



MKB Bank Nyrt.

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statistic code

***Consolidated
Interim Financial
Statements***

prepared under
International Financial Reporting Standards
as adopted by the EU

Budapest, 26 September 2019

30 June 2019

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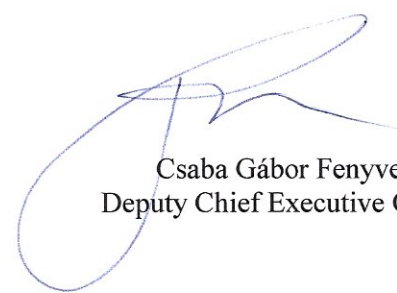
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MKB Bank Nyrt.
Consolidated Statement of Financial Position as at 30 June 2019

| | Note | 30 June 2019 | 31 December 2018 |
|--|------|------------------|------------------|
| Assets | | | |
| Cash reserves | 7 | 79 652 | 19 240 |
| Loans and advances to banks | 8 | 67 747 | 63 610 |
| Derivative financial assets | 9 | 17 846 | 17 914 |
| Securities | 10 | 643 121 | 773 029 |
| Loans and advances to customers | 11 | 924 823 | 895 203 |
| Non-current assets held for sale and discontinued operations | 37 | 10 335 | 4 238 |
| Other assets | 12 | 18 648 | 21 699 |
| Current income tax assets | | 50 | 2 |
| Deferred tax assets | 25 | 7 190 | 5 814 |
| Investments in jointly controlled entities and associates | 13 | 3 912 | 4 687 |
| Intangibles, property and equipment | 14 | 54 350 | 52 143 |
| Total assets | | 1 827 674 | 1 857 579 |
| Liabilities | | | |
| Amounts due to other banks | 15 | 196 182 | 214 340 |
| Deposits and current accounts | 16 | 1 340 175 | 1 372 046 |
| Derivate financial liabilities | 17 | 34 857 | 31 608 |
| Liabilities held for sale and discontinued operations | 37 | 206 | - |
| Other liabilities and provisions | 19 | 44 174 | 48 425 |
| Current income tax liabilities | | 722 | 16 |
| Deferred tax liabilities | 25 | 249 | 2 |
| Issued debt securities | 20 | 2 123 | 4 974 |
| Subordinated debt | 21 | 37 701 | 28 002 |
| Total liabilities | | 1 656 389 | 1 699 413 |
| Equity | | | |
| Share capital | 22 | 100 000 | 100 000 |
| Treasury Shares | | (70) | (1 987) |
| Reserves | 23 | 71 285 | 58 166 |
| Total equity attributable to equity holders of the Bank | | 171 215 | 156 179 |
| Non-controlling interests | 24 | 70 | 1 987 |
| Total equity | | 171 285 | 158 166 |
| Total liabilities and equity | | 1 827 674 | 1 857 579 |

Budapest, 26 September 2019


dr. Ádám Balog
Chairman and Chief Executive Officer



Csaba Gábor Fenyvesi
Deputy Chief Executive Officer

MKB Bank Nyrt.
Consolidated Statement of Profit or Loss and Other Comprehensive Income for the period ended 30 June 2019

| | Note | 2019 | 2018 |
|--|------|---------------|-----------------|
| <i>Statement of profit or loss</i> | | | |
| Interest income | 26 | 30 407 | 29 775 |
| Interest expense | 27 | 8 893 | 8 813 |
| Net interest income | | 21 514 | 20 962 |
| Net income from commissions and fees | 28 | 11 716 | 14 035 |
| Other operating income / (expense), net | | (9 937) | 15 451 |
| Impairments / (Reversal) and provisions for losses | 29 | (4 562) | (1 595) |
| Operating expenses | | 20 975 | 33 716 |
| Share of jointly controlled and associated companies' profit | | 1 073 | 760 |
| Profit before taxation | | 7 953 | 19 087 |
| Income tax (income) / expense | 30 | (217) | 1 084 |
| PROFIT FOR THE YEAR | | 8 170 | 18 003 |
| <i>Other comprehensive income</i> | | | |
| <i>Items that may be reclassified subsequently to profit or loss</i> | | | |
| Revaluation on financial assets measured at FVTOCI | 10 | 5 490 | (11 792) |
| IFRS 9 impact on revaluation of financial assets measured at FVTOCI* | | - | (7 434) |
| Other comprehensive income for the year net of tax | | 5 490 | (19 226) |
| TOTAL COMPREHENSIVE INCOME FOR THE YEAR | | 13 660 | (1 223) |
| Profit / (Loss) attributable to: | | | |
| Shareholders of the bank | | 8 170 | 18 003 |
| Non-controlling interests | | - | - |
| Total comprehensive income attributable to: | | | |
| Shareholders of the bank | | 13 660 | (1 223) |
| Non-controlling interests | | - | - |
| Net income available to ordinary shareholders | | 8 170 | 18 003 |
| Average number of ordinary shares outstanding (thousands) | | 99 812 | 85 000 |
| Earnings per Ordinary Share (in HUF) | 31 | | |
| Basic | | 82 | 212 |
| Diluted | | 82 | 205 |

* The IFRS 9 impact on revaluation of financial assets measured at FVTOCI was restated.

Budapest, 26 September 2019


dr. Ádám Balog
Chairman and Chief Executive Officer

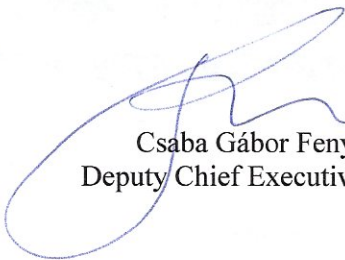

Csaba Gábor Fenyvesi
Deputy Chief Executive Officer

MKB Bank Nyrt.
Consolidated Statement of Changes in Equity for the period ended 30 June 2019

| | Share capital | Treasury shares | Share premium | Share-based payments | Retained earnings | Revaluation on financial assets measured at FVTOCI | Non-controlling interests | Total equity |
|---|---------------|-----------------|---------------|----------------------|-------------------|--|---------------------------|--------------|
| At 1 January 2018 | 100 000 | (5 550) | 21 729 | 54 | 15 135 | 9 789 | 5 549 | 146 706 |
| Profit for the year | - | - | - | - | 25 132 | - | - | 25 132 |
| Other comprehensive income for the year | - | - | - | - | - | (13 255) | - | (13 255) |
| First / (final) consolidation of subsidiaries | - | - | - | - | (558) | - | - | (558) |
| Change in non-controlling interests | - | - | - | - | - | - | 1 | 1 |
| Equity settled share-based payments | - | - | - | 140 | - | - | - | 140 |
| Disposal of treasury shares | - | 3 563 | - | - | - | - | (3 563) | - |
| At 31 December 2018 | 100 000 | (1 987) | 21 729 | 194 | 39 709 | (3 466) | 1 987 | 158 166 |
| Dividend for the year 2018 | - | - | - | - | (4 665) | - | - | (4 665) |
| Profit for the year | - | - | - | - | 8 170 | - | - | 8 170 |
| Other comprehensive income for the year | - | - | - | - | - | 5 490 | - | 5 490 |
| Equity settled share-based payments | - | - | - | (194) | 194 | - | - | - |
| Disposal of treasury shares | - | 1 917 | - | - | 4 124 | - | (1 917) | 4 124 |
| At 30 June 2019 | 100 000 | (70) | 21 729 | - | 47 532 | 2 024 | 70 | 171 285 |

Budapest, 26 September 2019

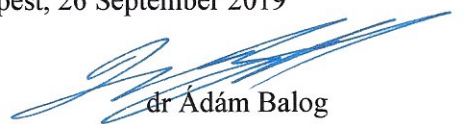

dr. Ádám Balog
Chairman and Chief Executive Officer



Csaba Gábor Fenyvesi
Deputy Chief Executive Officer

MKB Bank Nyrt.
Consolidated Statement of Cash Flows for the period ended 30 June 2019

| | Note | 2019 | 2018 |
|---|-------------------------|-----------------|------------------|
| <i>Cash flows from operating activities</i> | | | |
| Profit before taxation | | 7 953 | 24 697 |
| <i>Adjustments for:</i> | | | |
| Depreciation, amortisation and impairment | 14 | 5 955 | 8 368 |
| Impairment on other assets | 12 | 152 | 230 |
| Reversal of provisions for off-BS items and settlement for customers | 19, 32 | (1 659) | (1 088) |
| Reversal of impairment loss on loans and advances | 11 | (27 186) | (9 640) |
| Impairment/(reversal of impairment) on securities | 10 | 35 | (118) |
| Impairment on jointly controlled entities and associates | 13 | 63 | (2 044) |
| Deferred tax movement | 25, 30 | (1 129) | (2 505) |
| Net interest income | 26, 27 | (22 608) | (44 365) |
| Dividends on securities | Change in equity | (680) | (708) |
| Revaluation of issued securities | 20 | (428) | 716 |
| Revaluation and other result on securities measured at FVTOCI | Change in equity | 5 490 | (5 820) |
| Foreign Exchange movement | | 30 | 89 |
| Cash flows from operating activities | | (34 012) | (32 188) |
| Change in loans and advances to banks | 8 | (4 156) | 14 401 |
| Change in loans and advances to customers | 11 | (2 415) | (27 199) |
| Change in non-current assets held for sale and discontinued operations | 37 | (6 097) | 17 410 |
| Change in derivative assets | 9 | 68 | 1 843 |
| Change in other assets | 12 | 2 899 | 5 379 |
| Change in amounts due to banks (short term) | 15 | (30 430) | 24 458 |
| Change in current and deposit accounts | 16 | (31 871) | (167 094) |
| Change in liabilities held for sale and discontinued operations | 37 | 206 | - |
| Change in other liabilities and provisions (without provision charge of the year) | 19 | (2 592) | (324) |
| Change in derivative liabilities | 17 | 3 249 | (11 758) |
| Interest received | 26 | 35 554 | 49 250 |
| Interest paid | 27 | (12 946) | (4 885) |
| Dividends received | | 680 | - |
| Income tax | 30 | 875 | 159 |
| | | (46 976) | (98 361) |
| Net cash used in operating activities | | (80 988) | (130 549) |
| <i>Cash flow from investing activities</i> | | | |
| Investment in Group companies | 13 | 712 | - |
| Purchase of PPEs and intangible assets | 14 | (8 162) | (13 835) |
| Disposals of securities | 10 | 129 873 | 182 215 |
| Net cash generated by investing activities | | 122 423 | 168 380 |
| <i>Cash flow from financing activities</i> | | | |
| Change in issued securities | 20 | 1 701 | (6 365) |
| Change in subordinated liabilities | 21 | 9 699 | 5 695 |
| Change in amounts due to banks (Borrowings) | 15 | 12 272 | (49 431) |
| Dividends paid | Change in equity | (4 665) | - |
| Net cash (used in)/ generated by financing activities | | 19 007 | (50 101) |
| Net increase of cash and cash equivalents | | 60 442 | (12 270) |
| Cash reserves at 1 January | | 19 240 | 31 599 |
| FX change on cash reserve | | (30) | (89) |
| Cash reserves at the end of period | | 79 652 | 19 240 |

Budapest, 26 September 2019


dr. Adam Balog
Chairman and Chief Executive Officer


Csaba Gabor Fenyvesi
Deputy Chief Executive Officer

Notes to the Financial Statements

(from page 8 to page 82)

1. General information

MKB Bank Nyrt. former MKB Bank Zrt. (hereinafter: “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. As of 30 May 2019 MKB continues its activity as a public limited company, the shares of MKB were recorded in the product list of the Budapest Stock Exchange, by which the shares of MKB were introduced on the Budapest Stock Exchange. The address of MKB is Váci u. 38., HU-1056 Budapest, Hungary.

The consolidated financial statements of the Bank as at and for the period ended 30 June 2019 comprise the Bank and its subsidiaries (together referred to as the “MKB Group” or “Group”). The Group conducts its financial services businesses through domestic banking and non-banking subsidiaries.¹

The Hungarian government acquired 100% direct ownership in MKB on 29 September 2014. On 18 December 2014, the Financial Stability Board of the National Bank of Hungary ordered the reorganization of MKB Bank based on the Act XXXVII of 2014 (Act on the further development of the system of institutions strengthening the security of the individual players of the financial intermediary system). The ownership rights were exercised by the National Bank of Hungary under the reorganization process and NBH together with MKB started restructuring measures aiming at improving profitability. The reorganization of MKB Group has been carried out in compliance with EU directives² in each case. The National Bank of Hungary launched the reorganisation plan, which was approved by the European Commission on 16 December 2015. The commitments included in the plan have to be fulfilled by 31 December, 2019, and the process of the completion is controlled regularly by the independent Monitoring Trustee. On 23 July 2015 – continuing the reorganization procedure – the four reorganizational commissioners were recalled, and through the appointment of the new Chief Executive Officer and election as Chairman of the Board, the Board of Directors is capable of exercising its full powers.

At the end of 2015, through the asset-separation major part of the commercial real estate loan portfolio generating significant losses in the previous years was transferred from MKB to MSZVK Magyar Szanálási Vagyongkezelő 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 Vagyongkezelő Zrt. acquired 100% direct ownership in MKB, while the ownership rights and obligations were continued to be exercised by the National Bank of Hungary.

The open, transparent and non-discriminatory sales procedure of MKB Bank under close monitoring of the European Commission was successfully closed on 29 June 2016, after the conditions were met, including obtaining permission for the winning consortium members to gain interest and paying the purchase price. The new owners of MKB Bank became members of a consortium established by Blue Robin Investments S.C.A., METIS Private Capital Funds and Pannónia Pension Fund (45 - 45 - 10% ownership).

¹ For further information on consolidated subsidiaries please see Note 5

² BRRD

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

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

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

On 1 June 2017 RKOFIN Befektetési és Vagyonkezelő Kft. (RKOFIN Investment and Asset Management Ltd., hereinafter: "RKOFIN Ltd.") acquired 4% direct ownership in MKB from Blue Robin Investment S.C.A. The Court of Registration registered the transaction on 10 August 2017.

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

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

By way of share sale and purchase, RKOFIN Ltd. purchased part of the share package issued by MKB and held by the ESOP Organisation, altogether 9,620,597 pieces of series "A" dematerialised ordinary shares with a face value of HUF 1000 each. The Board of Directors of MKB decided on the registration of this change into the Share Registry on 1 October 2018 subject to the condition. Following the closing of the transaction on the transfer of shares, the previous 4% stake of RKOFIN Ltd. in the Bank increased to 13.620597%, while the former 15% ownership stake of the ESOP Organisation decreased to 5.379403%.

On 11 January 2019 Blue Robin Investment S.C.A., shareholder of MKB, officially informed MKB of the change in the person of its beneficiary owner.

BanKonzult Kft., the previous 100% owner of BanKonzult Finance Befektetési Zártkörűen Működő Részvénytársaság (BanKonzult Finance Investment Private Limited Company - hereinafter referred to as: "BanKonzult Finance Zrt."), sold its 100% participation in BanKonzult Finance Zrt. to László Szíjj. The participation embodies 32.9% indirect share in MKB - directly owned by Blue Robin Investment S.C.A. Having regard to the fact of the sale the indirect participation of BanKonzult Kft. in MKB ceased.

