branch network has been rationalised, as a result of which at the end of year 2016 MKB Bank provides services for its customer in 73 **branches.** In the third quarter of 2016 MKB's share of the card market maintained the same level achieved in 2015, and in the retail segment its market share was 2.2% by issuing 200 thousand cards, while in the corporate segment it was 5.4%. The number of **NetBankár** service users is close to 151 thousand, while the **PC Bankár,** designed mostly for companies, closed the year 2016 have almost 8 900 corporate users. The Bank's **Telebankár** service is also highly popular among the users, it had more than 140 thousand users at the end of year 2016. After surveying the needs of users the retail mortgage loans and unsecured credit products, as well as small company account management and credits have been added to the product portfolio of external sales partners; the sale of MKB products is supported by 89 **external sales partners.**

CORPORATE AND INSTITUTIONAL CUSTOMERS

MKB's focus on the SME sector increased in 2016 even more than in the past. In relation with that, several projects were launched to develop processes and products. The bank refined its business strategy, whose two basic pillars are digitalization and the concept of relationship-banking. Within its frames MKB created a new value offer, product and service portfolio, and strengthened the presence of an advisor attitude. As part of the small company project, the structure of corporate customer management has been transformed and the fundaments of digital service were built. Thanks to the changes, better customer experience and quality services are offered to corporate customers. The bank's strategic objective is to strengthening market positions and its mission is to ensure that the gain of its customers should be the primary source of the bank's growth.

In the segment of non-financial enterprises, regarded as a strategic one, the Bank's customer portfolio and market share continuously decreased following the separation of SCU in 2015. Since August 2016, however, the credit portfolio has stabilized, then increased by the end of the year. The number of the MKB Bank corporate customers exceeded 44 thousand as of the end of the year and the core

[4] Source of information: Hungarian National Bank (MKB analysis)

credit portfolio managed amounted to HUF 543 Bln. The Bank's market share compared to the sector portfolio was 8.2% at the end of 2016. The corporate business line success is reflected by more than 18% client's credit portfolio growth in business management.

Government programmes have outstanding significance in corporate lending. The market share of the MKB Group in the third phase of the Lending for Growth Program, launched by the National Bank of Hungary, is close to 14%. Since the start of (NHP) phase III the customers of MKB contracted for a credit amount of approx. HUF 65 Bln, from which HUF 53 Bln represent credits linked to Pillar I, and HUF 11 Bln linked to Pillar II of the credit programme. In addition to the Lending for Growth Program, the other important tool of corporate financing at MKB is. With 20% of factored turnover, MKB continues to be one of the biggest market players with a 12% portfolio share. Export promoting Credit Programme (EHP) products offered by EXIM are also an element of financing of outstanding importance. In 2016 MKB extended export stimulating credits to its corporate customers in an amount equivalent to a total of approx. HUF 20 Bln, thus the year-end closing portfolio increased to HUF 41 Bln, which represents 54% growth compared to previous year's HUF 27 Bln. The Bank's financing products also include the card, operating assets and investment credit options offered under the Széchenyi economic development programme. In the frames of the programme in 2016 financing was ensured by the participating banks in the total amount of HUF 165 Bln, and the market share of MKB was 19% in 2016 based on its lending portfolio. The Agrarian Széchenyi card appeared as a new product, which reached a market share of 1.9% in the Bank by the end of 2016.

The market share of MKB Bank reached 10.7% regarding the total corporate deposit portfolio. In the segment of non-financial enterprises, regarded as a strategic one, the Bank has 10.4% market share which represents a slight growth compared to previous year's 9.9%. In addition to active and passive products, the MKB Group, by involving its members, is able to provide a wide-range of other financial services to the corporate customers of MKB. These include, among others, insurance policies for both the companies and their owners; the advisor services of the MKB Euroleasing complex vehicle financing group and MKB Consulting supporting EU projects; the up-to-date Cafeteria solutions for the handling of fringe benefits, such as 'Széchenyi Pihenő Kártya' Card, MKB-Pannónia Health and Mutual Fund, and MKB Voluntary Pension Fund.

