CIB BANK LTD.
and its subsidiaries

Consolidated financial statements
prepared in accordance with
International Financial Reporting Standards
as adopted by EU
for the year ended 31 December 2018

with the report of the Independent Auditor

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Independent Auditors' Report

To the shareholder of CIB Bank Zrt.

Opinion

We have audited the 2018 consolidated financial statements of CIB Bank Zrt. and its subsidiaries (hereinafter referred to as "the Group"), which comprise the consolidated statement of financial position as at 31 December 2018, which shows total assets of MHUF 1,905,081, the consolidated statement of profit or loss and other comprehensive income, which shows profit for the year of MHUF 13,738, and the consolidated statements of changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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

Basis for Opinion

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

KPMG Hungária Kft., a Hungarian limited liability company and a member firm of the KPMG network of independent member firms affiliated with
KPMG International Cooperative ("KPMG International"), a Swiss entity.
Company registration: Budapest, Fővárosi Törvényszék Cégbírósága, no: 01-09-063183

Key Audit Matters

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

Valuation of loans to customers (net carrying amount: HUF 869,801 million, accumulated impairment loss: HUF 43,668 million)

Refer to note 21 to the financial statement.

The key audit matter	*How the matter was addressed in our audit*
Impairment of loans to customers is considered to be a key audit matter owing to the significance of loans to customers, and the high degree of complexity and judgment applied by the Group in determining impairment. Net carrying amount of loans to customers represents 45.6% of the total assets of the Group, and the accumulated impairment amounts to HUF 43,668 millions as at 31 December 2018. Without having appropriate impairment assessment the carrying value of the loans might be under or overstated. Impairment on individually significant, non-performing loans are based on the Group's judgment in estimating the present value of expected future cash flows and the probability of the estimated outcomes, which are inherently uncertain. The present value of expected future cash flows is influenced by amongst others the applied discount factor on the value of collateral, the length of the recovery process and the cost of liquidation or sale process. The estimation of these items is very difficult. This is challenging from an audit perspective as the forecast cash flows reflect future expectations and may vary depending on the possible scenarios. Collective impairment is determined either by a rating based approach at customer level, or segmenting the portfolio into pools with homogeneous risk profiles for retail loans. Based on the assigned rating or pool, an estimate of the	Our audit procedures included: Assessing design and implementation, and testing operating effectiveness of key controls over impairment calculations and customer ratings, and annual reviews and approvals of monthly impairment changes. Performing specific loan inspection for a sample of individually significant loans. Our sampling methodology ensured that the conclusion based on this sample can be projected to the whole population of the individually significant loans. Our inspection – among others - included examination of days past due information, financial performance and industry comparison. Moreover, we inspected the latest correspondence with the borrower, provision estimates prepared by credit risk officers and consideration of the resolution period estimated for the impaired loans. We challenged the assumptions based on our professional judgment and industry knowledge. We assessed collateral values with reference to valuations prepared by valuation specialists engaged by the Bank. We also re-performed key calculations. For collective impairment, independent assessment of the Group's judgment in the application of model parameters by applying sensitivities to assumptions underlying these parameters, and evaluation of current economic conditions. We involved our financial risk

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probability of default and the potential loss given default is applied to determine the collective impairment provision. This is challenging from an audit perspective due to the use of complex models to predict probability of default and loss given default estimates and the application of the Group's judgment to the determination of the applied model parameters.	management specialists to evaluate whether the methodologies and models applied by the Group are appropriate in accordance with requirements of IFRS 9 Financial instruments on impairment.

Transition to and adoption of IFRS 9

Refer to note 7 to the financial statement.

The key audit matter	*How the matter was addressed in our audit*
Transition to and adoption of IFRS 9 Financial Instruments is considered to be a key audit matter owing to the complex transition accounting requirements underlying the determination of transition adjustment, subjective assumptions made by the Group to ensure that financial assets are classified into the appropriate category and high degree of judgement in determining impairment. Transition to IFRS 9 required the Group to implement new accounting policies, and make appropriate changes in accounting systems and internal controls. Regarding classification and measurement of financial instruments, the business model test and the assessment of the solely payments of principal and interest (SPPI) criteria is complex, and requires a compound analysis of contractual provisions, cash-flows and other features. Complexity, variability and vintage of products with different contractual terms issued or held by the Group could lead to an inappropriate SPPI assessment.	Our audit procedures included: Evaluating the appropriateness of the accounting policies based on the requirements of IFRS 9, our business understanding and industry practice. Evaluating the Group's process for identifying contracts to be assessed based on the selected transition approach and any practical expedients applied. Assessing whether transition gives rise to any specific fraud risks. Understanding the Group's process and the controls implemented to assess the completeness and accuracy of the transition adjustments. Involving our specialists to challenge key assumptions/judgements relating to IFRS 9 transition adjustments. Assessing the Group's new or revised processes, systems and controls implemented over classification and measurement.