PROMID FINANCE Zrt. under the indirect influence of dr Ádám Balog, chairman - chief executive officer of MKB Bank, purchased 2,564,411 dematerialised ordinary shares of

series “A” of HUF 1,000 face value each from the share package of the ESOP Organisation embodying 2.564411%-share of the equity of MKB. After the transaction the ESOP Organisation has a total of 2.814992% share in the Bank. As of 27 February 2019 the Board of Directors of MKB registered PROMID FINANCE Zrt. in the share register as a shareholder with 2.564411% ownership in the Bank.

The new name of Konzum Befektetési Alapkezelő Zrt. managing METIS Private Fund shareholder has been OPUS GLOBAL Befektetési Alapkezelő Zártkörűen Működő Részvénytársaság (OPUS GLOBAL Investment Fund Manager Private Limited Company) since 28 June 2019.

1.1

| Name of the shareholders of MKB Bank Zrt. | Number of shares (pieces) | Total face value of shares (HUF) | Ownership share (%) |
|---|---------------------------|----------------------------------|---------------------|
| METIS Magántőkealap | 35 000 001 | 35 000 001 000 | 35.000001% |
| Blue Robin Investments S.C.A. | 32 900 000 | 32 900 000 000 | 32.900000% |
| RKOFIN Befektetési és Vagyonkezelő Kft. | 13 620 597 | 13 620 597 000 | 13.620597% |
| EIRENE Magántőkealap | 9 999 999 | 9 999 999 000 | 9.999999% |
| Total | 91 520 597 | 91 520 597 000 | 91.520597% |

The free float ratio was: 8.48%

These financial statements are prepared for general purposes as defined in IAS 1; 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. The stock exchange Flash report is prepared for special purposes for the same period, which based on the key figures of these financial statements.

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. The financial statements are authorised for issue by the Board of Directors on 26 September 2019.

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

The 2019 figures in this consolidated financial statements have been compiled on the basis of the standards effective from January 1, 2019.

3. Basis of measurement

The consolidated financial statements have been prepared on initial recognition at fair value as inception carrying amount.

The Group classifies subsequent measurements into the following categories:

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

The consolidated financial statements have been prepared based on going concern assumption.

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

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 33.

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 financial statements. The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by Group entities.

To ensure data consistency the Group made reclassification in supplementary notes in some relevant cases.

a, Financial statement presentation

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

The functional currency of the Group was determined as Hungarian Forints (HUF).

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 potential voting rights are also taken into account. Newly acquired subsidiaries are consolidated from the date that the Group gains control. The acquisition accounting method is used to account for the acquisition of subsidiaries by MKB. The cost of an acquisition is measured at the fair value of the consideration given at the date of exchange, the acquisition – related costs are recognized in profit or loss. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair value of the Group’s share of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group’s share of the identifiable assets, liabilities and contingent liabilities of the business acquired, the difference is recognised immediately in the statement of comprehensive income.

Funds management

The Group manages and administers assets held in investment funds on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity.

Transactions eliminated on consolidation

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

c, Investments in Associates and Joint Ventures

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. 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 reporting period.

If the Group's share of losses of an associate equals or exceeds its interest in the associate, the Group discontinues recognising its share of further losses. The interest in an associate is the carrying amount of the investment in the associate determined using the equity method together with any long-term interests that, in substance, form part of the Group's net investment in the associate.

After the Group's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

Please find further details on Jointly controlled entities and Associates in Note 5.

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.

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. 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 amortisation and impairment.

Subsequent expenditure related 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.

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:

- components of freehold buildings are depreciated over maximum 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 depreciated over 5-10 years, but maximum over 20 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 recognised in “Other operating income / (expense), net”, in the year of disposal or retirement.

f, Investment property

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

The Group uses the cost model for investment property, according to which the property is accounted in the Group's books at the purchases cost and then depreciated.

The estimated useful lives of investment properties are as follows:

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

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

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

g, Cash reserves

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

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

h, Initial recognition and measurement of Financial Instruments

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

Through initial measurement, all financial instruments - except for accounts receivables - that were not measured at fair value, are recognized at a modified fair value by the Group.

The modified fair value includes all transaction costs which are directly attributable to the issuance and acquisition of financial instruments.

Financial instruments measured at fair value through profit or loss are recognized at their fair value by the Group. All related transaction costs incurred at their inception, issuance, and / or purchase accounted as expense through Profit or Loss. If accounts payables do not contain significant financing component, they are recognized at transaction price by the Group.

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

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

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

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

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

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

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

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

Simplified approach for trade receivables, contract assets and lease receivables

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

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

i, Classification and subsequent measurement of Financial Instruments

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

The Group's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. The Group use multiple business models to manage its financial instruments.

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

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

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

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

By Cash Flow Test the Group examines whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.

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

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

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

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

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

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

j, Classification and subsequent measurement of financial liabilities

The Group classify its financial liabilities into the following categories:

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

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

k, Fair Value Option (FVO)

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

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

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

l, Determination and recognition of the Expected Credit Loss

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

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

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

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

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

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

- changes in the clients’ rating after the issuance,
- PD change in the master scale compared to the initial value,
- default in payment,
- the amount of the client's exposure classified as Stage 2 exceeds a certain proportion of its gross exposure.

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

Financial assets whose default risk has increased to such an extent after initial recognition that there is objective evidence of impairment have to be assigned to Stage 3 and a loan loss provision has to be recognised by calculating the Lifetime Expected Credit Loss (ECL). Group defines materiality threshold, exposure that are below that threshold should be considered as a small amount (below the limit). The impairment of those assets which are above the threshold should be estimated individually.

In order to determine the impairment and provision for classes of clients, the expected credit loss (ECL) should be used according to the relevant principles of IFRS 9 impairment and provision for classes of clients calculated on monthly basis, automatically.

Factors taken into account when determining expected credit loss:

- remaining lifetime in years,
- exposure at default (EaD),
- loss given default (LGD),
- probability of default (PD),
- credit conversion-factor (CCF),
- loss rate of the non-default and default transaction,
- discount rate calculated on the remaining lifetime.

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

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

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

The applied risk parameters are determined on the basis of statistical models for homogeneous groups and transaction groups. The models are validated at least once a year, and if necessary it will be revised. Transactions that are recognised at fair value, the fair value calculation the credit risk component of the discount factor is calculated based on the principles related to determination of ECL as mentioned above.

The Group calculates the expected credit loss for the remaining lifetime, excepting the following financial instruments for which the loss is calculated for 12 months:

- debt securities with low credit risk at the reporting date,
- financial instruments excepting lease receivables and account receivables, which credit risk do not significantly increased compared to initial recognition.

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

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

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

If the credit risk of the financial instrument has increased significantly since its initial recognition until the reporting date, the Group recognises the loss on the asset at the same amount as the expected lifetime credit loss.

If the credit risk of the financial instrument has not significantly increased since the initial recognition until the reporting date, the Group recognizes loss on the asset at the same amount of the 12-month expected credit loss.

The impairment / expected credit loss calculated for 12 months is the part of the lifetime expected loss results from potential default events within 12 months of the reporting date.

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

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

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

- deducted amount from the gross carrying value (impairment) – in case of financial assets measured at amortised cost,
- provision – in case of financial guarantees and loan commitments, if the financial instrument includes both a loan and an undrawn components and the Group is unable to distinguish the expected credit loss calculated for the loan and for the undrawn

components, the Group will therefore determine the impairment loss on the two components together. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognised as a provision,

- in case of financial assets measured at fair value through other comprehensive income (OCI), the impairment loss is not recognized in the financial statement as part of the assets' fair value. The recognised impairment modifies the cumulative other comprehensive income.

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

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

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

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

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

The impairment and provision are based on the amount of loss calculated as above.

m, Determination of fair value

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

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

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When independent prices are not available, fair values are

determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. For financial instruments, fair values may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data.

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

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

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

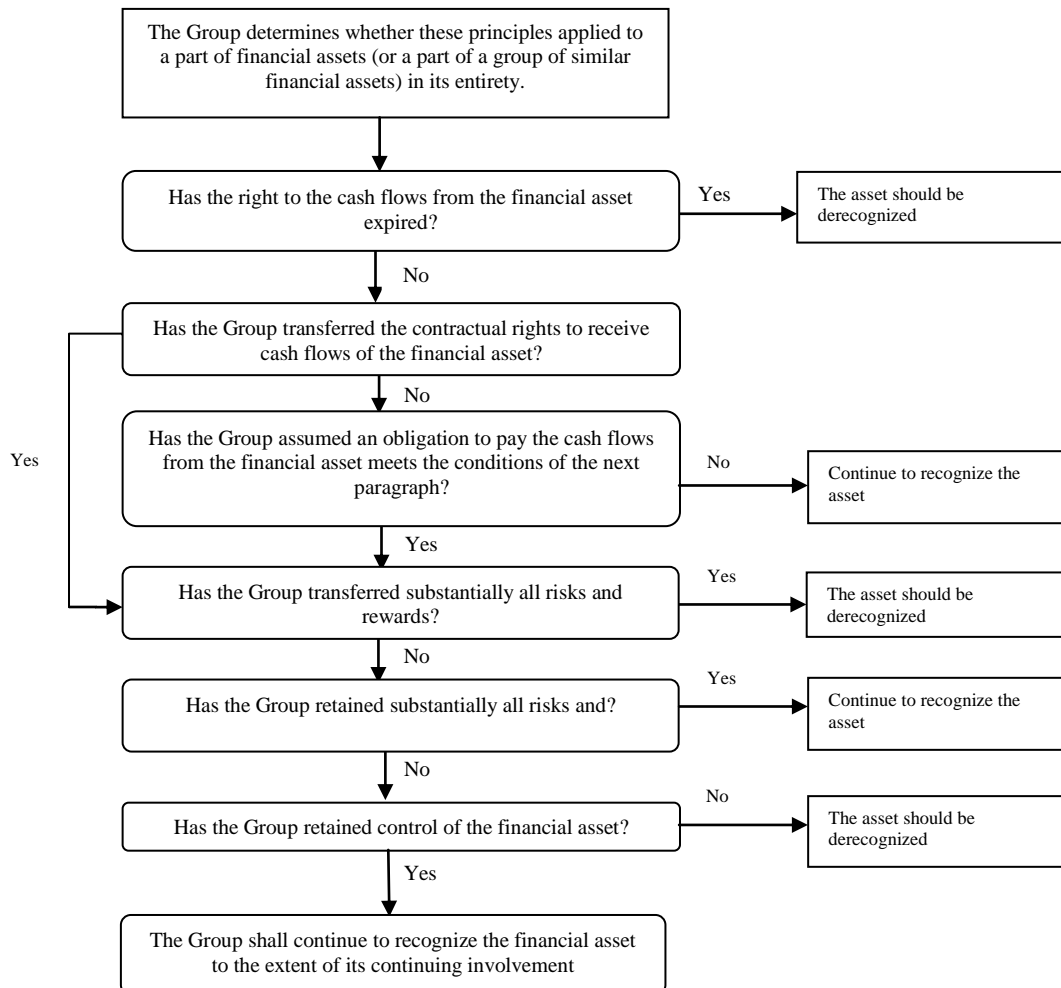
Factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when fair values are calculated using valuation techniques. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about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

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

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

n, Derecognition of Financial Assets

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



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

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

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

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

The Group examines the following before derecognition:

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

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

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

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

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

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

Derecognition due to significant changes in contractual cash flows

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

The Group considers it a significant change if the contractual currency is modified, or if the contractual interest rate is changed from variable to fix, or inversely.

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

Write-off of financial assets under legal proceeding

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

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

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

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

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

o, Derecognition of financial liabilities

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

Exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

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

p, Financial assets measured at Fair Value

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

The Group recognises the result from the fair value measurement (difference between the amortised cost and the fair value) excepting from the credit loss and foreign exchange gains and losses in other comprehensive income, until the financial asset is derecognised or reclassified, if it arise from asset measured at fair value through other comprehensive income, and in the profit or loss if measured through profit or loss.

At initial recognition measurement of financial assets and liabilities' amortised costs do not include transaction costs, these initially recognised in profit or loss, while amortised cost of transactions measured at fair value through other comprehensive income contains those.

q, Financial guarantees

The Group does not recognise the financial guarantees as contingent items in the Financial Statement items because this could cause recognition such income or expense which may not being realisable.

In case when the realisation of income or expense is substantially sure, the asset does not considered as contingent item and it should be recognised in the Financial Statement items assessed permanently in order to the Group post the changes up the Financial Statement in time.

Insofar the occurrence of economic benefits inflow or outflow being substantially sure, the relating income or expense should be accounted in that period wherein the probability of the occurrence changed.

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

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

r, Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Group which are classified as Fair Value Through Profit or Loss or Amortised cost. Loans and advances are recognised when cash is advanced to borrowers. They are derecognised when either borrower repay their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred.

If they are measured at amortised cost they are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost, otherwise they are measured at fair value. Where loans and advances are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

s, Non-current assets held for sale and discontinued operations

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

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

To meet the criteria for classification as held for sale:

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

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

A disposal group classified as held for sale may qualify for the definition of the discontinued operations.

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

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

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

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

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

Please find further details on non-current financial assets and liabilities held for sale in Note 37.

t, Financial assets and liabilities held for trading

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

Interest earned on trading debt securities is reported as interest revenue among the interest 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 interest expense.

Long-term deposit

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

Structured Bonds

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

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

u, Securities

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

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

v, Derivatives

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

Derivatives may be embedded in other financial instruments. Embedded derivatives are treated as separate derivatives according to the IFRS 9 standard.

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

w, Finance and operating leases

In accordance with the requirements of IFRS 16, the Group, as lessee, introduces a single model to recognise right-of-use asset and lease liability on balance sheet. In this case, presents separately the interest expense for the lease liability and the depreciation charge for the right-of-use asset. In some cases (e.g when there is a change in the lease term or in future

lease payments arising from a change in an index or rate) the Group as lessee remeasures the lease liability.

The Group recognises the right-of-use asset and the lease liability as at the commencement date of the lease. The right-of-use asset is initially measured at cost, which includes the initial amount of the lease liability, adjusted for lease payments incurred on or before the commencement date, increased initial direct costs and costs for dismantling, removing and restoring the underlying asset and for site restoration and less any leasing incentives.

The Group, as lessor, classifies its leasing contracts as finance or operating leases. Initially, the Group recognises the lease liability at the present value of the lease payments outstanding at the commencement date, discounted at the implicit interest rate of the lease. On subsequent measurement, the Group recognises depreciation on the right-of-use asset from the commencement date to the end of the useful life of the underlying asset.

After the commencement date of the lease term, the Group depreciates the asset on a straight-line basis, from the commencement date to the earlier of the useful life or the end of the lease term.

After the commencement date, the Group measures the lease liability at amortized cost using the effective interest rate method. The Group uses the revised interest rate at the date of the revaluation as the revised discount rate. In contrast, the Group reassesses the lease liability by discounting the revised lease payments if future lease payments are changed due to changes in an index or rate.