RETAIL CUSTOMERS

In 2015 our resources were tied up by the administration of settlement and conversion to HUF. In 2016, when such burdens ceased to exist the Bank was able to focus on re-thinking its business strategy and on product developments. MKB traditionally has highly-positioned customers, but along the digitization strategy the Bank also opens towards society's wider customer segments who have interest in/affinity for digital solutions. Parallel to the change in strategy the retail product portfolio has been reconsidered, the earlier housing loan products were reviewed, new products, interest periods and pricing structure were introduced in addition to adjusting these to the customers' needs. The business lines of strategic priority performed the changes under the control of dedicated managers and achieved positive results in 2016. The shift in strategy is successful, the number of customers leaving the bank dropped, while new acquisition increased, the number of customers by the year-end was closed to 190 thousand.

The credit market share of the retail division decreased slightly, and moved around 6% thought the year. At the end of the year the retail credit portfolio amounted to HUF 352.9 Bln, within which the total housing and free-use mortgage loans made up 96% of the portfolio. In 2016 the new retail credits

lent by MKB Bank significantly increased. The amount of contracted housing loans more than doubled, which is further increased by the sale of the new mortgage secured credit for optional use, introduced during the year. As a result, by the end of 2016 the market share of MKB in the disbursement of mortgage secured credits reached 4.1%, while increased to 4.4% in the market of housing loans, which is equivalent to a growth higher than 2 percentage points in a year. Furthermore, MKB also took an active part in the housing loan market in the housing credit programme with state subsidy. We were among the first ones to join the Családi Otthonteremtő Kedvezmény (Family Home Creation) programme, as a result of which the Bank accepted almost 1000 credit applications in the course of 2016, in the value of HUF 3.28 Bln. In the summer of 2016 the Bank started to sell unsecured credits and reengineered its consumer loans as well. The sale of this product grew fast and disbursements increased five times by the end of the year, compared to the level of the start of year.

In the domestic market, the bank savings of households (bank deposit, accounts, bonds, investment funds and government securities) grew last year, which is due primarily to the improving economic environment. The deposit portfolio still dominates the retail savings market, however, demand for domestic government securities significantly increased in the market. The asset portfolio of households in MKB retail management amounted to HUF 861.2 Bln at the end of the year. The Bank's market share compared to the sector is 4.9% in retail savings (within this, deposits 3.4%, bonds issued by credit institutions 11.9%,). The market share of investment funds increased from 4.1% to 4.6% at the end of 2016. In 2016 25% of retail savings was made up by the investment funds, which represents a slight decrease of 3% compared to 2015. MKB's market share in the retail government security market increased from 6.2% to 7.4% by the end of 2016 with a 46% growth of the managed portfolio.

MONEY AND CAPITAL MARKETS, INVESTMENT SERVICES

In the permanently low-yield environment also prevailing in 2016 the Bank's customers turned to investment services. Among the various investment products offered by the Bank, customers mostly regrouped their savings into retail government securities, but the portfolio of investment funds also increased significantly, among which mostly the actively managed mixed funds and absolute-yield funds were preferred by the investors, as well as the various versions of these available in foreign currency. As a consequence of the rearrangement of customer portfolios the Bank's market share also showed a significant growth in the sale of both government securities and investment funds.

Keeping in sight its customers' requirements, the Bank focused on the diversification of the portfolio in the introduction of its Premium service. In order to make decision on investments easier, sample portfolios representing various investment purposes were created that serve as a guideline for the customers for compiling their own portfolios and the continuous optimisation of these. This service was introduced in 28 branches, where the customers using the Premium service may receive information about the currently available investment possibilities through personal consulting.

The asset management business line dynamically grew in 2016 too. On the one hand, the number and volume of asset management portfolios increased, on the other hand the advisor staff has also expanded a tan outstanding pace. The bulk of the managed portfolios over-achieved the reference yields and the biggest portfolio (approx. HUF 93 Bln) can be proud to produce a yield of 7.3%. The assets managed for institutional and private investors exceeded HUF 157 Bln at the end of the reporting period, while the assets of the investment consulting mandate HUF 90 Bln, with a more than 40% growth in the latter. In addition to that, MKB Bank provides asset management services for the MKB Pension Fund and the MKB-Pannónia Health and Mutual Fund.