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Accounting for impairments is another major area of fundamental change. Estimating impairment involves difficult judgements about whether loans will be received as due – and, if not, how much will be recovered and when. The new model relies on estimates of expected credit losses and the point at which there is a significant increase in credit risk. Also judgement is needed to ensure that the measurement of expected credit losses reflects reasonable information that includes historical, current and forecast information. The new model have a significant impact on the system and the processes of the Group due to its extensive new requirements on inputs and calculations. From an audit prospective it is challenging to obtain evidence that these inputs, calculations and judgements are reasonable and supportable.	Evaluating the reasonableness of the Group's key judgements and estimates made in adopting IFRS 9, including selection of methods, models, assumptions and data sources. Assessing the completeness, accuracy and relevance of data. Involving our specialists to challenge significant assumptions and judgements relating to impairment, assess Probability of Default and Loss Given Default parameters applied by the Group in the impairment calculation (including assessment of how the Group applied internal historic default data and external data), and assess appropriateness and test mathematical accuracy of models applied by the Group. Assessing the completeness, accuracy and relevance of disclosures required by IFRS 9.

Other Information

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

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

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

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

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

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

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

This is an English translation of the Independent Auditors' Report on the 2018 consolidated financial statements of the CIB Bank Zrt. issued in Hungarian. If there are any differences, the Hungarian language original prevails. This report should be read in conjunction with the complete consolidated financial statements it refers to.

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

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

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

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

• Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures

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in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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

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

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

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

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

Report on Other Legal and Regulatory Requirements

We were appointed by members meeting on 10 June 2015 to audit the consolidated financial statements of the Group for the financial year ended 31 December 2018. Our total uninterrupted period of engagement is 7 years, covering the periods ending 31 December 2012 to 31 December 2018.

We confirm that:

• our audit opinion is consistent with the additional report presented to the Audit Committee of the Group dated 18 February 2019;

• we have not provided to the Group the prohibited non-audit services (NASs) as set out by Article 5(1) of EU Regulation (EU) No 537/2014 and in terms of the member state derogations by the Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors in force in Hungary. We also remained independent of the audited entity in conducting the audit.

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

Budapest, 19 February 2019

KPMG Hungária Kft.

Registration number: 000202

István Henye
Partner, Professional Accountant
Registration number: 005674

This is an English translation of the Independent Auditors' Report on the 2018 consolidated financial statements of the CIB Bank Zrt. issued in Hungarian. If there are any differences, the Hungarian language original prevails. This report should be read in conjunction with the complete consolidated financial statements it refers to.

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CIB BANK

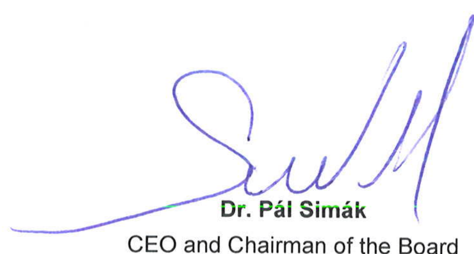
CIB Bank Ltd.
and its subsidiaries

Consolidated statements of profit or loss and other comprehensive income for the year ended 31 December 2018

(million HUF)

	Note	2018	2017
Interest income		25,892	28,392
a) interest income calculated using effective interest rate method		*27,199*	*27,110*
b) other interest income		*(1,307)*	*1,282*
Interest expense		(5,518)	(7,049)
Net interest income	**8**	**20,374**	**21,343**
Fee and commission income		34,309	33,707
Fee and commission expense		(7,537)	(6,205)
Net fee and commission income	**9**	**26,772**	**27,502**
Income from trading activities	10	10,108	9,831
Other operating income	11	1,310	2,517
Net banking income		**58,564**	**61,193**
Impairment releases on loans	12	1,388	11,698
Other impairment releases and provisions	12	6,887	5,559
Operating expenses without bank tax	13	(46,841)	(47,555)
Profit/(loss) before bank tax and income taxes		**19,998**	**30,895**
Bank tax	14	(3,428)	(3,762)
Profit/(loss) before income taxes		**16,570**	**27,133**
Income tax expense	15	(2,832)	(2,570)
Net profit/(loss) for the year		**13,738**	**24,563**
Items that may be reclassified to profit or loss		(145)	(495)
Items that may not be reclassified to profit or loss		345	3,017
Other comprehensive income for the year (net of tax)	**17**	**200**	**2,522**
Total comprehensive income for the year		**13,938**	**27,085**

18 February 2019



Dr. Pál Simák
CEO and Chairman of the Board

Dario Massimo Grassani
CFO

CIB Bank Ltd.