Presentation in the financial statements

During the lease term, the Group recognises lease payments for short-term leases and low value leases as an expense in Consolidated Statement of Profit or Loss and Other Comprehensive Income.

The right-of-use assets are included in 'Intangibles, property and equipment' and lease liabilities in 'Other liabilities and provisions' in the Consolidated Statement of Financial Position.

After the commencement date the Group recognises the related costs in Consolidated Statement of Profit or Loss and Other Comprehensive Income, if these are not recognised as part of the cost of the right-of-use asset. Interest on lease liabilities are included in 'Interest expenses'. The depreciation of a right-of-use asset are recognised as 'Operating expenses'.

The Group classify the right-of-use assets arising from operating leases that are leased or subleased in the Consolidated Statement of Financial Position by reference to the nature of the underlying asset.

x, 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 in profit or loss.

y, Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

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

z, Income tax

Income tax comprises current tax and deferred tax.

By accounting treatment for current and future income tax, the Group recognises the tax consequences of the future recovery / settlement of the carrying amount of assets, liabilities, transactions and other events of the current period that are recognised in the statement of financial position.

The Group applies the corporate income tax as income tax.

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

Deferred tax is measured at tax rates that are expected to be applied to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the end of the reporting period.

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 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 financial assets measured at fair value through other comprehensive income, which are charged or credited directly to equity, is also credited or charged directly to equity .

aa, Interest income and expense

Interest income and expense relating to use the effective interest method is recognised in 'Interest income' and 'Interest expense' in the statement of comprehensive income.

bb, Fees and commissions income

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) and
- income earned from the provision of services is recognised as revenue as the services are provided (for example asset management and service fees).

cc, 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 and foreign exchange differences.

dd, Dividends

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

ee, Segment reporting

MKB formed its reporting segments in line with IFRS 8 "Operating Segments. An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, and whose operating results are regularly reviewed by the Group's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; furthermore for which discrete financial information is available. The Group determines operating segments on nature of the business (business segment) or geographically (geographical segment).

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 36.

ff, 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.

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.

gg, Share capital

Shares are classified as share capital 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.

hh, Treasury shares

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

ii, 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 31.

jj, The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2019

The following amendments to the existing standards and new interpretation issued by the IASB and adopted by the EU are effective for the current reporting period:

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

The Group applied IFRS 16 Leases standard for annual reporting periods begins from 1 January 2019.

At the date of the initial application the Group has only a few leases that is previously classified as finance lease, for which transition to IFRS 16 have no significant impact.

The Group leases personal and commercial vehicles, leases and sub-leases office spaces. On transition, the Group reassessed the classification of a sub-lease contract, in which it acts as a lessor and there is no change in the classification of these contracts as a consequence there was not significant impact on transition to IFRS 16.

4.1

| | Balance at 31 December 2018 | Cost Revaluation | Balance at 30 June 2019 | Depreciation | Carrying amount |
|---------------------------------|--------------------------------|---------------------|----------------------------|--------------|--------------------|
| Other assets | 17 | - | 17 | 2 | 15 |
| Properties | 3 744 | 3 | 3 747 | 331 | 3 416 |
| Total right of use asset | 3 761 | 3 | 3 764 | 333 | 3 431 |

4.2

| 30 June 2019 | Within 3 months | Within 3 months and 1 year | Within 1 year and 3 years | Within 3 years and 5 years | Over 5 years |
|--|--------------------|-------------------------------|------------------------------|-------------------------------|-----------------|
| Contractual value of lease liabilities | 160 | 561 | 1 389 | 1 037 | 883 |

4.3

| 30 June 2019 | Long term | Short term | Total |
|--------------------------------------|-----------|------------|-------|
| Carrying amount of lease liabilities | 2 920 | 629 | 3 549 |

The amount of future cash outflows due to variable leasing payments is insignificant.

4.4

2019

| | |
|--|----|
| Interest expense recognized on lease liabilities | 48 |
| Expenses recognized for short-term leases | 46 |

The value of contracts for which the Group does not expect to exercise the extension and / or exercise option is immaterial.

The Group elected not to recognise right-of-use assets and lease liabilities for short-term leases of machinery that have a lease term of 12 months or less and leases of low-value assets (e.g including printers, IT equipment).

The relevant rules on measurement, recognition and presentation disclosed in Note 4.

- **Amendments to IFRS 9 “Financial Instruments”** - Prepayment Features with Negative Compensation – adopted by the EU on 22 March 2018 (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IAS 19 “Employee Benefits”** - Plan Amendment, Curtailment or Settlement – adopted by the EU on 13 March 2019 (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IAS 28 “Investments in Associates and Joint Ventures”** - Long-term Interests in Associates and Joint Ventures – adopted by the EU on 8 February 2019 (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to various standards due to “Improvements to IFRSs (cycle 2015 - 2017)”** resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 14 March 2019 (effective for annual periods beginning on or after 1 January 2019),
- **IFRIC 23 “Uncertainty over Income Tax Treatments”** – adopted by the EU on 23 October 2018 (effective for annual periods beginning on or after 1 January 2019).

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

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

At the date of authorisation of these financial statements, there are no new standards, amendments to the existing standards nor interpretations which are issued by IASB and adopted by the EU and which are not yet effective.

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

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except for the following new standards, amendments to the existing standards and new interpretation, which were not endorsed for use in EU as at 26 September 2019:

- **IFRS 14 “Regulatory Deferral Accounts”** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 3 “Business Combinations”** - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period).
- **Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures”** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),
- **Amendments to IAS 1 “Presentation of Financial Statements” and IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”** - Definition of Material (effective for annual periods beginning on or after 1 January 2020),
- **Amendments to References to the Conceptual Framework in IFRS Standards** (effective for annual periods beginning on or after 1 January 2020).

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

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).

The Bank, as the first step of the analysis considers the relevant activities of the investees; subsequently analyses 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.

The Group consolidates those subsidiaries, which operate as finance company, investment fund, subsidiary company and their total assets are more than HUF 3,000 million.

Subsidiaries (businesses to be included in the full consolidation approach) were excluded as well, in case the following conditions are jointly met:

- the net revenues are less than HUF 500 million,
- the share capital is less than HUF 500 million,
- the total equity is less than HUF 1,000 million, and
- the amount of total assets is less than HUF 3,000 million, because those investees are not considered material.

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.

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

- the Group's share in net revenues are less than HUF 500 million,
- the Group's share in share capital is less than HUF 500 million,
- the Group's share in total equity is less than HUF 1,000 million,
- the Group's amount of total assets is less than HUF 3,000 million, because those investees are not considered material, and
- the Group's exposure is less than HUF 500 million.

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

- the headquarter is situated in a country, where the legal system does not allow the submission of the necessary data and information,
- the consolidation would lead to misleading results (particularly, in case the duration of the control or the participation is foreseen to be less than one year),
- MKB's ability to control the investee is restricted legally or contractually,
- without these entities, the consolidated financial statements of the Group provide a true and fair view about the financial position and performance of the Bank and other subsidiaries. In case there are more subsidiaries complying with this requisite, they must be examined together, whether the exemption of these entities distort the true and fair value of the parent company and other subsidiaries, namely the sum of the total assets and contingent liabilities individually and collectively are less than 1% of total assets and contingent liabilities of the parent company,

- in case the entities do not reach the minimum of the defined conditions individually, but they exceed those collectively, they cannot be considered negligible, the Bank does not exempt them from the group of consolidation.

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

5.1

2019

| 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 | Collecting receivables |
| Extercom Vagyonkezelő Kft. | 100.00% | 100.00% | Hungary | Property investments |
| MKB-Euroleasing Autóház Szolgáltató Zrt. | 100.00% | 100.00% | Hungary | Car and consumer finance activities, other finance activities |
| MKB Bank MRP Szervezet | 100.00% | 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 |
| MKB-Pannónia Alapkezelő Zrt. | 49.00% | 49.00% | Hungary | Investment fund management activity |
| MKB Digital Szolgáltató Zrt. | 100.00% | 100.00% | Hungary | IT services |

2018

| Company | Percentage of equity owned | Percentage of voting rights | Country of incorporation | Brief description of activities |
|---|----------------------------|-----------------------------|--------------------------|--|
| Euro - Immat Üzemeltetési Kft. | 100.00% | 100.00% | Hungary | Intangible assets, license maintenance |
| Exter-Adósságkezelő Kft. | 100.00% | 100.00% | Hungary | Collecting receivables |
| Extercom Vagyonkezelő Kft. | 100.00% | 100.00% | Hungary | Property investments |
| MKB-Euroleasing Autóház Zrt. | 100.00% | 100.00% | Hungary | Car and consumer finance activities |
| MKB-Euroleasing Autóház Szolgáltató Zrt. | 100.00% | 100.00% | Hungary | Car finance activity |
| MKB Euroleasing Zrt. | 100.00% | 100.00% | Hungary | Holding of Euroleasing group, other finance activities |
| MKB Bank MRP Szervezet | 66.32% | 0.00% | Hungary | Special purpose entity for the Employee Share Program |
| MKB Bank Tejesítményjavadalmasági MRP szervezete | 100.00% | 100.00% | 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 |
| MKB-Pannónia Alapkezelő Zrt. | 49.00% | 49.00% | Hungary | Investment fund management activity |

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

a) Vehicle financing:

Euroleasing Group

MKB-Euroleasing Zrt.

Following the reorganization of the ownership structure of MKB-Euroleasing Group (hereinafter: Euroleasing Group), the Bank obtained 100% direct ownership and voting rights in the company in September 2015. There are still three companies in the market that are dominant in a broad spectrum of the market and have significant market share, including the Euroleasing Group.

On December 31, 2018, the structure of the Euroleasing Group changed. MKB Euroleasing Zrt. and MKB-Euroleasing Autóház Zrt. merged with MKB Euroleasing Autóház Zrt. Following the change in the structure, MKB Bank obtained 100% direct ownership and voting rights in MKB Euroleasing Autóház Zrt., while Retail Prod Zrt., Euroleasing Kft. and I.C.E. Kft. directly owned by MKB Euroleasing Autóház Zrt. (indirectly 100% owned by MKB Bank). MKB Bank consolidates the company.

Euroleasing Group's profit after taxation for 2018 amounted to HUF 1,357 million, which represents an 123% overperformance. The market volume of agricultural machinery financing in 2018 was 14% higher than in 2017. The Euroleasing Group is the 2nd largest player in this segment.

Retail Prod Zrt.

In 2015, Retail Prod Zrt. became part of the Group of consolidation as a subsidiary of MKB-Euroleasing Zrt. which has 100% ownership and voting rights in Retail Prod Zrt. The main activity of the company is car and consumer financing. Since 2015, the MKB Bank Nyrt. has nominated new members to the Board of Directors and to the Supervisory Board. From 2017, MKB Bank Nyrt. delegates all members of the Supervisory Board and the Chairman of the Board of Directors, therefore through these bodies and by common regulations and risk management the Bank is able to directly influence the important decisions related to the relevant activities. As a result of the acquisition of Retail Prod Zrt., HUF 604 million gain was recognized and disclosed in Other operating income / (expense), net in the financial statements for 2015. In order to cover the risks and potential contingent liabilities identified in the portfolio of the acquiree the Group recognized provision for liabilities. At the end of the reporting period the balance of the provision amounted to HUF 412 million.

Following the reorganization of the ownership structure of Euroleasing Group at 1 January 2019, MKB-Euroleasing Autólizing Zrt. obtained 100% direct ownership and voting rights in the company at 1 January 2019, consequently Retail Prod Zrt. is disclosed as subsidiary in the financial statements of MKB-Euroleasing Zrt..

b) Workout activity related to lending

Exter-Adósságkezelő Kft.
Extercom Kft.

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

c) Managing

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

MKB Üzemeltetési Kft.
Euro - Immat Üzemeltetési Kft.

Management of investment funds

MKB-Pannónia Alapkezelő Zrt. (minority interest)
MKB Kockázati Tőkealap-kezelő Zrt.
Solus Capital Kockázati Tőkealap-kezelő Zrt.

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

Pannónia Alapkezelő Zrt. on 1 December 2017. On 28 September 2018 MKB Bank sold MKB Befektetési Alapkezelő Zrt.

Support of health and pension funds

MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft. (Kiszolgáló Kft.)

The Bank owns 100% of the shares of MKB Nyugdíjpénztárt és Egészségpénztárt Kiszolgáló Kft. and has 100% of the voting rights. Accordingly MKB is entitled to appoint chief executives. The activities related to SZÉP cards are transferred to the Bank at the end of 2018. Kiszolgáló Kft is disclosed as subsidiary in the financial statements of the Group.

Information Technology services

MKB Digital Szolgáltató Zrt.

Another step to improve the efficiency of operation was that the Bank established MKB Digital Szolgáltató Zrt. on 9 May 2019, which wholly owned by the Bank. MKB Digital Zrt. began its operation on 1 June 2019 with a staff transferred from MKB Bank with successive employer rights. The purpose of outsourcing is to fulfil all IT operation development and strategic tasks of the Group comprehensively and efficiently and to develop a marketable service provider's model.

d) Employee Share Ownership Program

On 14 July 2016 MKB Bank established the Employee Share Ownership Program (ESOP) in order to purchase and manage the Bank's shares issued for employees. On 14 November 2017 MKB Bank established and registered another MRP organization ("MRP organization") to manage the rights to buy shares and bonds are granted on the remuneration policy on allowance of top management. The organisation, as an independent legal entity ended its operation on 30 June 2019, therefore its tasks granted by Employee Share Ownership Program (ESOP). The Bank is exposed to the variable returns of the MRP organization because employee shares that serve as a basis for unearned performance bonuses are returned to the Bank and therefore the MRP is recognized as a special purpose entity in the Group's financial statements.

e) Non-consolidated entities

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

Subsidiaries:

- MKB Ingatlan Kft.
- Exter-Reál Kft.
- Exter-Immo Zrt.
- MKB Consulting Kft.
- Euroleasing Kft.
- I.C.E. Kft.
- MKB Inkubátor Kft.
- MKB Kockázati Tőkealapkezelő Kft.
- Danube Capital R&A Zrt.

Associates:

- Pannonhalmi Apátsági Pincészet Kft.

Other affiliated entities:

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

f) Other entities sold or deconsolidated during the reporting periods

In 2018, the Bank sold one of its 100% owned subsidiaries, MKB Befektetési Alapkezelő Zrt. The company was fully consolidated.

In December 2018, derecognition of the fully consolidated MKB Jelzálogbank Zrt. was carried out by the Bank. The mortgage bank was ceased by completing its winding up.

In addition, the Bank sold its 3.94% interest in Trend Zrt. during 2018.

On 29 May 2019, MKB Bank sold its 2.27% interest in Kisvállalkozás-fejlesztő Pénzügyi Zrt.