PRIVATE BANKING

At the end of year 2016 the number of private banking customers was close to 2000, with more than 80% proportion of retail customers. Private banking increased the customers' assets by HUF 23 Bln, exceeding HUF 340 Bln.

MKB Subsidiaries/STRATEGIC PARTNERS

MKB- Euroleasing Autólízing Zrt.

In 2016 MKB Euroleasing became a strong leasing group in capital, developed the operation of its organisation and extended its product portfolio. Leaving its previous head office, the company moved into the renovated building of the MKB Group, where an up-to-date personal customer service office was built which is easy to access. Parallel to moving, within the frames of a major IT investment project the complete server and hardware infrastructure was replaced, which allowedextended product portfolio handling. Based on the MNB licenses obtained in September 2016, Euroleasing extended its services and in addition to vehicle financing it introduced asset, agrarian and large utility vehicle financing products as well, and now functions as a universal leasing company. The company's new placements more than doubled in total in year 2016, and far exceed the actual market growth. The growth of the retail car financing activity skyrocketed, thus it firmly holds its second position in its own market segment, while the agricultural machine financing business line, due to its unexpectedly high performance, became a determinant player of the segment. As a result of the above, MKB-Euroleasing Group is by now one of the three biggest players of the Hungarian leasing market.

MKB Fund Manager

At the end of 2016, MKB Fund Manager offered 25 open-end and 20 closed-end investment funds for the investors. Out of the 25 open-ended funds 15 is denominated in HUF, 5 in Euro and 5 in USD. As a result of the successful sales process at the bank and the favourable performance of the fund, the portfolio of the funds managed by the Fund Manager increased in the course of 2016 by 18 % to HUF 253 Bln, exceeding the growth of the market by far. The portfolio of the open-end funds reached HUF 203 Bln at the end of December 2016, compared to the earlier level of HUF 165 Bln. The portfolio of the closed-end funds amounted to HUF 50 Bln at the end of 2016, similarly to the level of one year before. In 2016 7 closed-end capital protected funds expired, in the approximate value of HUF 17 Bln, while a total of 6 new closed-end funds were launched. We are glad to report that the MKB Adaptive Bonds Fund from the HUF 2.3 Bln level of the beginning of year 2016, with an imposing annual performance, increased to HUF 20.8 Bln by the end of the year. MKB Fund Manager closed successfully the business year of 2016, its market share increased from the 2015 year-end level of 3.8 % to 4.4% by the end of year 2016.

MKB Consulting Kft.

MKB Consulting Kft. reinforces the performance of the MKB Group in the corporate sector, which continues to be active in the area of EU and domestic development grants. The activities of the subsidy include tender development, tender writing, tender management and financing. The purpose of MKB Consulting is provide high-quality complex services from the realisation of the development objectives throughout the overall project cycle and to contribute to the professional and efficient use of funds in compliance with the relevant regulations. In order to maximise quality service provision and

customer experience, MKB Consulting cooperates with the Bank in a number of areas. In cooperation with the Bank's capital market and transactions division, MKB Consulting took part in administering two major transactions and supports the innovative start-up companies selected under the Fintech Programme by providing expert consulting. In 2016 MKB Consulting achieved good results both in the small enterprise and medium-large corporate sector. As far as the tender business line is concerned, during the year the company sold 135 small company packages, and as part of that it signed 110 contracts for writing individual tender applications. For its VIP customers with sales revenues above HUF 1 Bln the company prepared and submitted a total of 80 tenders with a budget of HUF 26 Bln and with HUF 12.8 Bln total grant applied for. 14 of these tenders have already won: thus the customers of the company received grants in the amount of HUF 6.5 Bln.

MKB Funds and the 'SZÉP Kártya' Card Program

In 2016 the operation of the **MKB Pension Fund** was still characterised by tendencies generally typical of the sector. Retail savings increased by approx. 13% in the sector. The voluntary branch of the Pension Fund, regarding the number of its members and assets, is among the leading voluntary Pension Funds, on 31 December 2016 the number of its members was 85.6 thousand, and the value of the assets of all fund members handled by the Fund amounted to HUF 122 Bln. Regarding the assets of the voluntary Pension Fund, MKB's market share is around 10%, the number of members is close to 87 thousand, which represents 7.5 % market share. The private branch of the MKB Pension Fund had 3,936 members on 31 December 2016 and managed assets amounting to HUF 18 Bln.