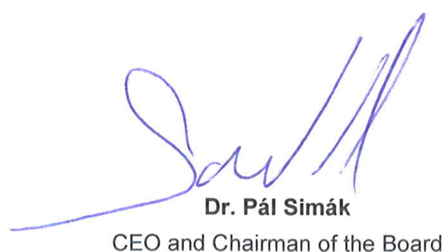
The accompanying notes form part of the consolidated financial statements.

Consolidated statements of financial position
as at 31 December 2018

(million HUF)

	Note	31/12/2018	31/12/2017
Cash and current accounts with central banks	18	47,108	38,876
Financial assets measured at fair value through profit or loss		47,449	82,171
c) securities held for trading	*19*	*24,685*	*63,717*
d) trading derivatives	*19*	*15,479*	*18,454*
e) financial assets mandatorily measured at fair value	*21*	*7,285*	*-*
Financial assets measured at fair value through other comprehensive income	22	285,732	247,653
Financial assets measured at amortised cost		1,467,023	1,250,911
a) loans to banks	*20*	*544,355*	*459,736*
b) loans to customers	*21*	*869,801*	*762,269*
c) debt securities	*21*	*52,867*	*28,906*
Hedging derivatives	23	1,840	1,151
Fair value change of financial assets in hedged portfolios (+/-)	23	1,315	332
Property, land and equipment	25	15,045	15,602
Intangible assets	26	11,151	9,620
Repossessed properties	24	10,417	25,261
Tax assets	15	821	1,079
a) current		*524*	*751*
b) deferred		*297*	*328*
Non-current assets held for sale		2,768	339
Other assets	27	14,412	10,235
Total assets		**1,905,081**	**1,683,230**

18 February 2019



Dr. Pál Simák
CEO and Chairman of the Board

Dario Massimo Grassani
CFO

CIB Bank Ltd.

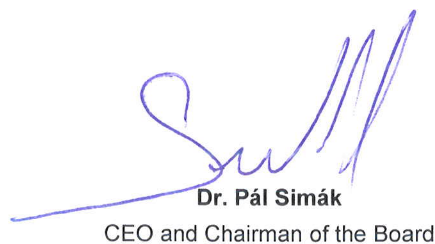
The accompanying notes form part of the consolidated financial statements.

Consolidated statements of financial position
as at 31 December 2018

(million HUF)

	Note	31/12/2018	31/12/2017
Financial liabilities measured at amortised cost		1,614,589	1,404,611
a) deposits from banks	*28*	*252,181*	*210,247*
b) deposits from customers	*29*	*1,362,408*	*1,191,755*
c) securities issued	*30*	*-*	*2,609*
Trading derivatives	19	9,488	16,557
Hedging derivatives	23	2,768	4,033
Tax liabilities	15	300	331
a) current		*19*	*28*
b) deferred		*281*	*303*
Other liabilities	31	23,609	18,618
Provisions		12,588	10,562
a) for commitments and contingencies	*32,36*	*1,280*	*1,344*
b) for other risk and charges	*32*	*11,308*	*9,218*
Subordinated debts	33	9,652	9,311
Total liabilities		**1,672,994**	**1,464,023**
Share capital	34	50,000	50,000
Reserves	35	76,990	203,223
Retained earnings		105,097	(34,016)
Total shareholder's equity		**232,087**	**219,207**
Total liabilities and shareholder's equity		**1,905,081**	**1,683,230**

18 February 2019



Dr. Pál Simák
CEO and Chairman of the Board

Dario Massimo Grassani
CFO

CIB Bank Ltd.

Statement of changes in equity
for the year ended 31 December 2018

(million HUF)

	Note	Ordinary shares	Retained earnings	Capital reserve	First time adoption reserve	Revaluation reserve	General reserve	Other reserve	Total
Balance at 1 January 2017		**50,000**	**(322,229)**	**393,919**	-	**1,380**	**751**	**89,301**	**213,122**
Other comprehensive income (OCI)	17	-	-	-	-	2,522	-	-	**2,522**
General reserve	35	-	(2,241)	-	-	-	2,241	-	-
Increase of share capital and capital reserve	35	-	-	15,000	-	-	-	-	**15,000**
Decrease of capital reserve	35		265,891	(265,891)	-	-	-	-	-
Reclassification of additional payment to shareholder to other liabilities	35	-	-	-	-	-	-	(36,000)	**(36,000)**
Net profit / (loss) for the period		-	24,563	-	-	-	-	-	**24,563**
Balance at 31 December 2017		**50,000**	**(34,016)**	**143,028**	-	**3,902**	**2,992**	**53,301**	**219,207**
IFRS 9 first time adoption	7	-	-	-	(1,057)	244	-	-	**(813)**
Balance at 1 January 2018		**50,000**	**(34,016)**	**143,028**	**(1,057)**	**4,146**	**2,992**	**53,301**	**218,394**
Other comprehensive income (OCI)	17	-	-	-	-	(44)	-	-	**(44)**
Decrease of capital reserve	35	-	126,803	(126,803)	-	-	-	-	-
General reserve	35	-	(1,426)	-	-	-	1,426	-	-
Net profit / (loss) for the period		-	13,738	-	-	-	-	-	**13,738**
Rounding difference		-	(2)	-	-	-	-	1	**(1)**
Balance at 31 December 2018		**50,000**	**105,097**	**16,225**	**(1,057)**	**4,102**	**4,418**	**53,302**	**232,087**