6. Risk management

a. Introduction and overview

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

Risk management is an integral part of the Group's operations and a crucial component of its business and overall financial performance. The MKB Group's risk management framework has been designed to support 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 typically 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 originated from loans or other loan type commitments extended to associated enterprises are also included in the Group'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 Group 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 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 risk (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 risk:
Operational risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk, conduct risk, reputational risk, modelling risk respectively information and communication technology (ICT) risk. Operational risk does not include business and strategic risks.
- conduct risk:
The conduct risk is classified among the operational risks and reflects any risk in the supply of financial services originated from an inadequate supply of services or deliberately exhibited impermissible conduct. This includes risks arising from fraud and unfair, unethical or aggressive trading practices harmful to consumers.
- 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, a delay in reacting to changes in legal framework conditions, unexpected or ex post facto changes in legal framework respectively courts diverse legal judgements from the Group's side.
- reputational risk:
Reputational risk is defined as risks have indirect effect on liquidity, capital or profitability based on unfavourable consumer, partnership, shareholder, investor or official sentiment, which is cancelled from the Bank's expected assessment level.
- model risk:
Model is the risk of loss resulting from decisions based on using insufficiently accurate models. Mistakes in models are not necessarily, or not primarily occur from negligence instead limitations of knowledge, not enough data, or changes that cannot be read from past data: simply the fact that the models are never perfect.

- **information and communication technology (ICT) risk:**
ICT risk means the current or prospective risk of losses due to the inappropriateness or failure of the hardware and software of technical infrastructures, which can compromise the availability, integrity, accessibility and security of such infrastructures and of data. ICT risk also includes risks occur from outsourcing of ICT relevant systems.
- **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, Encumbered assets

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

6.1

| | 30 June 2019 | | 31 December 2018 | |
|---|-----------------|----------------|------------------|----------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| <i>Assets of the reporting institution</i> | | | | |
| Loans on demand | 226 | 226 | 291 | 291 |
| Debt securities | 191 647 | 190 884 | 202 562 | 200 935 |
| Loans and advances other than loans on demand | 93 949 | - | 47 083 | - |
| Total encumbered assets | 285 822 | 191 110 | 249 936 | 201 226 |

6.2

| | Non-encumbered | |
|---|---|--|
| | Fair value of collateral received or own debt securities issued available for encumbrance | Nominal value of collateral received or own debt securities issued non available for encumbrance |
| 30 June 2019 | | |
| <i>Collateral received by the reporting institution</i> | | |
| Loans on demand | 1 219 | - |
| Loans and advances other than loans on demand | 26 279 | - |
| Other collateral received | - | 269 132 |
| Collateral received and own debt securities issued | 27 498 | 269 132 |
| 31 December 2018 | | |
| <i>Collateral received by the reporting institution</i> | | |
| Loans on demand | 749 | - |
| Loans and advances other than loans on demand | 25 571 | - |
| Other collateral received | - | 306 265 |
| Collateral received and own debt securities issued | 26 320 | 306 265 |

6.3

| | 30 June 2019 | | 31 December 2018 | |
|--|---|---|---|---|
| | 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 |
| <i>Carrying amount of selected financial liabilities</i> | 92 050 | 285 822 | 73 640 | 249 936 |
| Derivatives | 10 616 | 46 353 | 5 179 | 48 651 |
| Deposits | 81 434 | 239 469 | 68 461 | 201 285 |
| Repurchase agreements | 12 973 | - | - | - |
| Collateralised deposits other than repurchase agreements | 68 461 | 239 469 | 68 461 | 201 285 |
| Total Sources of encumbrance | 92 050 | 285 822 | 73 640 | 249 936 |

At the end of June 2019 the level of encumbered assets determined in accordance with the aforementioned regulation was 15.4%. The total of Group's encumbered assets belonged to MKB Bank. The main sources and types of encumbrance were arising from having secured refinancing, from collaterals of mortgage loans, money market deposits as well as collateralized derivative transactions and repo transactions. Encumbrance due to collateral requirement of used clearing systems and central counterparties was not significant. MKB did not have covered bond issues or securitization.

The most significant secured refinancing facilities was participating in the "Funding for Growth Scheme" refinancing loan program of the National Bank of Hungary. The majority of collateralized derivative transactions were concluded to hedge on balance sheet FX position and interest rate.

c, 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 Group 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 Group 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.

6.4

| | 30 June 2019 Basel III IFRS | 31 December 2018 Basel III IFRS |
|--|--------------------------------|------------------------------------|
| Share capital | 100 000 | 100 000 |
| <i>Outstanding share capital</i> | <i>100 000</i> | <i>100 000</i> |
| Reserves | 57 426 | 56 688 |
| Intangible assets | (19 269) | (19 398) |
| AVA - additional valuation adjustments | (270) | (421) |
| Additional Tier 1 | - | - |
| Tier 1: Net core capital | 137 887 | 136 869 |
| Subordinated debt | 37 459 | 28 002 |
| Tier 2: Supplementary capital | 37 459 | 28 002 |
| Regulatory capital | 175 346 | 164 871 |
| Risk-weighted assets (RWA) | 731 892 | 743 016 |
| Operational risk (OR) | 168 511 | 168 511 |
| Market risk positions (MR) | 7 373 | 9 297 |
| Total risk weighted assets | 907 776 | 920 824 |
| Regulatory capital / Total assets | 9.59% | 8.89% |
| Tier1 ratio | 15.19% | 14.86% |
| Capital adequacy ratio | 19.32% | 17.90% |

The table above contains the Group's consolidated capital adequacy ratio. Standalone capital adequacy ratio was 21.78%.

As at 30 June 2019, as an actual figure of the Group regulatory capital was HUF 175.3 billion based on Basel III IFRS under Supervisory Regulation. The increase of regulatory capital - by HUF 10.5 billion – is derived from the increase of subordinated debt and revaluation reserve, which was compensated by the decrease of revenue reserve calculated as requirements of Basel III.

Risk-weighted assets including operational and market risk decreased by 1.4% from HUF 920.8 billion in 2018 to HUF 907.8 besides approximately 0.6% weakening of domestic currency. The main part of the decrease derived from the decreasing market risk capital requirement and decrease of business volumes in wholesale segment, increase of collateral and the RWA reduction project.

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

Planning and limitation of capital requirements

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

d, 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,
- strengthening of collateral structure (potential new collaterals in the cases of actual collateral position, non-reducing outstandings and new commitments),
- refinancing of the loan,
- interest rate cut, or lower conditions,
- interest capitalization.

Such exposures and associated credit risks are managed, monitored and reported distinctly by specific restructuring and debt management units of the Group on the basis of guidelines and procedure rules set by internal regulations incorporating also both legal and supervisory requirements and recommendations. When the conditions of forbearance cease to exist and the following cure period expires, respective assets are returned to normal treatments both from business and risk management perspectives.

To revert to normal treatment regarding Corporate customers, additional criteria is that the customer performs its amended contractual obligations duly through a specified period (90 days, 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 IFRS 9.

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

6.5

| | Balance at 30 June 2019 | Balance at 31 December 2018 |
|-----------------------------------|----------------------------|--------------------------------|
| Corporate Banking | | |
| Forborn financial assets | 16 121 | 16 096 |
| Allowances for impairment | (14 954) | (15 006) |
| Carrying amount | 1 167 | 1 090 |
| Retail and Private Banking | | |
| Forborn financial assets | 18 601 | 20 643 |
| Provision | (8 814) | (10 675) |
| Carrying amount | 9 787 | 9 968 |
| Total carrying amount | 10 954 | 11 058 |

e, 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 Group set up bank and sector level KPI's (key performance indicator) set and product limits, in order to restrain the assumption of further risks arising from the characteristics / risks rooted in different sectors and the assumption of risks of products representing high or special risk. Aiming to avoid high risk concentration within the portfolio, the concentration risk limit value has been established for the total bank portfolio, with the stipulation that the limits of the individual customers / customer groups may exceed this target value only in extraordinary and justified cases, based exclusively on the strategic guidelines approved by the relevant Committee.

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

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

6.6

| 30 June 2019 | Cash reserves | Loans and advances to banks | Loans and advances to customers | Securities | Derivative financial assets | OFF B/S exposures |
|--|---------------|-----------------------------|---------------------------------|----------------|-----------------------------|-------------------|
| <i>Individually impaired</i> | | | | | | |
| Non-default | - | - | 56 | - | - | - |
| Default | - | - | 17 074 | - | - | 257 |
| Total individually impaired gross amount | - | - | 17 130 | - | - | 257 |
| Total individually impaired allowance for impairment | - | - | (13 345) | - | - | (120) |
| Total individually impaired carrying amount | - | - | 3 785 | - | - | 137 |
| <i>Collectively impaired</i> | | | | | | |
| Non-default | 68 924 | 66 447 | 886 330 | 436 612 | - | 390 922 |
| Default | - | - | 25 771 | - | - | 338 |
| Total collectively impaired gross amount | 68 924 | 66 447 | 912 101 | 436 612 | - | 391 260 |
| Total collectively impaired allowance for impairment | - | (34) | (29 348) | (98) | - | (974) |
| Total collectively impaired carrying amount | 68 924 | 66 413 | 882 753 | 436 514 | - | 390 286 |
| <i>Past due but not impaired</i> | | | | | | |
| Non-default | - | - | 7 | - | - | - |
| Default | - | - | - | - | - | - |
| Total past due but not impaired carrying amount | - | - | 7 | - | - | - |
| <i>Neither past due nor impaired</i> | | | | | | |
| Non-default | 10 728 | 1 334 | 29 421 | - | - | 75 |
| Default | - | - | 51 | - | - | - |
| Total neither past due nor impaired carrying amount | 10 728 | 1 334 | 29 472 | - | - | 75 |
| Total assets measured at fair value | - | - | 8 806 | 206 607 | 17 846 | - |
| <i>Other contingent liabilities</i> | | | | | | |
| Gross amount of other contingent liabilities | - | - | - | - | - | 9 064 |
| Provision for other contingent liabilities | - | - | - | - | - | (1 862) |
| Total gross amount | 79 652 | 67 781 | 967 516 | 643 219 | 17 846 | 400 656 |
| Total allowance for impairment | - | (34) | (42 693) | (98) | - | (2 956) |
| Total carrying amount | 79 652 | 67 747 | 924 823 | 643 121 | 17 846 | 397 700 |

| 31 December 2018 | Cash reserves | Loans and advances to banks | Loans and advances to customers | Securities | Derivative financial assets | OFF B/S exposures |
|--|---------------|-----------------------------|---------------------------------|----------------|-----------------------------|-------------------|
| <i>Individually impaired</i> | | | | | | |
| Non-default | - | - | 209 | - | - | 184 |
| Default | - | - | 32 958 | - | - | 467 |
| Total individually impaired gross amount | - | - | 33 167 | - | - | 651 |
| Total individually impaired allowance for impairment | - | - | (27 368) | - | - | (446) |
| Total individually impaired carrying amount | - | - | 5 799 | - | - | 205 |
| <i>Collectively impaired</i> | | | | | | |
| Non-default | - | 62 790 | 842 799 | 61 541 | - | 310 314 |
| Default | - | - | 47 677 | - | - | 376 |
| Total collectively impaired gross amount | - | 62 790 | 890 476 | 61 541 | - | 310 690 |
| Total collectively impaired allowance for impairment | - | (15) | (42 744) | (63) | - | (1 031) |
| Total collectively impaired carrying amount | - | 62 775 | 847 732 | 61 478 | - | 309 659 |
| <i>Past due but not impaired</i> | | | | | | |
| Non-default | - | - | 3 | - | - | - |
| Default | - | - | 50 | - | - | - |
| Total past due but not impaired carrying amount | - | - | 53 | - | - | - |
| <i>Neither past due nor impaired</i> | | | | | | |
| Non-default | 19 240 | 835 | 33 610 | 349 799 | - | 92 452 |
| Default | - | - | 111 | - | - | 112 |
| Total neither past due nor impaired carrying amount | 19 240 | 835 | 33 721 | 349 799 | - | 92 564 |
| Total assets measured at fair value | - | - | 7 898 | 361 752 | 17 914 | - |
| <i>Other contingent liabilities</i> | | | | | | |
| Gross amount of other contingent liabilities | - | - | - | - | - | 24 074 |
| Provision for other contingent liabilities | - | - | - | - | - | (3 551) |
| Total gross amount | 19 240 | 63 625 | 965 315 | 773 092 | 17 914 | 427 979 |
| Total allowance for impairment | - | (15) | (70 112) | (63) | - | (5 028) |
| Total carrying amount | 19 240 | 63 610 | 895 203 | 773 029 | 17 914 | 422 951 |

In order to provide a more accurate picture of the Group's maximum exposure, the structure of the note has been changed.

7. Cash reserves

7.1

| | 30 June 2019 | 31 December 2018 |
|--------------------------------------|---------------|------------------|
| Cash and balances with Central Banks | 79 652 | 19 240 |
| Cash reserves | 79 652 | 19 240 |

The Group is required to maintain a minimum reserve with the National Bank of Hungary (NBH) equivalent to 1% (2018: 1%) of certain deposits. The balance of the minimum reserve, in line with the prescription of NBH, is based on the balance at the end of April of these deposit accounts and amounted to HUF 13,323 million as at 30 June 2019 (2018: HUF 13,334 million). As at 30 June 2019, cash on hand amounted to HUF 12,840 million (2018: HUF 15,267 million).

8. Loans and advances to banks

8.1

| | 30 June 2019 | 31 December 2018 |
|--|---------------|------------------|
| Current and clearing accounts | 12 666 | 15 676 |
| Money market placements | 54 926 | 47 796 |
| Loans and advances | 189 | 153 |
| Loans and advances to banks (gross amount) | 67 781 | 63 625 |
| <i>Allowance for impairment</i> | | |
| Balance at 1 January | (15) | (11) |
| Impairment loss for the year: | | |
| Increases due to origination and acquisition | (44) | (21) |
| Decreases due to derecognition | 29 | 18 |
| Changes due to change in credit risk (net) | (4) | (1) |
| Allowance for impairment at the end of period | (34) | (15) |
| Carrying amount | 67 747 | 63 610 |

9. Derivative financial assets

9.1

| | 30 June 2019 | | | 31 December 2018 | | |
|---------------------------------------|--------------|-----------------------|---------------|------------------|-----------------------|---------------|
| | Cost | Fair value adjustment | Book value | Cost | Fair value adjustment | Book value |
| <i>Derivative instruments by type</i> | | | | | | |
| FX-based derivative instruments | - | 4 344 | 4 344 | - | 2 517 | 2 517 |
| Index-based derivative instruments | - | 88 | 88 | - | - | - |
| Interest-based derivative instruments | - | 12 963 | 12 963 | - | 14 761 | 14 761 |
| Options | 123 | 328 | 451 | 299 | 337 | 636 |
| Derivative financial assets | 123 | 17 723 | 17 846 | 299 | 17 615 | 17 914 |

10. Securities

10.1

| | 30 June 2019 | 31 December 2018 |
|--------------------------------------|----------------|------------------|
| <i>Securities measured at FVTOCI</i> | | |
| Hungarian Government bonds | 161 886 | 281 414 |
| Hungarian corporate sector bonds | 20 542 | 17 978 |
| Foreign equities | 1 173 | 882 |
| Less allowance for impairment | (55) | (65) |
| <i>Securities measured at AC</i> | | |
| Hungarian Government bonds | 406 365 | 372 499 |
| Hungarian corporate sector bonds | 30 247 | 38 841 |
| Less allowance for impairment | (98) | (63) |
| <i>Securities measured at FVTPL</i> | | |
| Government Treasury bills | 11 034 | 59 211 |
| Government bonds | 11 495 | 1 673 |
| Hungarian corporate sector bonds | 206 | 535 |
| Hungarian equities | 271 | 59 |
| Securities | 643 121 | 773 029 |

The amount of impairment of the FVTOCI financial assets, which is accounted for between other comprehensive income reserve and profit or loss, does not decrease the carrying amount of the financial asset.