As of 1 October 2016 the general meeting finalised the merger of Pannónia Health and Mutual Fund into MKB Health and Mutual Fund, through which **MKB-Pannónia Health and Mutual Fund** was founded. After the merger, the health and mutual services continue to be available for the fund members in the same form and high quality. The number of members of the Fund increased from 175 thousand to 187 thousand in 2016, thus it is the 3rd biggest player on the market. The assets of the fund increased by 17% to HUF 12.4 Bln compared to the end of year 2015. The fund has reached the highest income from membership fees during its operation – HUF 9.7 Bln F – with an outstanding amount (HUF 4.1 Bln) and rate (42.7%) of individual deposits. The Fund is ready to serve its members and other partners with well-balanced work and in high quality, which is supported by contracts signed with 11 thousand service providers and more than 8 thousand card acquisition points.

Among the fringe benefits 'Széchenyi Pihenőkártya' card ('SZÉP Kártya' card) is an elements of the past period that shows dynamic growth. It is an attractive cafeteria item offered for a number of corporate customers. The issue of the '**MKB SZÉP Kártya'** card and the operation of the system is performed by MKB Nyugdíjpénztár és Egészségpénztárt Kiszolgáló Kft. This company has been a reliable partner for more than 15 years in the area of voluntary fund services. The company has issued more than 187 thousand 'SZÉP Kártya' cards up to date. In the course of year 2016, employers transferred benefits to card accounts in the amount of HUF 13.6 Bln, and the cardholders used services in the value of 13 Bln. The Company is owned by MKB Bank, which, as a secure bank in the background, guarantees reliable services for the market.

FINANCIAL PERFORMANCE

In 2016, the structure of MKB Group changed compared to previous year-end as follows.

MKB Bank Zrt. established a new mortgage bank, MKB Jelzálogbank Zrt., in 2016 and the new bank was registered during the year with HUF 4 billion total equity. Its main shareholder is MKB Bank Zrt. with a 99% participation, while Gránit Bank Zrt. holds 1% of the shares. The main role of the specialized credit institution is to refinance the mortgage loans granted by commercial banks through the financing obtained by issuing mortgage bonds.

On July 14, 2016, MKB Bank established the Employee Share Ownership Program (ESOP) organization of the Bank in order to fulfill the objectives of the remuneration policies.

On December 16, 2015, the Bank signed an agreement on selling its participations in MKB-Euroleasing Autópark Zrt. and MKB Autopark OOD, its car fleet management, jointly-controlled companies. The transaction was closed on 30 June, 2016.

Statement of Financial Position

Total assets of the Group increased by 7.5%, compared to the end of 2015, and amounted to HUF 2,101,616 million as at December 31, 2016.

During 2016, there has been growth in almost every asset category in the statement of financial positions with the most significant nominal rise in the balances of Investment in securities, Cash reserves as well as Loans and advances to customers. Cash reserves increased by 136.0%, i.e. HUF 56,421 million compared to the end of 2015: cash on hand decreased by HUF 783 million, while the balance of the account held at NBH grew by HUF 57,204 million. Parallel with this net growth, the volume of Investments in securities also increased by 7.5%, i.e. HUF 64,396 million compared to prior year end. The growth was mainly driven by the increase in the volume of Treasury bills issued by the Hungarian government of HUF 124,949 million while the balances of Hungarian government bonds and bonds issued by other corporate entities decreased as compared to 2015 year-end.

Loans and advances to banks rose by 29.6%, i.e. HUF 15,298 million compared to the end of 2015, mainly because of the higher volume of money market balances with other domestic commercial banks while the maturity structure shifted towards short-term lending.

During the reporting period Amounts due to other banks also reflected an increase of 15.9%, or HUF 51,611 million. The growth resulted from the increase of the deposits placed by NBH and the higher volume of refinancing of the Funding for Growth Scheme.

Following the decreases in previous periods, in 2016 the balance of Loans and advances to customers increased by 6.9%, i.e. HUF 55,118 million from the closing balance of HUF 802,954 million at the end of 2015. The main reasons for this highly favorable growth were the intensified business activities, driven by the Funding for Growth Scheme of NBH, which were only partially counterbalanced by the on-going work-out and restructuring efforts as the Group continued to improve its loan portfolio during the reporting year as well as sold further receivables in line with the strategy of intentional decreasing the real estate project financing. Parallel, the currency structure of the portfolio remained relatively unchanged.