18 February 2019

Dr. Pál Simák
CEO and Chairman of the Board

Dario Massimo Grassani
CFO

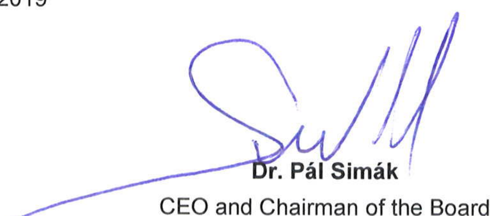
CIB Bank Ltd.

The accompanying notes form part of the financial statements.

(million HUF)

	Note	2018	2017
Operating activities			
Net profit/(loss) before income taxes		16,570	27,133
Depreciation and amortization	13	3,739	3,686
Fair value adjustment on PPE		(2)	264
Net unrealized (gain) / loss on financial instruments		(4,657)	(1,052)
Increase / (decrease) in impairment loss on loans		3,004	(19,333)
Increase / (decrease) in allowance for repossessed properties, own properties and intangible assets		1,504	1,675
Working capital changes			
Decrease / (increase) in loans to banks	20	(124,681)	81,524
Decrease / (increase) in financial assets at fair value through profit and loss	19	36,450	(30,652)
Decrease / (increase) in loans to customers	21	(118,402)	16,925
Decrease / (increase) in other assets (non-current assets, tax assets, other assets)	27	(3,819)	(405)
Increase / (decrease) in deposits from banks	28	41,934	14,463
Increase / (decrease) in deposits from customers and liabilities from issued securities	29	168,432	20,457
Increase / (decrease) in other liabilities (provisions, tax liabilities, other liabilities)	31,32	7,008	4,350
Income tax charged	15	(2,803)	(3,090)
Cash flows used in operating activities		**24,277**	**115,945**
Investing activities			
Purchase of financial investments		(163,394)	(271,946)
Proceeds from sale of financial investments		108,640	200,102
Acquisitions to intangible and tangible assets		(4,743)	(4,672)
Acquisitions to repossessed properties		(329)	(765)
Disposals of intangible and tangible assets		-	4
Disposals of repossessed properties		11,134	21,669
Cash flows used in investing activities		**(48,692)**	**(55,608)**
Financing activities			
Inrease / (decrease) of subordinated debt	33	341	(21)
Issue of shares		-	15,000
Inrease / (decrease) of other equity contribution		-	(36,000)
Cash flows used in investing activities		**341**	**(21,021)**
Net increase / (decrease) in cash and cash equivalents		**(24,074)**	**39,316**
Cash and cash equivalents at the beginning of year	43	437,860	399,578
Effect of exchange rate fluctuations on cash and equivalents held		920	(1,034)
Cash and cash equivalents at the end of year		**414,706**	**437,860**

18 February 2019



Dr. Pál Simák
CEO and Chairman of the Board

Dario Massimo Grassani
CFO

CIB Bank Ltd.

The accompanying notes form part of the consolidated financial statements.

Additional information for cash flows from operating activities

(million HUF)

	2018	2017
Interest received	24,773	34,915
Interest paid	6,725	8,068
Dividend received	44	35
Income tax paid	3,018	3,200

Cash and cash equivalents presents the following statements of financial position categories

(million HUF)

	2018	2017
Cash and current accounts with central bank	47,108	38,876
Loans to banks	356,922	396,984
Financial assets at fair value through profit or loss	200	2,000
Financial assets at fair value through other comprehensive income	10,476	-
Cash and cash equivalents at the year end	**414,706**	**437,860**

Notes to the consolidated financial statements

Part A Accounting policies

(1) Corporate information

The sole owner and ultimate parent company of CIB Bank Ltd. ("the Bank") is Intesa Sanpaolo S.p.A. /IT Torino, Piazza San Carlo 156/, a bank registered in Italy that holds 100% of the shares of the Bank as at 31 December 2018.