The revaluation on financial assets measured at FVTOCI is decreased to HUF 5,490 million from HUF 19,226 million.

At 30 June 2019, HUF 191,647 million (2018: HUF 202,562 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.

As at 30 June 2019 the total amount of revaluation excluding deferred taxes in equity comprises HUF 2,219 million (2018: HUF (3 815) million), in addition HUF (195) million deferred tax (2018: HUF 349 million deferred tax) recognized in the other comprehensive income.

In 2019 HUF 1,475 million gain (2018: HUF 3,423 million gain) was recognized in the profit or loss relating to securities measured at FVTOCI, which is a reclassification from other comprehensive income into profit or loss.

11. Loans and advances to customers

The net amount of Loans and advances to customers was HUF 924,823 million, of which HUF 916,017 million was measured at amortised cost and HUF 8,806 million at fair value. The amount of fair value customer loans belongs to the wholesale portfolio was HUF 753 million, while the amount of retail loans was HUF 8,053 million on 30 June 2019.

11.1

| | 30 June 2019 | 31 December 2018 |
|--|----------------|------------------|
| <i>Loans and advances to customers</i> | | |
| measured at AC | 916 017 | 887 305 |
| measured at FVTPL | 8 806 | 7 898 |
| Loans and advances to customers | 924 823 | 895 203 |

Loans and advances to customers at amortised cost

11.2

| 30 June 2019 | Gross amount | Allowance for impairment Stage 1 | Allowance for impairment Stage 2 | Allowance for impairment Stage 3 | Carrying amount |
|----------------------------|----------------|----------------------------------|----------------------------------|----------------------------------|-----------------|
| Carrying amount | | | | | |
| <i>Wholesale</i> | | | | | |
| Refinanced loan | 56 830 | (251) | (7) | (40) | 56 532 |
| Funding for Growth Scheme | 53 787 | (141) | (1 963) | (471) | 51 212 |
| Factoring | 15 808 | (63) | (86) | (7) | 15 652 |
| Overdraft | 89 261 | (284) | (115) | (1 010) | 87 852 |
| Széchenyi Loans | 32 399 | (184) | (66) | (859) | 31 290 |
| Other | 401 782 | (2 271) | (5 289) | (14 418) | 379 804 |
| Total Wholesale | 649 867 | (3 194) | (7 526) | (16 805) | 622 342 |
| <i>Retail</i> | | | | | |
| Residential mortgage | 197 057 | (835) | (269) | (7 794) | 188 159 |
| <i>HUF</i> | 195 916 | (831) | (265) | (7 649) | 187 171 |
| <i>Foreign currency</i> | 1 141 | (4) | (4) | (145) | 988 |
| Credit card | 2 136 | (19) | (33) | (94) | 1 990 |
| Overdraft | 1 233 | (10) | (23) | (143) | 1 057 |
| Personal loan | 6 869 | (161) | (21) | (271) | 6 416 |
| Car finance | 81 174 | (66) | (7) | (3 974) | 77 127 |
| Other | 6 327 | (16) | (3) | (517) | 5 791 |
| Total Retail | 294 796 | (1 107) | (356) | (12 793) | 280 540 |
| Total Core business | 944 663 | (4 301) | (7 882) | (29 598) | 902 882 |
| Non-core business | | | | | |
| CRE | 14 261 | (5) | (73) | (1 048) | 13 135 |
| Total | 958 924 | (4 306) | (7 955) | (30 646) | 916 017 |

| 31 December 2018 | Gross amount | Allowance for impairment Stage 1 | Allowance for impairment Stage 2 | Allowance for impairment Stage 3 | Carrying amount |
|----------------------------|----------------|----------------------------------|----------------------------------|----------------------------------|-----------------|
| Carrying amount | | | | | |
| <i>Wholesale</i> | | | | | |
| Refinanced loan | 54 212 | (245) | (45) | (64) | 53 858 |
| Funding for Growth Scheme | 50 596 | (155) | (1 645) | (546) | 48 250 |
| Factoring | 12 879 | (33) | (99) | (68) | 12 679 |
| Overdraft | 77 671 | (213) | (133) | (1 434) | 75 891 |
| Széchenyi Loans | 31 638 | (164) | (140) | (819) | 30 515 |
| Other | 404 796 | (1 827) | (5 084) | (29 127) | 368 758 |
| Total Wholesale | 631 792 | (2 637) | (7 146) | (32 058) | 589 951 |
| <i>Retail</i> | | | | | |
| Residential mortgage | 220 537 | (903) | (333) | (19 391) | 199 910 |
| <i>HUF</i> | 218 184 | (898) | (330) | (18 403) | 198 553 |
| <i>Foreign currency</i> | 2 353 | (5) | (3) | (988) | 1 357 |
| Credit card | 2 306 | (21) | (44) | (105) | 2 136 |
| Overdraft | 1 260 | (13) | (43) | (138) | 1 066 |
| Personal loan | 7 068 | (634) | (70) | (219) | 6 145 |
| Car finance | 75 658 | (218) | (29) | (4 224) | 71 187 |
| Other | 2 039 | (32) | (3) | (717) | 1 287 |
| Total Retail | 308 868 | (1 821) | (522) | (24 794) | 281 731 |
| Total Core business | 940 660 | (4 458) | (7 668) | (56 852) | 871 682 |
| Non-core business | | | | | |
| CRE | 16 757 | (7) | (98) | (1 029) | 15 623 |
| Total | 957 417 | (4 465) | (7 766) | (57 881) | 887 305 |

In 2019, other items included in HUF 229,545 million working capital loans, HUF 39,957 million investment loans, HUF 71,112 million syndicated loans, HUF 34,493 million loans relating to purchased loans.

In 2018, other items included in HUF 225,436 million working capital loans, HUF 43,014 million investment loans, HUF 64,877 million syndicated loans, HUF 35,830 million loans relating to purchased loans.

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

CRE (previously SCU) remaining portfolio

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

According to the EU commitments forming part of the Restructuring Plan approved by the European Commission, the gross volume of the remaining CRE (i.e. Commercial Real Estate previously SCU) portfolio has to be reduced below HUF 60 billion by the end of 2019. The Group fulfilled the commitment by the end of 2017, further steps for dismantling the portfolio is not necessary. Even so the portfolio has been reduced significantly by nearly HUF 10 billion in 2018. The CRE-portfolio has been decreased by further HUF 2,6 billion in 2019 H1. Nevertheless any new CRE type of business can be approved until 2020 based on the EU commitments.

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 Group keeps some assets in long-term in order to maximize recovery from those assets.

Allowances for impairment

11.3

| | 30 June 2019 | 31 December 2018 |
|---|---------------|------------------|
| <i>Allowances for impairment on loans and advances to customers</i> | | |
| Balance at 1 January | 70 112 | 93 508 |
| Impairment loss for the year: | | |
| Increases due to origination and acquisition | 3 176 | 7 166 |
| Decreases due to derecognition | (2 383) | (14 905) |
| Changes due to change in credit risk (net) | (27 507) | (9 914) |
| Changes due to modifications without derecognition (net) | 2 | (740) |
| Decrease in allowance account due to write-offs | (441) | (5 663) |
| Other adjustments | (52) | 660 |
| Allowance for impairment at the end of period | 42 907 | 70 112 |

The aim of the IFRS 9 credit risk scoring system is to assign a PiT (point-in-time) PD to each relevant customer. The IRB rating system for Pillar II. capital requirement calculation was modified according to IFRS 9 requirements. Both of rating systems use the same default definition and model structure, including the quantitative and qualitative sub-models and the explicative variables. The calibration processes are different. In the case of IFRS 9 it depends on the stage of a given customer. In the stage 1, the time horizon is one year, in the stage 2 the lifetime PiT PD's are estimated. The stage 3 contains the defaulted customers, where the PD equals to 1.

In the stage 2, the one year PD is transformed to the lifetime PD, based on the Markov chain, and Vintage analysis estimation of transition probabilities and taken into account the macroeconomic, especially the year-on-year GDP forecasts, in the first three years of the estimation horizon. From the fourth year, the TTC (through-the-cycle) PD has been used.

11.3.1

| 30 June 2019 | Gross amount | | | POCI |
|---------------------------|----------------|---------------|---------------|--------------|
| | Stage 1 | Stage 2 | Stage 3 | |
| <i>Retail</i> | | | | |
| Investment grade | 118 775 | 1 228 | - | - |
| Standard credit quality | 139 470 | 6 991 | - | 2 583 |
| Intensive monitoring | 2 992 | 2 918 | - | 554 |
| Default | 98 | - | 14 858 | 4 329 |
| Total Retail | 261 335 | 11 137 | 14 858 | 7 466 |
| <i>Wholesale</i> | | | | |
| Investment grade | 217 993 | 6 073 | - | - |
| Standard credit quality | 351 838 | 4 587 | - | - |
| Intensive monitoring | 9 517 | 36 620 | 265 | - |
| Default | 248 | - | 22 726 | - |
| Total Wholesale | 579 596 | 47 280 | 22 991 | - |
| <i>CRE</i> | | | | |
| Standard credit quality | 12 000 | - | - | - |
| Intensive monitoring | - | 1 185 | - | - |
| Default | 1 | - | 1 075 | - |
| Total CRE | 12 001 | 1 185 | 1 075 | - |
| Total gross amount | 852 932 | 59 602 | 38 924 | 7 466 |

| 30 June 2019 | Allowance for impairment | | | POCI |
|---------------------------------------|--------------------------|--------------|---------------|--------------|
| | Stage 1 | Stage 2 | Stage 3 | |
| <i>Retail</i> | | | | |
| Investment grade | 208 | 2 | - | - |
| Standard credit quality | 873 | 235 | - | 302 |
| Intensive monitoring | 23 | 119 | - | 34 |
| Default | 3 | - | 10 231 | 2 226 |
| Total Retail | 1 107 | 356 | 10 231 | 2 562 |
| <i>Wholesale</i> | | | | |
| Investment grade | 1 132 | 567 | - | - |
| Standard credit quality | 1 692 | 135 | - | - |
| Intensive monitoring | 370 | 6 824 | 251 | - |
| Default | - | - | 16 554 | - |
| Total Wholesale | 3 194 | 7 526 | 16 805 | - |
| <i>CRE</i> | | | | |
| Standard credit quality | 5 | - | - | - |
| Intensive monitoring | - | 73 | - | - |
| Default | - | - | 1 048 | - |
| Total CRE | 5 | 73 | 1 048 | - |
| Total allowance for impairment | 4 306 | 7 955 | 28 084 | 2 562 |

| 31 December 2018 | Gross amount | | | POCI |
|---------------------------|----------------|---------------|---------------|---------------|
| | Stage 1 | Stage 2 | Stage 3 | |
| <i>Retail</i> | | | | |
| Investment grade | 113 299 | - | - | - |
| Standard credit quality | 137 132 | 8 652 | - | 2 620 |
| Intensive monitoring | 3 321 | 3 662 | 64 | 587 |
| Default | 145 | 8 | 25 209 | 14 169 |
| Total Retail | 253 897 | 12 322 | 25 273 | 17 376 |
| <i>Wholesale</i> | | | | |
| Investment grade | 49 254 | - | - | - |
| Standard credit quality | 485 876 | 8 168 | - | - |
| Intensive monitoring | 7 399 | 40 303 | 362 | - |
| Default | 351 | - | 40 079 | - |
| Total Wholesale | 542 880 | 48 471 | 40 441 | - |
| <i>CRE</i> | | | | |
| Standard credit quality | 14 173 | 1 | - | - |
| Intensive monitoring | - | 1 522 | - | - |
| Default | 1 | - | 1 060 | - |
| Total CRE | 14 174 | 1 523 | 1 060 | - |
| Total gross amount | 810 951 | 62 316 | 66 774 | 17 376 |

| 31 December 2018 | Allowance for impairment | | | POCI |
|---------------------------------------|--------------------------|--------------|---------------|--------------|
| | Stage 1 | Stage 2 | Stage 3 | |
| <i>Retail</i> | | | | |
| Investment grade | 371 | - | - | - |
| Standard credit quality | 1 412 | 284 | - | 87 |
| Intensive monitoring | 38 | 238 | 18 | 16 |
| Default | - | - | 16 969 | 7 704 |
| Total Retail | 1 821 | 522 | 16 987 | 7 807 |
| <i>Wholesale</i> | | | | |
| Investment grade | 962 | - | - | - |
| Standard credit quality | 1 334 | 615 | - | - |
| Intensive monitoring | 341 | 6 531 | 301 | - |
| Default | - | - | 31 757 | - |
| Total Wholesale | 2 637 | 7 146 | 32 058 | - |
| <i>CRE</i> | | | | |
| Standard credit quality | 7 | - | - | - |
| Intensive monitoring | - | 98 | - | - |
| Default | - | - | 1 029 | - |
| Total CRE | 7 | 98 | 1 029 | - |
| Total allowance for impairment | 4 465 | 7 766 | 50 074 | 7 807 |

12. Other assets

12.1

| | 30 June 2019 | 31 December 2018 |
|--|---------------|------------------|
| Prepayments and other debtors (other financial assets) | 18 031 | 21 216 |
| Inventory | 514 | 553 |
| Collaterals held in possession | 196 | 56 |
| Other taxes refundable | 459 | 274 |
| Impairment | (552) | (400) |
| Other assets | 18 648 | 21 699 |

13. Investments in jointly controlled entities and associates

13.1

| | 30 June 2019 | 31 December 2018 |
|--|--------------|------------------|
| Cost | 3 912 | 4 687 |
| Investments in jointly controlled entities and associates | 3 912 | 4 687 |

14. Intangibles, property and equipment

14.1

| 30 June 2019 | Intangible assets | Freehold property | Equipment | Total |
|--|-------------------|-------------------|---------------|----------------|
| <i>Cost or deemed cost</i> | | | | |
| Balance at 1 January | 68 563 | 37 622 | 21 297 | 127 482 |
| Additions – including internally developed | 3 574 | 3 861 | 850 | 8 285 |
| Other additions | (77) | - | (70) | (147) |
| Disposals | (2 306) | (639) | (1 191) | (4 136) |
| Balance at 30 June | 69 754 | 40 844 | 20 886 | 131 484 |
| <i>Depreciation and impairment losses</i> | | | | |
| Balance at 1 January | 49 165 | 11 542 | 14 632 | 75 339 |
| Amortization and depreciation for the year | 1 406 | 755 | 784 | 2 945 |
| Impairment loss | - | 17 | 55 | 72 |
| Disposals | (86) | (447) | (679) | (1 212) |
| Other additions | - | - | (10) | (10) |
| Balance at 30 June | 50 485 | 11 867 | 14 782 | 77 134 |
| <i>Carrying amounts</i> | | | | |
| At 1 January | 19 398 | 26 080 | 6 665 | 52 143 |
| Balance at 30 June | 19 269 | 28 977 | 6 104 | 54 350 |

| 31 December 2018 | Intangible assets | Freehold property | Equipment | Total |
|--|-------------------|-------------------|---------------|----------------|
| <i>Cost or deemed cost</i> | | | | |
| Balance at 1 January | 61 146 | 40 703 | 19 940 | 121 789 |
| Additions – including internally developed | 10 416 | 600 | 2 818 | 13 834 |
| Other additions | (986) | 23 | (26) | (989) |
| Disposals | (2 013) | (3 704) | (1 435) | (7 152) |
| Balance at 31 December | 68 563 | 37 622 | 21 297 | 127 482 |
| <i>Depreciation and impairment losses</i> | | | | |
| Balance at 1 January | 47 883 | 12 794 | 14 436 | 75 113 |
| Amortization and depreciation for the year | 2 280 | 1 024 | 1 417 | 4 721 |
| Impairment loss | - | 1 430 | 9 | 1 439 |
| Disposals | (8) | (3 712) | (1 224) | (4 944) |
| Other additions | (990) | 6 | (6) | (990) |
| Balance at 31 December | 49 165 | 11 542 | 14 632 | 75 339 |
| <i>Carrying amounts</i> | | | | |
| At 1 January | 13 263 | 27 909 | 5 504 | 46 676 |
| Balance at 31 December | 19 398 | 26 080 | 6 665 | 52 143 |

Depreciation and amortization is presented among the “Other operating income / (expense), net”.