Deposits and current accounts reflected an increase of 10.2% in comparison with the volume as at 2015 year end, induced mainly by the rise of balances on current accounts and the growth in short-term deposits.

Financial assets measured at fair value through profit or loss showed a decrease of 19.6%, i.e. HUF 18,359 million, caused by the lower volume of securities by HUF 12,620 million which was accompanied by the reduction of derivatives with positive fair values in the amount of HUF 5,641 million. Among securities mainly zero-coupon treasury bills decreased, while interest-bearing T-bills and government bonds increased. Within derivative transactions, both the balances of interest-related and currency-related instruments were lower.

Simultaneously, Negative fair values of derivative financial instruments grew by 44.5%, i.e. by HUF 9,232 million, due to the interest-related derivative transactions whereas currency-related derivative instruments declined.

At the end of 2015, Non-current assets held for sale and discontinued operations incorporated loans and receivables held for sale in the amount of HUF 26 936 million, the investments held in MKB-Euroleasing Autópark Zrt. and MKB Autopark OOD in the amount of HUF 5,566 million and an own operational purpose real estate held for sale amounted to HUF 133 million. However, till the end of 2016, these loans and investments had been sold, and the asset category included only such real estates in the amount of HUF 309 million at the balance sheet date.

In 2016, other asset balances showed an increase of 34.6%, or HUF 7,224 million, resulting mainly from the receivable of HUF 5,698 million that related to ESOP while prepayments and other accruals also grew during the period.

Other liabilities and provisions also increased by HUF 2,177 million from previous year end, due mainly to higher balances of deferred income and trade creditors, the growth in the amount of payable taxes as well the increase in provisions for contingencies and commitments.

For the end of the financial year 2016 the volume of issued bonds dropped by 84.9% compared to the end of 2015. In 2016, the Bank issued no new bonds while repaid the maturing volumes of HUF, EUR and USD denominations in the total amount of HUF 81,542 million and repurchased a total portfolio of HUF 10,211 million.

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

As at December 31, 2016, non-material non-controlling interest existed in the case of MKB Jelzálogbank Zrt. where the main shareholder is MKB Bank Zrt. with 99% participation, while Gránit Bank Zrt. holds 1% of the shares. The Group disclosed also a Non-controlling interest of HUF 5,550 million related to the special purpose entity for the Employee Share Ownership Program (ESOP). This amount represented the contribution of the participating members.

Statement of Profit or Loss and Other Comprehensive Income

In 2016, Net interest income showed a HUF 3,658 million decline compared to the previous year. From the total change in net interest income, there was a decrease of HUF 11,496 million in interest income whereas interest expense fell by HUF 7,838 million. Net interest income from cash reserves decreased by HUF 1,737 million due to the lower average volume of cash reserves and falling market interest rates while such income from investments in securities increased significantly, by HUF 7,092 million, parallel to the growth in the securities portfolios. The Group realized a net interest expense of HUF 2,600 on inter-bank transactions, representing a HUF 875 million net growth over the previous year’s figure, due mainly to the increased amount of such refinancing. Net interest income from customers have been lower by HUF 9,342 million as a result of lower average business volumes, a consequence of the portfolio spin-off at 2015 year-end and further sales during 2016 in line with the

Group's loan portfolio strategy, on the one hand, and continuously decreasing market interest rates on the other. Meanwhile, the cost of debt financing was less by HUF 3,060 million compared to the previous year. The main reason for the reduction in interest expenses in the case of bonds was the gradually decreasing interest rates and shrinking volumes due to the repayments at maturity dates. In addition to that, net interest income resulting from interest related derivative transactions in hedge relationships fall by HUF 2,958 million while other net interest income increased by HUF 1,103 million during the year.

Net income from commissions and fees increased by 7.2% compared to the previous year, due to the change of pricing policies, product conditions, and the expansion of specific business volumes. Within the income group, brokerage fees and commissions related to other securities business showed a remarkable growth and exceeded their level in 2015 by HUF 1,781 million.