The Bank is a fully licensed Hungarian bank conducting local and international banking business both within and outside Hungary.

The registered address of the Bank is 4-14 Medve utca, Budapest.

Persons authorized to sign the consolidated financial statement are Dr. Pál Simák Chief Executive Officer, Chairman of the Board and Dario Massimo Grassani Chief Financial Officer.

Person responsible for directing and managing the tasks related to accounting is Hajnalka Szarvas (Budaörs), the chartered accountant registration number: 005105.

The Bank and its subsidiaries ("the Group") engaged KPMG Hungary Ltd. (1134 Budapest, Váci út 31.; Chamber of Hungarian Auditors reg. no.: 000202) to perform the statutory audit of the business year 2018. The individual responsible for the auditing is István Henye, member of the Chamber of Auditors (MKVK registration number: 005674). The Group paid HUF 101.5 million plus VAT for audit, the fee includes the statutory audit fees of CIB Bank and its subsidiaries and group reportings to the auditor of the parent and HUF 5.4 million plus VAT for other assurance services to the auditor company in 2018.

The average number of active employees of the Group was 2,123 in 2018 and 2,174 in 2017, respectively.

As at 31 December 2018 the Bank had the following subsidiaries:

Company	CIB Group's share %	Country of incorporation	Principal business
CIB Leasing Co. Ltd.	100%	Hungary	Financial leasing services
CIB Rent Leasing and Trading Company Ltd.	100%	Hungary	Leasing services
CIB Insurance Broker Ltd.	100%	Hungary	Insurance agency services
CIB Factor Ltd. „u.l."	100%	Hungary	Factoring financing services
Recovery Ltd.	100%	Hungary	Real estate management

The Bank took over CIB Factor's activity and its financial assets as of 1st January 2017, because of it CIB Factor's activity ceased and the winding up procedure of CIB Factor commenced on 27th December 2017.

CIB Real Estate Leasing Co.Ltd merged into CIB Leasing Ltd. with the effective date of 1st January 2018.

(2) Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by European Union.

The consolidated financial statements for the year ended 31 December 2018 were authorized for issue in accordance with a resolution of the Management Board on 18th February 2019.

These consolidated financial statements are prepared for statutory filing purposes.

The Group is consolidated by its ultimate parent company. The ultimate parent company's consolidated financial statements are available at www.intesasanpaolo.com web site.

The original consolidated financial statements have been prepared in Hungarian and it is the translation of the Hungarian version. The original consolidated financial statements are available at www.cib.hu web site.

(3) Basis of measurement and consolidation

The consolidated financial statements of the Group have been prepared on a historical cost basis except for financial instruments which are measured at fair value, so the financial instruments measured at fair value through other comprehensive income, derivative financial instruments, other financial assets and liabilities held for trading, which all have been measured at fair value. The carrying values of recognized assets and liabilities that are hedged items in fair value hedges are adjusted to record changes in fair value of hedged items attributable to the risks that are being hedged.

These financial statements are presented in Hungarian Forint (HUF) and all amounts are rounded to the nearest million except when otherwise stated.

Basis of consolidation

The consolidated financial statements comprise the financial statements of CIB Bank Ltd. and its subsidiaries as at 31 December each year. The financial statements of subsidiaries are prepared for the same reporting year as the parent company, using accounting policies consistent with those of the parent.

All inter-company balances and transactions, including unrealized profits arising from intra-group transactions, have been eliminated in full.

Subsidiaries are investees controlled by the Bank. According to IFRS 10 the Bank controls an investee if it is exposed to or has the right to, variable return from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are consolidated from the date on which control commences until the date when control ceases. The list of consolidated subsidiaries is included in Note (1).

(4) Changes in accounting policies and disclosures

The Group has applied IFRS 9 and IFRS 7 R, effective for the periods beginning 1 January 2018, for the first time. Due to the transition method choosen by the Group in applying IFRS 9, comparative information throughout these financial statements has not generally been restated to reflect its requirement. For additional disclosures related to transition see Notes 7.

4.1 IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 for the periods on and after 1 January 2018. The Group decided to continue applying hedge accounting under IAS 39.

4.1.1 Changes to classification and measurement

IFRS 9 introduces a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristic.

The standard eliminates the previous IAS39 measurement categories of held-to-maturity, loans and receivables and available-for-sale and replacing by:

- Financial assets measured at amortised cost (AC)
- Financial assets measured at fair value through other comprehensive income (FVOCI)
- Financial assets measured through profit or loss (FVPL)

IFRS9 largely retains the existing requirements in IAS39 for the classification of financial liabilities. The Bank's classification of its financial assets and liabilities is explained in Notes 5.