During 2018, the most significant component of these investments and developments was the costs related to the Core system replacement process at the Bank. MKB Bank has completed successfully its entire digital transformation, including a full replacement of its core banking system, between 29 June and 5 July 2018 in accordance with plans. The services relating to the new digital core system were implemented gradually in daily operational functioning of the credit institution. In addition, the Group disclosed several other items here concerning capitalisations of functional developments of other IT systems.

In accordance with the requirements of IFRS 16, the Group, as lessee recognises the right-of-use assets in ‘Intangibles, property and equipment’ line since 1 January 2019. On 30 June 2019 the carrying amount of the right-of-use assets was HUF 3,431 million.

15. Amounts due to other banks

15.1

| | 30 June 2019 | 31 December 2018 |
|-----------------------------------|----------------|------------------|
| Due on demand | 2 346 | 4 787 |
| Money market deposits | 1 219 | 31 157 |
| Borrowings | 190 668 | 178 396 |
| Repurchase agreement owed to bank | 1 949 | - |
| Amounts due to other banks | 196 182 | 214 340 |

The largest balance of the amount is HUF 70,961 million, which is the re-financing loans relating to Funding for Growth Scheme at National Bank of Hungary.

16. Deposits and current accounts

16.1

| | 30 June 2019 | 31 December 2018 |
|--------------------------------------|------------------|------------------|
| Corporate clients related | 999 691 | 1 043 397 |
| Retail clients related | 340 484 | 328 649 |
| Deposits and current accounts | 1 340 175 | 1 372 046 |

As at 30 June 2019, and 31 December 2018 the Group had no deposit and current accounts measured at fair value from the total amount.

17. Derivative financial liabilities

17.1

| | 30 June 2019 | | | 31 December 2018 | | |
|---|--------------|-----------------------|---------------|------------------|-----------------------|---------------|
| | Cost | Fair value adjustment | Book value | Cost | Fair value adjustment | Book value |
| <i>Derivative instruments by type</i> | | | | | | |
| FX-based derivative instruments | - | 1 927 | 1 927 | - | 2 986 | 2 986 |
| Index-based derivative instruments | - | 238 | 238 | - | 1 | 1 |
| Interest-based derivative instruments | - | 31 956 | 31 956 | - | 28 063 | 28 063 |
| Credit default swaps | - | 83 | 83 | - | 132 | 132 |
| Options | 568 | 85 | 653 | 223 | 203 | 426 |
| Derivative financial liabilities | 568 | 34 289 | 34 857 | 223 | 31 385 | 31 608 |

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 provision

19.1

| | 30 June 2019 | 31 December 2018 |
|---|---------------|------------------|
| Accruals and other creditors | 39 223 | 40 776 |
| Other taxes payable | 1 582 | 2 621 |
| Provision for contingencies and commitments | 3 369 | 5 028 |
| Other liabilities and provisions | 44 174 | 48 425 |

Provision for contingencies and commitments

19.2

| | 30 June 2019 | 31 December 2018 |
|--|--------------|------------------|
| <i>Provision for contingencies and commitments</i> | | |
| Balance at 1 January | 4 383 | 5 001 |
| Provisions made during the year | 2 079 | 3 111 |
| Provisions used during the year | (1 487) | (2 203) |
| Provisions reversed during the year | (2 409) | (1 530) |
| Unwinding effect of discount | 2 | 3 |
| Other movements | 1 | 1 |
| Balance at the end of the reporting period | 2 569 | 4 383 |

Provisions recognized for different type of products are disclosed in Note 32.

20. Issued debt securities

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

20.1

| Interest | Balance at 1 January | Repurchased debt securities | Repaid debt securities | Revaluation result | Balance at 30 June |
|-------------------------|----------------------|-----------------------------|------------------------|--------------------|------------------------|
| 30 June 2019 | | | | | |
| Structured | 4 906 | 136 | (2 835) | (84) | 2 123 |
| Accrued interest | 68 | - | - | - | - |
| Total | 4 974 | 136 | (2 835) | (84) | 2 123 |
| Interest | Balance at 1 January | Repurchased debt securities | Repaid debt securities | Revaluation result | Balance at 31 December |
| 31 December 2018 | | | | | |
| Fixed rate | 1 276 | 300 | (1 711) | 135 | - |
| Structured | 9 315 | 117 | (4 735) | 209 | 4 906 |
| Accrued interest | 33 | - | - | - | 68 |
| Total | 10 624 | 417 | (6 446) | 344 | 4 974 |

The Group uses fair value option revaluation through profit or loss for structured bonds, as they are related to assets, which share the same risk that give rise to opposite changes in fair value. On 30 June 2019, the carrying amount of FVTPL own issued bonds amounted to HUF 2,103 million (2018: HUF 4,974 million). The transaction recognized at fair value through profit or loss as option at initial recognition expired on 2 July 2019.

21. Subordinated debt

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

21.1

| 30 June 2019 | Interest | Date of issue | Amount in original currency | Original currency | Carrying amount in million HUF |
|-------------------|------------|---------------|-----------------------------|-------------------|--------------------------------|
| Subordinated debt | Fixed rate | 26.05.2017 | 70 000 000 | EUR | 22 751 |
| Subordinated debt | Fixed rate | 19.03.2018 | 15 000 000 | EUR | 4 875 |
| Subordinated debt | Fixed rate | 28.03.2019 | 31 000 000 | EUR | 10 075 |
| Total | | | 116 000 000 | EUR | 37 701 |

| 31 December 2018 | Interest | Date of issue | Amount in original currency | Original currency | Carrying amount in million HUF |
|-------------------|------------|---------------|-----------------------------|-------------------|--------------------------------|
| Subordinated debt | Fixed rate | 26.05.2017 | 70 000 000 | EUR | 23 061 |
| Subordinated debt | Fixed rate | 19.03.2018 | 15 000 000 | EUR | 4 941 |
| Total | | | 85 000 000 | EUR | 28 002 |

The amount of the subordinated debt increased by EUR 31 million to EUR 116 million related to new commitment in March 2019.

22. Share capital

The Bank's authorised, issued, and fully paid share capital comprises 100,000,000 (2018: 100,000,000) ordinary shares of HUF 1,000 (2018: HUF 1,000) each. All issued shares rank pari passu in the event of a winding up.

23. Reserves

Share premium

Share premium comprises of premiums on share capital issuances.

Retained Earnings

Retained earnings comprise the accumulated profit after taxes earned in the course of the operating life of an entity of the Group less any dividend payment. The Bank paid dividend in the amount of HUF 4.8 billion (48 HUF / share), of which HUF 135 million paid to the MRP organization.

General reserve

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

The Group discloses general reserve as part of retained earnings. In 2018, MKB recognized general reserve of HUF 6,624 million.

Revaluation reserves

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

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

24. Non-controlling interest

The Bank discloses also a Non-controlling interest of HUF 70 million (2018: HUF 1,987 million) related to the special purpose entity for the Employee Share Ownership Program (ESOP). This amount represents the contribution of the participating members. The decrease in the amount of the non-controlling interest is in connection with the financial fulfillment for the members of the ESOP.

25. Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

25.1

| | 30 June 2019 | | | 31 December 2018 | | |
|---|--------------|-------------|--------------|------------------|-------------|--------------|
| | Assets | Liabilities | Net | Assets | Liabilities | Net |
| Intangibles, property and equipment | 192 | 530 | (338) | 205 | 538 | (333) |
| Investments in jointly controlled entities and associates | - | - | - | 137 | - | 137 |
| FVTOCI securities | 892 | 196 | 696 | 1 273 | 33 | 1 240 |
| Loans and advances to customers | 815 | 23 | 792 | 690 | 94 | 596 |
| Allowances for loan losses | - | - | - | 77 | 688 | (611) |
| Amounts due to customers | 479 | - | 479 | 479 | - | 479 |
| Issued debt securities | - | 36 | (36) | - | 36 | (36) |
| Provision | 252 | - | 252 | 351 | - | 351 |
| Derivatives | 122 | 6 | 116 | 122 | 6 | 116 |
| Other items | 111 | 59 | 52 | 73 | 44 | 29 |
| Tax loss carry-forwards | 4 188 | - | 4 188 | 3 104 | - | 3 104 |
| Offsetting | (601) | (601) | - | (1 437) | (1 437) | - |
| Assets from held for sale | 40 | - | 40 | 40 | - | 40 |
| Effect on implementation of IFRS | 700 | - | 700 | 700 | - | 700 |
| Net tax assets / (liabilities) | 7 190 | 249 | 6 941 | 5 814 | 2 | 5 812 |

26. Interest income

26.1

| | 2019 | 2018 |
|---------------------------------|---------------|---------------|
| Cash reserves | 98 | 77 |
| Loans and advances to banks | 145 | 213 |
| Loans and advances to customers | 15 130 | 14 092 |
| Derivatives | 8 774 | 4 691 |
| Securities | 6 260 | 10 702 |
| Interest income | 30 407 | 29 775 |

Included within various captions under interest income for the period ended 30 June 2019 is a total of HUF 1,010 million (2018: HUF 1,664 million) accrued on credit impaired financial assets.

27. Interest expense

27.1

| | 2019 | 2018 |
|---|--------------|--------------|
| Amounts due to other banks | 489 | 327 |
| Deposits from customers | 1 128 | 1 100 |
| Issued debt securities | (65) | (140) |
| Subordinated liabilities | 724 | 702 |
| Other fees and commissions similar to interest expenses | 165 | 184 |
| Derivatives | 6 452 | 6 640 |
| Interest expense | 8 893 | 8 813 |

28. Net income from commissions and fees

28.1

| | 2019 | 2018 |
|--|---------------|---------------|
| Commission and fee income | 16 140 | 17 420 |
| Payment and account services | 9 900 | 10 740 |
| Credit related fees | 1 061 | 965 |
| Card services | 1 602 | 1 258 |
| Brokerage fees and other securities business | 1 509 | 2 682 |
| Other commission and fee income | 2 068 | 1 775 |
| Commission and fee expense | 4 424 | 3 385 |
| Payment and account services | 1 119 | 1 203 |
| Credit related fees | 1 015 | 721 |
| Card services | 942 | 751 |
| Brokerage fees and other securities business | 225 | 517 |
| Other commission and fee expense | 1 123 | 193 |
| Net income from commissions and fees | 11 716 | 14 035 |

29. Net impairments / (reversal) and provisions for losses

29.1

| | Note | 2019 | 2018 |
|--|------|----------------|----------------|
| <i>Net impairment loss / (reversal)</i> | | | |
| Loans and advances to banks | 8 | 18 | (3) |
| Loans and advances to customers | 11 | (2 859) | 705 |
| Securities | 10 | 25 | (140) |
| Other assets | 12 | 6 | 5 |
| Realised loss on sale of loans | | (215) | (998) |
| Non-current assets held for sale and discontinued operations | 37 | 121 | 52 |
| <i>Provision on</i> | | | |
| Guarantees and contingencies | 32 | (1 658) | (1 216) |
| Of which: on restructuring | 32 | (782) | - |
| Impairments and provisions for losses | | (4 562) | (1 595) |

30. Income tax

Income tax expense recognized in the Statement of Comprehensive Income

30.1

| | 2019 | 2018 |
|---|--------------|--------------|
| <i>Current tax expense</i> | | |
| Hungarian corporation tax charge – on current year profit | 1 456 | 1 097 |
| <i>Deferred tax (income) / expense</i> | | |
| Origination (reversal) of temporary differences | (1 673) | (13) |
| Income tax (income) / expense | (217) | 1 084 |

Both in the previous period and in 2019 9% income tax rate was applied on taxable profit in Hungary. Due to this, 9% current income tax rate and 9% deferred tax rate applied based on the available future plans.

31. Earnings per share

Basic value

The calculation of basic earnings per share on 30 June 2019 based on the net income attributable to ordinary shareholders of HUF 8,170 million (31 December 2018: HUF 25,132 million and 30 June 2018: HUF 18,003 million) and a weighted average number of ordinary shares outstanding of 99,812 thousands (31 December 2018: 94,621 thousands and 30 June 2018: 85,000 thousands).

30 June 2019

$$\begin{array}{r} \text{Earnings per} \\ \text{Ordinary Share} \\ \text{(in HUF)} \end{array} = \frac{\begin{array}{r} \text{Net income available to} \\ \text{ordinary shareholders} \\ \text{(in HUF million)} \end{array}}{\begin{array}{r} \text{Average number of ordinary} \\ \text{shares outstanding (thousands)} \end{array}} = \frac{\begin{array}{r} \text{HUF 8,170 million} \\ \\ \end{array}}{\begin{array}{r} \\ 99,812 \text{ thousands} \end{array}} = \text{HUF 82}$$

31 December 2018

$$\begin{array}{r} \text{Earnings per} \\ \text{Ordinary Share} \\ \text{(in HUF)} \end{array} = \frac{\begin{array}{r} \text{Net income available to} \\ \text{ordinary shareholders} \\ \text{(in HUF million)} \end{array}}{\begin{array}{r} \text{Average number of ordinary} \\ \text{shares outstanding (thousands)} \end{array}} = \frac{\begin{array}{r} \text{HUF 25,132 million} \\ \\ \end{array}}{\begin{array}{r} \\ 94,621 \text{ thousands} \end{array}} = \text{HUF 266}$$

30 June 2018

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

Diluted value

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. As at 30 June 2019 there was no any dilution effect, while on 31 December 2018 the vesting conditions were valid; so 2,626 thousands number of shares were equity-settled as share-based compensation.