In 2016, the net balance of other operating income and expense showed a loss of HUF 2,098 million that reflected a slight increase over the HUF 594 million net loss for 2015. The higher net loss was a result of different effects: the fair value revaluation result of financial instruments measured through profit and loss was lower by HUF 12,350 million which was further decreased by the HUF 2,050 million additional loss accounted for on hedging transactions. Meanwhile, as an off-setting effect, the net gain realised on investments in securities rose by HUF 5,965 million and the amount of banking tax declined by HUF 12,344 million, the latter due to changes in the respective legislation and the allocation of its part to special tax to be paid by credit institutions. Simultaneously, other net expenses increased by HUF 1,622 million during 2016.

Impairments and provisions decreased by HUF 79,222 million compared to prior year end, and amounted to HUF 15,236 million. The main reasons for the significant decline in such charges were the improvement in the quality of the customer loan portfolio due to the spin-off as at 2015 year-end, and the work-out initiatives as well as the more favourable macro-economic environment throughout 2016.

Operating costs declined substantially, by 27.6% or HUF 14,268 million, due to cost cutting and efficiency improving measures introduced in 2015 and 2016. Personnel related expenses dropped by HUF 3,687 million, depreciation decreased by HUF 4,810 million, meanwhile the other administrative expense fell by HUF 6,130 million.

Similar to the preceding year, the Group accounted for a tax income of HUF 1,692 million for 2016 (2015: HUF 1,771 million) as a result of deferred taxes in both years.

Based on above factors, after several years of loss-making operations, MKB Group's profit after taxation for 2016 was again in the positive range and amounted to HUF 9,469 million (2015: HUF 76,402 million loss).

For end of 2016, the total comprehensive income was significantly higher, by HUF 97,105 million, compared to the previous year. The substantial growth resulted from the higher profit after taxation as well as the increase in the revaluation gain of HUF 11,202 million on available-for-sale securities due to more advantageous market conditions.

CAPITAL MANAGEMENT

The Capital situation of MKB Group was sufficient at the end of 2016.
As a result of the 2016YE profit (an therefore core capital accumulation) the available core capital increased significantly. The owner of the MKB Bank is committed to maintain the bank's capital adequacy and implement all the necessary measures.

Domestic and international guidelines require the Bank to maintain certain minimum capital-to-asset ratios. These risk-based ratios are determined by allocating assets and specified off-balance sheet instruments into 4 weighted categories, with higher levels of capital being required for categories perceived as representing greater risk. Regulatory capital is divided into Tier 1 Capital and Tier 2 Capital. In addition to retained earnings, the Bank may raise regulatory capital by issuing several types of financial instruments to the public. These financial instruments are then classified as either Tier 1 or Tier 2, depending on the types of conditions or covenants they place upon the issuer.

Tier 1 Capital includes securities with no fixed maturity date, such as ordinary shares. At December 31, 2016, as an actual figure of tier1 capital the Group had HUF 112.8 billion based on Basel III IFRS under Supervisory Regulation. The regulatory capital has increased by HUF 12.5 billion, which mainly derived from increase of interim profit and revaluation reserve, which was compensated partly by the increase of deduction related to intangible assets and the core capital deduction (by HUF 3.33 billion) related to contribution to ESOP program.

Risk-weighted assets including operational and market risk increased by 5.5% from HUF 888.2 billion in 2015 to HUF 936.8 besides approximately 0.7% strengthening of domestic currency. The main part of the decrease derived from the increasing operational risk capital requirement due to accounting standard change and increasing business volumes.

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

Legal limits defined by the

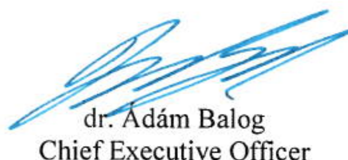
Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (Banking Act),

Regulation (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT on prudential requirements for credit institutions and investment firms and amending Regulation (CRR):

- CRR 395-400.§, Banking Act 302.§ large loan limit -> no excess
- Banking Act 100.§ investment limit -> no excess
- Banking Act 101-102.§ total investment limit -> no excess

Budapest, 10 March, 2017

János Jaksa
Chairman



dr. Ádám Balog
Chief Executive Officer