The quantitative impact of applying IFRS 9 is presented in Note 7.

(4) Changes in accounting policies and disclosures (continued)

4.1.2 Changes to impairment calculation

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model (ECL). The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS9, credit losses are recognized earlier than under IAS39.

IFRS 9 requires the Bank to record an allowance for ECL's for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts.

Details of the Bank's impairment method are disclosed in Notes 5 and Note 6

The quantitative impact of applying IFRS 9 is presented in Note 7.

4.2 IFRS 7 R

IFRS 7 *Financial Instruments Disclosures* also requires additional and more detailed disclosures.

Transition disclosures are shown in Note 7.

Reconciliation from opening to closing ECL allowances are presented in Note 21.

(5) Significant accounting policies

The significant accounting policies adopted in the preparation of these financial statements are set out below:

5.1 Foreign currency transactions

The presentation currency of the Group is the Hungarian Forint (HUF). Transactions in foreign currencies are translated into the respective functional currency of the Group at the spot exchange rates at the date of transactions. Spot rate is the official rate of exchange quoted by the Hungarian Central Bank. At 31 December 2018 the euro was EUR 1 = HUF 321.51 (2017: EUR 1 = HUF 310.14) and Swiss Franc was CHF 1 = HUF 285.16 (2017: CHF 1 = HUF 265.24).

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction. Non-monetary items measured at fair value in a foreign currency are translated into the functional currency at the spot exchange rate at the date on which the fair value is determined.

Foreign currency differences arising on translation are generally recognized in profit or loss. However foreign currency differences arising from financial assets measured at fair value through other comprehensive income are recognized in OCI.

5.2 Financial instruments

5.2.1 Date of recognition

All "regular way" purchases and sales of financial assets and liabilities are recognized on the settlement date, i.e. the date that the financial asset is delivered except for derivatives. Regular way purchases or sales are purchases or sales that require delivery of assets within the time frame generally established by regulation or convention in the market place.

Derivatives are recognized on a trade date basis. Trade date is the date that the Group commits itself to purchase or sell an asset.

The evidence of the fair value of a financial instrument on initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received.

If the Group determines that the fair value on initial recognition differs from the transaction price and the fair value measurement is not evidenced by a valuation technique that uses only data from observable markets, then the carrying amount of the financial instrument on initial recognition is adjusted to defer the difference between the fair value measurement and the transaction price.

Subsequently, the difference recognized in profit and loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out. If the fair value measurement is evidenced by a quoted price in an active market or is based in another valuation technique that uses only data from observable markets, then the Group immediately recognizes gain or loss.

Government grant is recognised only when there is reasonable assurance that the entity will comply any conditions attached to the grant and the grant will be received.

(5) Significant accounting policies (continued)

The Group's financial instruments include loans initiated by the National Bank of Hungary under the Funding for Growth scheme program, which are in scope for recognizing initial fair value difference and for accounting as government grant under IAS 20.

5.2.2. Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments, as described in Notes 5. All financial instruments are measured initially at their fair value plus transaction costs, except for financial assets and financial liabilities recorded at fair value through profit or loss. Transaction cost and other adjustment at initial recognition is amortized using the effective interest rate method.

In 2013 the National Bank of Hungary launched its program called Funding for Growth Scheme (FGS). Under the program the National Bank granted refinancing funds for Hungarian credit institution with 0% interest rate mainly in order to finance small- and medium businesses (SMB) by providing loans with discount rate and exchange foreign currency loans to HUF loans. The program had three phases. The maximum interest rate of loans granted was 2.5% which, in case of the first two phases, was lower than the interest rate of similar loans available in the market. The difference between the fair value and gross book value of loans (granted and given as well) was recognized as operating income and expenses. The discount factor used for determining the fair value of loans was swap yield curve that belongs to the currency of the loan, increased by the risk premium of the partner group.

5.2.3 Measurement categories of financial assets and liabilities

The Group classifies its financial assets based on the business model for managing the assets and its contractual terms, financial assets are measured at either:

- Amortised cost
- Fair vaule through other comprehensive income (FVOCI)
- Fair vaule through profit or loss (FVPL)

5.2.4 Business model assessment

The Group determines its business model reflecting its intention to generate cash flows, that is, whether the Group's objective is solely to collect contractual cash flows from the instruments or is to collect both the contractual cash flows arising from sale. If none of these is suitable, then the financial instrument is measured at FVPL.