30 June 2019

$$\begin{array}{r} \text{Diluted Earnings} \\ \text{per Share} \\ \text{(in HUF)} \end{array} = \frac{\begin{array}{r} \text{Net income available to} \\ \text{ordinary shareholders} \\ \text{(in HUF million)} \end{array}}{\begin{array}{r} \text{Average number of ordinary} \\ \text{shares outstanding taking into} \\ \text{account the dilution factors} \end{array}} = \frac{\begin{array}{r} \text{HUF 8,170 million} \\ \\ \end{array}}{\begin{array}{r} \\ 99,812 \text{ thousands} \end{array}} = \text{HUF 82}$$

31 December 2018

| | | | | | |
|---|---|---|--------------------|---|---------|
| Diluted Earnings per Share (in HUF) | = | Net income available to ordinary shareholders (in HUF million) | HUF 25,132 million | = | HUF 258 |
| | | Average number of ordinary shares outstanding taking into account the dilution factors (thousands) | 97,247 thousands | | |

30 June 2018

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

32. Contingencies and commitments

32.1

| 30 June 2019 | Gross amount | Provision | | | | Net amount |
|---|----------------|--------------|--------------|--------------|----------------|----------------|
| | | Stage 1 | Stage 2 | Stage 3 | IAS 37 | |
| <i>Contingencies</i> | | | | | | |
| Guarantees and similar obligations | 151 035 | (106) | (162) | (17) | - | 150 750 |
| Obligations from letters of credit and other short term trade related items | 8 758 | (9) | - | - | - | 8 749 |
| Other contingent liabilities (including litigation) | 9 140 | (1) | (4) | (193) | (1 664) | 7 278 |
| Total contingencies | 168 933 | (116) | (166) | (210) | (1 664) | 166 777 |

Commitments

| | | | | | | |
|--------------------------------------|----------------|--------------|--------------|--------------|----------|----------------|
| Undrawn commitments to extend credit | 231 723 | (444) | (165) | (191) | - | 230 923 |
| Total commitments | 231 723 | (444) | (165) | (191) | - | 230 923 |

| 31 December 2018 | Gross amount | Provision | | | | Net amount |
|---|----------------|--------------|--------------|--------------|----------------|----------------|
| | | Stage 1 | Stage 2 | Stage 3 | IAS 37 | |
| <i>Contingencies</i> | | | | | | |
| Guarantees and similar obligations | 147 627 | (109) | (285) | (70) | - | 147 163 |
| Obligations from letters of credit and other short term trade related items | 4 625 | (10) | - | - | - | 4 615 |
| Other contingent liabilities (including litigation) | 24 075 | - | - | (220) | (3 331) | 20 524 |
| Total contingencies | 176 327 | (119) | (285) | (290) | (3 331) | 172 302 |
| <i>Commitments</i> | | | | | | |
| Undrawn commitments to extend credit | 251 299 | (361) | (149) | (140) | - | 250 649 |
| Total commitments | 251 299 | (361) | (149) | (140) | - | 250 649 |

33. 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).

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:

33.1

| | Note | Quoted market prices in active markets | Valuation techniques - observable inputs | Valuation techniques - significant unobservable inputs | Total |
|---------------------------------|------|--|--|--|----------------|
| 30 June 2019 | | | | | |
| Derivative financial assets | 9 | - | 17 846 | - | 17 846 |
| Securities | 10 | 146 243 | 60 364 | - | 206 607 |
| Loans and advances to customers | 11 | - | - | 8 806 | 8 806 |
| Derivate financial liabilities | 17 | - | 34 857 | - | 34 857 |
| Issued debt securities | 20 | - | 2 123 | - | 2 123 |
| Total | | 146 243 | 115 190 | 8 806 | 270 239 |
| 31 December 2018 | | | | | |
| Derivative financial assets | 9 | - | 17 914 | - | 17 914 |
| Securities | 10 | 184 947 | 176 805 | - | 361 752 |
| Loans and advances to customers | 11 | - | - | 7 898 | 7 898 |
| Derivate financial liabilities | 17 | - | 31 608 | - | 31 608 |
| Issued debt securities | 20 | - | 4 974 | - | 4 974 |
| Total | | 184 947 | 231 301 | 7 898 | 424 146 |

The determination of fair value level and the transfers between levels are in line with accounting policy (see Note 4). There were no transfers between fair value levels in the reporting period ended on 30 June 2019.

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, the Group 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.

The following table 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.

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

33.2

| | Note | Interest | Foreign exchange rate | Other |
|----------------------------------|------|----------------|--------------------------|--------------|
| 30 June 2019 | | | | |
| Derivative financial assets | 9 | 4 867 | 11 856 | - |
| Securities | 10 | 202 417 | 1 750 | 125 |
| Loans and advances to customers | 11 | 8 806 | 224 | - |
| Derivative financial liabilities | 17 | 31 956 | 1 927 | 974 |
| Issued debt securities | 20 | 2 123 | - | 2 123 |
| Total | | 250 169 | 15 757 | 3 222 |
| 31 December 2018 | | | | |
| Derivative financial assets | 9 | 3 111 | 13 179 | 43 |
| Securities | 10 | 357 230 | 3 156 | 225 |
| Loans and advances to customers | 11 | 7 898 | 318 | - |
| Derivative financial liabilities | 17 | 28 063 | 2 986 | 560 |
| Issued debt securities | 20 | 4 974 | - | 4 974 |
| Total | | 401 276 | 19 639 | 5 802 |

34. 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, and Note 33), 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:

34.1

| 30 June 2019 | Note | Fair value through profit or loss | Amortised cost | Fair value through other comprehensive income | Total carrying amount | Fair value |
|---------------------------------|------|-----------------------------------|------------------|---|-----------------------|------------------|
| <i>Financial assets</i> | | | | | | |
| Cash reserves | 7 | - | 79 652 | - | 79 652 | 79 652 |
| Loans and advances to banks | 8 | - | 67 747 | - | 67 747 | 67 211 |
| Derivative financial assets | 9 | 17 846 | - | - | 17 846 | 17 846 |
| Securities | 10 | 23 006 | 436 514 | 183 601 | 643 121 | 647 048 |
| Loans and advances to customers | 11 | 8 806 | 916 017 | - | 924 823 | 921 266 |
| Total | | 49 658 | 1 499 930 | 183 601 | 1 733 189 | 1 733 023 |

Financial liabilities

| | | | | | | |
|--------------------------------|----|---------------|------------------|----------|------------------|------------------|
| Amounts due to other banks | 15 | - | 196 182 | - | 196 182 | 196 182 |
| Deposits and current accounts | 16 | - | 1 340 175 | - | 1 340 175 | 1 340 175 |
| Derivate financial liabilities | 17 | 34 857 | - | - | 34 857 | 34 857 |
| Issued debt securities | 20 | 2 123 | - | - | 2 123 | 2 123 |
| Subordinated debt | 21 | - | 37 701 | - | 37 701 | 37 701 |
| Total | | 36 980 | 1 574 058 | - | 1 611 038 | 1 611 038 |

| 31 December 2018 | Note | Fair value through profit or loss | Amortised cost | Fair value through other comprehensive income | Total carrying amount | Fair value |
|---------------------------------|------|-----------------------------------|------------------|---|-----------------------|------------------|
| <i>Financial assets</i> | | | | | | |
| Cash reserves | 7 | - | 19 240 | - | 19 240 | 19 240 |
| Loans and advances to banks | 8 | - | 63 610 | - | 63 610 | 62 534 |
| Derivative financial assets | 9 | 17 914 | - | - | 17 914 | 17 914 |
| Securities | 10 | 61 478 | 411 277 | 300 274 | 773 029 | 769 384 |
| Loans and advances to customers | 11 | 7 898 | 887 305 | - | 895 203 | 888 633 |
| Total | | 87 290 | 1 381 432 | 300 274 | 1 768 996 | 1 757 705 |

Financial liabilities

| | | | | | | |
|--------------------------------|----|---------------|------------------|----------|------------------|------------------|
| Amounts due to other banks | 15 | - | 214 340 | - | 214 340 | 214 340 |
| Deposits and current accounts | 16 | - | 1 372 046 | - | 1 372 046 | 1 372 046 |
| Derivate financial liabilities | 17 | 31 608 | - | - | 31 608 | 31 608 |
| Issued debt securities | 20 | 4 974 | - | - | 4 974 | 4 974 |
| Subordinated debt | 21 | - | 28 002 | - | 28 002 | 28 002 |
| Total | | 36 582 | 1 614 388 | - | 1 650 970 | 1 650 970 |

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

Cash reserves

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

Financial assets measured at FVTPL

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

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.

Loans and advances to banks and to customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by coupon rates. In general, contractual cash flows are discounted using a rate which is sum of the available interest rate which would have been offered if the customer applied for loan at the end of the reporting period plus the counterparty marge. The used interest rates are available in published Terms and Conditions as of 30 June, 2019 and the counterparty marge is available in the Bank's systems.

The rediscounted cash flows are decreased using by the same impairment percentage as it was used for impairment purpose, and it is considered as fair value of the loan portfolio. Non-performing loans which are assessed for impairment individually are discounted with discount factors which are calculated as in case of performing loans, but that estimated cash flows of these loans are used for calculation, which was also used for impairment purpose.

In the case of work-out loans where the bank expects cash flows only from sale of collaterals and therefore they are impaired to the net present value of this amount, the fair value is equal with the carrying amount.

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

Amounts due to other banks and Current and deposit accounts

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

Issued debt securities and Subordinated debt

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

35. Related parties

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

Transactions with related parties

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

35.1

| | Parent company and its group | | Non-consolidated subsidiaries | | Associates | | Key Management Personnel | | Other related parties | |
|--------------------------------------|------------------------------|--------|-------------------------------|-------|------------|------|--------------------------|-------|-----------------------|-------|
| | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 |
| <i>Assets</i> | | | | | | | | | | |
| Loans and advances to customers | 11 187 | 12 796 | 1 005 | 976 | 180 | 332 | 117 | 134 | 131 | - |
| Equity instruments | - | - | 652 | 715 | 610 | 611 | - | - | 146 | 244 |
| <i>Liabilities</i> | | | | | | | | | | |
| Current and deposit accounts | 17 124 | 25 807 | 243 | 276 | 86 | 207 | 373 | 258 | 3 447 | 4 658 |
| Derivative financial liabilities | - | - | - | - | - | - | - | - | - | 229 |
| Other liabilities | - | - | - | - | - | - | - | - | - | 70 |
| <i>Income statement</i> | | | | | | | | | | |
| Interest income | 267 | 747 | 10 | 21 | 2 | 6 | 2 | 10 | 1 | - |
| Interest expense | (1) | (1) | - | 1 | - | - | - | - | - | - |
| Net income from commissions and fees | 209 | 772 | 4 | 8 | 32 | 6 | 1 | - | 7 | 7 |
| Other net income / (expense) | (2) | (188) | (2) | (4) | (2) | 46 | (456) | (659) | (3) | (4) |
| <i>Contingencies and commitments</i> | | | | | | | | | | |
| | 21 997 | 12 202 | 2 044 | 1 089 | 100 | 97 | 2 | 711 | 689 | 290 |
| <i>Provision</i> | | | | | | | | | | |
| | 3 368 | 2 637 | 3 066 | 2 113 | - | 4 | - | - | 1 | - |

The table includes half-yearly data for the current period and yearly data for the previous period in the 'Income statement' line, while in lines 'Assets' and 'Liabilities' contain data for 30 June 2019 and 31 December 2018.

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:

35.2

| | 2019 | 2018 |
|----------------------------------|------------|--------------|
| Short-term employee benefits | 455 | 658 |
| Share-based payment transactions | - | 799 |
| Total | 455 | 1 457 |

36. Segment information

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

Business segments

The business segments identified by the Group represent the organizational structure as reflected in its internal management reporting systems. The Group is organized into four business lines, each with its own distinct market and products. Each business line has its own set of objectives and targets broken down by operating units, which are consistent with the Group's overall strategic direction. As of 30 June 2019, 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, project and structured finance, investment and financial advisory services to large entities through branches and electronic delivery channels.

Institutional Banking

Group serves financial institutions, financial service companies and other entities with financial services, as well as international and domestic payments, the Treasury department deals with investments in securities, hedging transactions and correspondent banking services The Group participates in bank-to-bank finance.

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 51 full-service branches and sub-branches (2018: 51 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.

36.1

| 30 June 2019 | Note | Corporate Banking | Institutional Banking | Retail and Private Banking | Other | Total |
|---|------------|-------------------|-----------------------|----------------------------|----------------|------------------|
| Assets | | | | | | |
| Cash reserves | 7 | - | 79 652 | - | - | 79 652 |
| Loans and advances to banks | 8 | - | 67 747 | - | - | 67 747 |
| Derivative financial assets | 9 | - | 17 846 | - | - | 17 846 |
| Securities | 10 | 29 004 | 614 117 | - | - | 643 121 |
| Loans and advances to customers | 11 | 641 425 | 733 | 282 665 | - | 924 823 |
| Liabilities held for sale and discontinued operations | 37 | 3 313 | - | 7 022 | - | 10 335 |
| Other assets | 12 | - | - | - | 18 648 | 18 648 |
| Current income tax assets | | - | - | - | 50 | 50 |
| Deferred tax assets | 25 | - | - | - | 7 190 | 7 190 |
| Investments in jointly controlled entities and associates | 13 | 3 912 | - | - | - | 3 912 |
| Intangibles, property and equipment | 14 | - | - | - | 54 350 | 54 350 |
| Total assets | | 677 654 | 780 095 | 289 687 | 80 238 | 1 827 674 |
| Liabilities | | | | | | |
| Amounts due to other banks | 15 | - | 196 182 | - | - | 196 182 |
| Deposits and current accounts | 16 | 989 691 | 10 000 | 340 363 | 121 | 1 340 175 |
| Derivate financial liabilities | 17 | - | 34 857 | - | - | 34 857 |
| Liabilities held for sale and discontinued operations | 37 | 203 | - | 3 | - | 206 |
| Other liabilities and provisions | 19 | 593 | 251 | 1 499 | 41 831 | 44 174 |
| Current income tax liabilities | | - | - | 1 | 721 | 722 |
| Deferred tax liabilities | 25 | - | - | - | 249 | 249 |
| Issued debt securities | 20 | 82 | 76 | 1 965 | - | 2 123 |
| Subordinated debt | 21 | - | 37 701 | - | - | 37 701 |
| Shareholders' equity | 22, 23, 24 | - | - | - | 171 285 | 171 285 |
| Total liabilities | | 990 569 | 279 067 | 343 831 | 214 207 | 1 827 674 |
| Income statement | | | | | | |
| Gross revenue - external customers | | 9 104 | 15 248 | 14 111 | 169 | 38 632 |
| Gross revenue - inter-segment | | (942) | 2 420 | (1 478) | - | - |
| Interest and commission expenditure | 26, 27, 28 | 367 | (12 680) | (1 003) | - | (13 316) |
| Impairments / (Reversal) and provisions for losses | 29 | 865 | (23) | 2 409 | 1 311 | 4 562 |
| Operating costs | | (8 248) | (3 465) | (8 749) | (513) | (20 975) |
| Expenses related to bank levies | | - | - | - | (2 023) | (2 023) |
| Share of associates' profit | | 1 073 | - | - | - | 1 073 |
| Segment result | | 2 219 | 1 500 | 5 290 | (1 056) | 7 953 |
| Other information | | | | | | |
| Capital expenditure | | - | - | - | 8 285 | 8 285 |
| Depreciation and amortisation | 14 | 2 175 | 22 | 748 | - | 2 945 |
| Other non-cash expenses | | 588 | 247 | 624 | 36 | 1 495 |