Business model assessment is based on reasonably expected scenarios, considering the following factors:

- Frequency, volume and timing of the sales in prior periods, the reason for such sales and the expectation about the future sales activity considered as an overall assessment on how the cash flows were collected.
- Main purpose of holding securities
- Evaluation of the instrument's performance and it's reporting to the management
- Risk assessment of the financial instrument and strategy for managing those risks

5.2.5 The SPPI test

In case, when the business model is to hold financial instruments to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash represent solely payment of principle and interest (the SPPI test), so that the interest includes only consideration for the time value of money, credit risk and a profit margin that is consistent with a basic lending arrangement.

Where the contractual terms represent exposure to risk or volatility that are unrelated to a basic lending arrangement, so they do not give rise to solely payment of principle and interest, the financial instrument is measured at FVPL.

Assessing whether the contractual terms of the instrument are SPPI, the Group considers the following factors:

- leverage features;
- prepayment and extension terms;
- conditions that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse loans)
- convertible options;
- condition regarding contractually linked instruments

A relevant question when assessing the SPPI Test features for a financial instrument is whether the time value of money is modified. In cases, when the time value of money is modified, benchmark cash flow is test is performed in order to determine how different the contractual cash flows of such instrument could be in respect of the cash flows that would arise had the "time value of money" element not been modified.

(5) Significant accounting policies (continued)

Assessing benchmark cash flow test the following factors are considered:

- Currency
- Refixing period of the interest rate;
- Frequency of interest payment;
- Tenor of the interest rate (underlying rate);
- Maturity

5.2.6. Loans to banks

Loans to banks include financial assets with fixed or determinable payments that are not quoted in an active market.

Measurement of loans to banks is driven by business model and the result of the SPPI test.

For ECL calculation please refer to Note 5 and Note 6.

5.2.7. Loans to customers

Loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market.

Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction. All loans and advances are recognized when cash is advanced to borrowers.

Measurement of loans to banks is driven by business model and the result of the SPPI test.

For ECL calculation please refer to Note 5.2.16.

Where possible the Group seeks to restructure loans rather than to take possession of collateral. Restructuring may involve extending the payment period arrangements and the agreement of new loan conditions, particularly interest level. Management continuously monitors renegotiated or restructured loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to an individual or collective impairment assessment.

The Group provides commercial factoring services in order to finance its partners' business activity. There are two main types of factoring deals: deal with recourse and non-recourse. The Group classifies the financed receivables whether all the risks and rewards has been transferred, or not. Accordingly:

- in case of non-recourse factoring deals the Group acquires all risks and rewards of the receivable and therefore the total amount of the receivable is recognised in its books irrespectively of paying the total amount, or not;
- in case of recourse factoring deals the Group does not acquire all risks and rewards of the receivable therefore only the paid amount is recognised in its books as loan advance to customers.

Receivables from factoring transactions are initially recognised at fair value which is the invoiced amount less purchase discount. Thereafter the receivables are measured at amortised cost using the effective interest rate method less allowance for impairment. In case of non-recourse factoring deals the Group applies net presentation: if the total amount of the acquired receivable is not paid, any related liability is deducted from the carrying amount of the receivable. The Group does not apply the simplified provisioning method when determining the allowance of impairment. Receivables from factoring transactions are not represented separately but disclosed within loans and advances to customers.

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the established future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal repayments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

A credit risk allowance for loan impairment is established for significant loans if there is objective evidence that the Group will not be able to collect all amounts due. If the Group determines that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, it includes the loan in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Loans that are individually assessed for impairment (i.e. non-performing exposure exceeding HUF 75 million at the customer level) and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment. When a loan is uncollectible, it is written off against the related allowance for impairment; subsequent recoveries are recognized in the profit or loss as other operating income.

(5) Significant accounting policies (continued)

If the amount of the impairment subsequently decreases due to an event occurring after the write-down, the release of the allowance is credited to the allowance.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal systems that consider credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors and have been estimated based upon historical patterns of losses in each component.

The Group classifies exposures as default exposure when the exposure is more than 90 day past due or it is unlikely that the Group can collect the contractual cash flows, in line with CRR 178 paragraph.

The general mostly applied rule of calculating impairments and allowances are based on discounted expected future cash flow method, with best available data for the Group. The present value of the available estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the available estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Method under IAS 39

Under IAS39 the method for calculating impairment and allowances were different. At each reporting date, the Group assesses whether there was objective evidence that loans and advances are impaired. Loans and advances were impaired when objective evidence demonstrates that a loss event had occurred after the initial recognition of the asset(s) and that the loss event had an impact on the future cash flows of the asset(s) that could be estimated reliably.

Objective evidence that financial assets are impaired includes:

- significant financial difficulty of the borrower,
- default or delinquency by a borrower,
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise,
- indications that the borrower will enter bankruptcy,
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

The Group considers objective evidence of impairment for loans and advances at both a specific asset and a collective level.