| 31 December 2018 | Note | Corporate Banking | Institutional Banking | Retail and Private Banking | Other | Total |
|---|------------|-------------------|-----------------------|----------------------------|----------------|------------------|
| Assets | | | | | | |
| Cash reserves | 7 | - | 19 240 | - | - | 19 240 |
| Loans and advances to banks | 8 | - | 63 610 | - | - | 63 610 |
| Derivative financial assets | 9 | - | 17 914 | - | - | 17 914 |
| Securities | 10 | 70 501 | 702 528 | - | - | 773 029 |
| Loans and advances to customers | 11 | 613 741 | 1 481 | 279 981 | - | 895 203 |
| Liabilities held for sale and discontinued operations | 37 | 3 359 | - | 879 | - | 4 238 |
| Other assets | 12 | - | - | - | 21 699 | 21 699 |
| Current income tax assets | | - | - | - | 2 | 2 |
| Deferred tax assets | 25 | - | - | - | 5 814 | 5 814 |
| Investments in jointly controlled entities and associates | 13 | 4 687 | - | - | - | 4 687 |
| Intangibles, property and equipment | 14 | - | - | - | 52 143 | 52 143 |
| Total assets | | 692 288 | 804 773 | 280 860 | 79 658 | 1 857 579 |
| Liabilities | | | | | | |
| Amounts due to other banks | 15 | - | 214 340 | - | - | 214 340 |
| Deposits and current accounts | 16 | 1 043 397 | - | 321 749 | 6 900 | 1 372 046 |
| Derivate financial liabilities | 17 | - | 31 608 | - | - | 31 608 |
| Other liabilities and provisions | 19 | 855 | 968 | 1 040 | 45 562 | 48 425 |
| Current income tax liabilities | | - | - | 11 | 5 | 16 |
| Deferred tax liabilities | 25 | - | - | - | 2 | 2 |
| Issued debt securities | 20 | 156 | 320 | 4 498 | - | 4 974 |
| Subordinated debt | 21 | - | 28 002 | - | - | 28 002 |
| Shareholders' equity | 22, 23, 24 | - | - | - | 158 166 | 158 166 |
| Total liabilities | | 1 044 408 | 275 238 | 327 298 | 210 635 | 1 857 579 |
| Income statement | | | | | | |
| Gross revenue - external customers | | 24 183 | 47 261 | 31 082 | 65 | 102 591 |
| Gross revenue - inter-segment | | (1 269) | 3 896 | (2 627) | - | - |
| Interest and commission expenditure | 26, 27, 28 | (583) | (23 322) | (2 163) | - | (26 068) |
| Impairments / (Reversal) and provisions for losses | 29 | 4 003 | 1 666 | (5 421) | 552 | 800 |
| Operating costs | | (19 430) | (5 325) | (23 225) | (4 884) | (52 864) |
| Expenses related to bank levies | | - | - | - | (2 073) | (2 073) |
| Share of associates' profit | | 2 311 | - | - | - | 2 311 |
| Segment result | | 9 215 | 24 176 | (2 354) | (6 340) | 24 697 |
| Other information | | | | | | |
| Capital expenditure | | - | - | - | 13 834 | 13 834 |
| Depreciation and amortisation | 14 | 3 589 | - | 1 107 | 24 | 4 720 |
| Other non-cash expenses | | 604 | 166 | 722 | 152 | 1 644 |

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.

37. Non-current assets and liabilities held for sale and discontinued operations

On 31 December 2018, a significant loan-portfolio in gross value of HUF 13,274 million and the relating loss allowances of HUF 9,036 million, which resulted in net amount of HUF 4,238 million was reclassified to non-current assets held for sale.

On 30 June 2019, the net amount of non-current assets held for sale and discontinued operations was HUF 10,335 million and the amount of liabilities held for sale and discontinued operations was HUF 206 million.

In the first half of 2019, the key management of the Group decided to sale a loan portfolio of HUF 43,213 million (related loss allowances of HUF 32,878 million), which resulted in a reclassification of HUF 10,335 million of loans to held for sale. The Agreement of receivables assignment was signed in the third quarter of 2019. The buyer paid up the total price of HUF 9,022 million before the disclosure of the consolidated financial statements.

The summarized amount of the related other assets, contingencies and commitments and deposits is not significant at 30 June 2019.

38. 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 277,434 million loan to SME's since the beginning of the program, with an interest rate of 2.5% and EUR 56 million in course of the third phase.

The loans lent as part of FGS are measured at amortised cost at MKB Bank, however at initial recognition the difference between the carrying amount and the fair value of the loans and parallel of the NBH funds denominated in HUF was deferred to Other assets (HUF 1,787 million) and to Other liabilities (HUF 1,792 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 denominated in HUF amounted to HUF 39,399 million as of 30 June 2019 (2018: HUF 48,161 million).

MKB Bank joined Market Loan Program - called PHP - on 19 January 2016 that is aimed at stimulating the banks' transition towards lending on market terms, and to continue to encourage banks to grant loans to SMEs. At the same time, the National Bank of Hungary also started to phase out the NHP III program.

MKB Bank undertook a HUF 25 billion growth in the net volume of SME lending in 2016 concerning Market-based Lending Scheme (PHP), which increased by HUF 5 billion in 2017 in the framework of the second phase of PHP. Therefore MKB concluded HIRS transactions with NBH in a total amount of HUF 120 billion.

The MNB intends to improve the structure of domestic SME lending through the NHP Fixed Income Facility , by improving access to long-term, fixed-rate loans for SMEs, which will be part of the NHP, starting January 1, 2019. Under the NHP Fix program, the NBH provides credit institutions with a null per cent interest rate refinancing loan for a maximum of 10 years, which they further lend to SMEs in the form of loans or financial leases at a limited interest rate up to 2.5% per annum.

39. Share based compensation

On 14 July, 2016 MKB Bank established the Employee Share Ownership Program (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 were entitled to purchase the shares of the Bank given certain vesting conditions. In certain group of eligible employees are entitled to cash compensation based on the disposal of the shares held by the ESOP organization given certain vesting conditions are met. The vesting conditions include employment during the vesting period and a successful stock exchange process of the Bank or three years of prudential operation according to efficient and effective risk management prescribed by law. On 19th April the existence of the vesting conditions and the advanced fulfillment was approved at the General Meeting.

Details of the share based compensation:

39.1

| 2019 | Number of shares | Weighted average exercise price (HUF/share) |
|--|------------------|---|
| outstanding at the beginning of the period | 5 379 403 | 370 |
| <i>thereof distributable</i> | - | - |
| saled during the period | (5 190 910) | 370 |
| outstanding at the end of the period | 188 493 | 370 |
| <i>thereof distributable</i> | - | - |

| 2018 | Number of shares | Weighted average exercise price (HUF/share) |
|--|------------------|---|
| outstanding at the beginning of the period | 15 000 000 | 370 |
| <i>thereof distributable</i> | 665 161 | 370 |
| forfeited at the beginning of the period* | 130 784 | 370 |
| reallocated at the period | (795 945) | 370 |
| saled during the period | (9 620 597) | 370 |
| outstanding at the end of the period | 5 379 403 | 370 |
| <i>thereof distributable</i> | - | - |

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

The cash-based payment has been completed until March 2019 except the outstanding shares at the end of the period. The stock of the shares was sold to one of the Shareholders of the Bank at market price. The related costs that amounted to HUF 3,121 million was accounted in 2018, of which HUF 2,980 million through profit or loss and HUF 140 million through the equity. Treasury share transactions related to the disposal improved the shareholder's equity of the MKB Group by HUF 4.1 billion.

40. Events after the end of the reporting period

On 2 July 2019, the Bank fully settled the repayment obligation of MKB German Equity Indexed Bond 20190702 (ISIN: HU0000356506) issued on 1 July 2015 in the amount of HUF 2.2 billion. No interest has been paid on the bond in accordance with its settlement condition.

Géza Sebestyén received the permission of the National Bank of Hungary's (NBH) as member of Board of Directors of MKB Kockázati Tőkealap-kezelő Zártkörűen Működő Részvénytársaság. Registration is still pending.

The Court of Registration registered László Krisán as member of Board of Directors of MKB-Pannónia Alapkezelő Zrt as of 16 July 2019.

Based on liquidity settlement the Board of Directors of the Bank approved a capital contribution amounted to HUF 3 billion to Euro-Immat Kft. After this transaction share capital increased from HUF 1.758 billion to HUF 1.8 billion and HUF 2.9 billion was transferred to retained earnings. The Court of Registration registered as at 5 August 2019.

CONSOLIDATED MANAGEMENT REPORT

OPERATING ENVIRONMENT

Macroeconomic environment

Significant changes took place in the first half of 2019 regarding communication and monetary policy outlook of developed markets' central banks. In the US, the Federal Reserve maintained the target range for the federal funds rate for the first half of 2019. According to its June 2019 forecast, monetary conditions in the U.S. are expected to remain unchanged in 2019.

Neither did the European Central Bank (ECB) change its key interest rates during the first half of 2019. The central bank's communication has shifted towards loose monetary policy this year in contrast to earlier projections. Significant downward movement in yields has been also seen internationally during the first half of 2019: the US 10-year government bond yield fell by almost 70 basis points, while euro area 10-year government bond yield dropped by about 60 basis points between the end of 2018 and June 2019.

The Hungarian economy expanded by 5.3% on a yearly basis in the first quarter of 2019, mainly due to the strong performance of the service sector. Growth dynamics comparable to 1Q 2019 was last seen in 2Q 2004. Rise in employment and wage growth and continued high levels of consumer confidence contributed significantly to the increase in consumption figures. The dynamic expansion of gross earnings (first six months of 2019: 10.6% annual wage dynamics) is partly due to the rise in the minimum wage and the guaranteed wage minimum; while the still tight domestic labor market also played a role. The unemployment rate – at its historic low level of 3.3% in the second quarter of 2019 – is well below pre-crisis levels. The significant decline in the rate is mainly due to the economic recovery after the global financial crisis and the government's actions to reform the labor market.

The surplus of the general government in the first quarter of 2019 was 0.1% of GDP. This positive performance was greatly driven by the significant increase in budget revenues. During the first six months of the year the revenues from personal income tax, social contribution tax and VAT were significantly higher than in the last year's same period. In addition, the debt of the general government sector fell to 70.1% of GDP by the end of the first quarter. This ratio was 70.8% at the end of 2018.

The domestic price pressure has risen in the first half of the year. The inflation rate approached the upper limit of the National Bank of Hungary's (NBH) tolerance range (it touched 3.9% in April and in May compared to the same period of the last year): the tight labor market and the rising international oil prices have also fueled this tendency. The HUF's exchange rate against major currencies (EUR/HUF, USD/HUF) was highly volatile in the first half of the year. In the first quarter the HUF was mainly strengthening, while in the second quarter it was mostly weakening coupled with generous fluctuation. The EUR/HUF was around 313 in March and rose above 326 in May.

In March 2019, a significant increase in domestic price pressure has come to the fore. Accordingly, NBH raised the overnight deposit rate from -0.15% to -0.05% and it started tightening liquidity by gradually reducing the FX swap volumes. However, monetary conditions remained unchanged in the second quarter of 2019. The reason behind is the gloomier external environment and ECB's communication towards monetary easing at end of the first half of 2019.

The Hungarian government securities market wasn't boring in the first half of the year. The 10-year government bond yields decreased in the first two months of the year; its lowest value was 2.62% in February. From March it started to rise significantly (with a larger swing), by 60 basis point in two months. Its top was 3.34% in May. Then yields began to fall and declined by 70 basis points to 2.63% by the end of June.

Banking sector³

In the first half of 2019, inter-bank pricing competition eased, but corporate credit conditions remained broadly unchanged (the average annualized interest rate on other forint loans to non-financial corporations increased by only 0.01 percentage points compared to the second half of 2018). Both corporate (+ 8.6%) and retail (+ 3.7%) loans increased in the first half of the year, while deposits increased slightly. Within retail lending, new personal loan portfolios rose to historic highs and new housing loans were close to their previous peak.

In the first half of 2019, a significant event in the life of the banking sector was the announcement of the „Magyar Állampapír Plusz (MÁP+)” and the „Babaváró Kölcsön” as an element of the „Családvédelmi Akcióterv”. MÁP+ generated a turnover of HUF 883 billion in one month, thanks to which, among others, the retail government securities portfolio increased by nearly HUF 800 billion (almost 14%) compared to the end of 2018 (partly because of this retail deposits increased only 1.5% during the current period). Interest rates remained broadly unchanged compared to the second half of 2018, with a slight decline in interest rates on both housing and personal loans (-0.02% points and -0.29% points).

In the first half of 2019, portfolio quality continued to improve, with the average NPL rate continuing to decline in the sector.

The sector is facing major digitization challenges with the introduction of PSD2 (including the use of strong customer authentication) and the instant payment system (which has been postponed to 2020). In order to maintain profitability, it is increasingly important to control the constantly rising staff costs and to overcome the challenges of low interest rate environment.

OVERVIEW OF MKB GROUP PERFORMANCE IN THE FIRST HALF OF 2019

In the first half of 2019, the Group reached HUF 8.17 billion pre-tax profit. Interest income was HUF 21.5 billion and commission income reached HUF 11.7 billion. The Group's financial results was further improved by the release of impairments and provisions for losses of HUF 4.6 billion due to the successful problematic portfolio downsizing and the booming economic environment. Banking expenses decreased significantly, by HUF 12.7 billion compared to the same period of the previous year, and amounted to HUF 21 billion at the end of the reporting period.

The Group reported HUF 1,827.7 billion total assets at the end of the first half of 2019. Customer deposits were HUF 1,340.2 billion, net customer loan volume reached HUF 924.8 billion.

The consolidated Basel III. capital adequacy ratio was 19.3% at the end of June, 2019.

³ NBH

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

STATEMENT

on the consolidated semi-annual financial statements of 2019
and on the Report of the Management
Pursuant to Ministry of Finance Decree no. 24/2008. (VIII.15.)

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


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

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

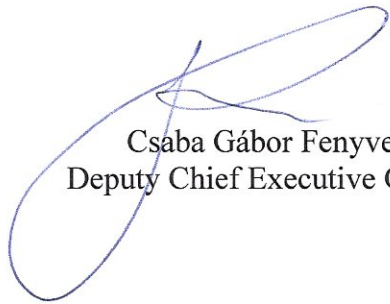
The Bank declares furthermore that the consolidated Report of the Management (Management's discussion & analysis) provides a reliable picture of the position, situation, development and performance of the Bank as an issuer of securities and of the consolidated enterprises, and describes the key risks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

Budapest, 26 September 2019

MKB Bank Nyrt.



dr. Ádám Balog
Chairman and Chief Executive Officer



Csaba Gábor Fenyvesi
Deputy Chief Executive Officer