All individually significant loans and advances are assessed for specific impairment. The individual component of the total allowance for impairment is based on 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 debtor's financial situation and the net realizable 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 Credit Risk function.

A collective component of the total allowance is established for:

- groups of homogeneous loans that are not considered individually significant, and
- groups of assets that are individually significant but that were not found to be individually impaired (loss incurred but not reported).

In assessing the need for collective loss allowance, management considers factors such as credit quality, portfolio size, concentration and economic factors.

Parameters used in the collective assessment are calculated with statistical methodologies and models which are to the largest extent possible aligned or identical to those used in the processes of approval of facilities or calculation of capital adequacy.

5.2.8 Derivatives financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices, and valuation techniques such as discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Group has elected to continue to apply hedge accounting under IAS 39, until the standard resulting from the IASB's separate project on dynamic risk management is effective.

(5) Significant accounting policies (continued)

The Group applies hedge accounting to its fixed rate assets and liabilities hedged by interest rate swaps in order to mitigate its interest rate risk in the banking book. Hedged instruments are identified both on individual and portfolio level. Fair value change of financial assets hedged in portfolio is presented as a separate line in the statement of financial position.

The method of recognising fair value gain or loss depends on whether the derivative is designated as a hedging instrument or not. The Group, in accordance with the Intesa Sanpaolo Group's policies, designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way provided the following criterias are met.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items (efficiency tests). The effectiveness of the hedge must be tested both at its inception (designation of hedging relationship) and regularly during the entire lifetime of the hedge. In the case of a fair value hedge, changes in the fair value of derivatives that are designated as hedging items in fair value hedges are recorded in the profit or loss, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Interest income and interest expense recognized on hedging derivative instruments are presented as interest income and interest expense in the statement of comprehensive income together with the interest income and interest expense recognized on hedged items. Change in fair value of hedging derivatives are presented in the income from trading activities in the statement of comprehensive income together with the change in fair value of the hedged instrument attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity.

If the hedged item is derecognised, the unamortized fair value adjustment is recognised immediately in profit or loss.

IAS 39 Financial Instruments: Recognition and Measurement requires hedge effectiveness to be assessed both prospectively and retrospectively. Retrospective test reveals the degree of hedge effectiveness achieved during the period from designation to the performance of the test; in other words, it measures how much the actual results have deviated from those of a perfect hedge.

Prospective test demonstrates the expected effectiveness of the hedge in future periods. To qualify for hedge accounting at the inception of a hedge and, at a minimum, at each reporting date, the delta in the fair value or cash flows of the hedged item attributable to the hedged risk must be expected to be highly effective in offsetting the changes in the fair value or cash flows of the hedging instrument on a prospective basis, and on a retrospective basis where actual results are within a range of 80% to 125%.

Notes 23 and 46 provide further details regarding derivative financial instruments and hedge accounting.

5.2.9 Debt securities at FVOCI

The Group classifies debt instruments measures at FVOCI when both of the following conditions are met:

- The objective of the business model is to collect contractual cash flow and sell the debt instrument
- The contractual terms of the instrument meet the SPPI test

These instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognized in OCI. Interest income and foreign exchange gains and losses are recognized in profit or loss.

For ECL calculation of debt instruments at FVOCI please refer to Note 5.

On derecognition, cumulative gains or losses previously recognized in OCI are reclassified to profit or loss.

5.2.10 Equity instruments at FVOCI

The Group occasionally classifies equity instruments at FVOCI, such classification is irrevocable and is made on an instrument-by-instrument basis. Equity instruments can be classified as equity instruments at FVOCI when they meet the definition of equity under IAS 32 and are not held for trading.

Gains and losses on these equity instruments are never recycled to profit, accumulated gain or loss is transferred to retained earning upon derecognition.

Equity instruments at FVOCI are not subject to an impairment assessment, no impairment is recognised on them.

(5) Significant accounting policies (continued)

5.2.11 Deposits from bank and customers

All money market and customer deposits are initially recognized at fair value. After initial recognition, all interest-bearing deposits, other than liabilities held for trading, are subsequently measured at amortized cost with the interest expense taken to profit or loss with effective interest method.

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

For liabilities carried at amortized cost, any gain or loss is recognized in profit or loss when the liability is derecognized.

5.2.12 Financial liabilities measured at amortized cost – securities issued

Financial instruments issued by the Group – other than deposits from banks and customers - that are not designated at fair value through profit or loss, are classified as Financial liabilities measured at amortized cost., where the substance of the contractual arrangement results in the Group having an obligation to deliver cash to the holder. After initial measurement liabilities from issued securities are subsequently measured at amortised cost. The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL.

5.2.13 Financial assets at fair value through profit or loss

Financial instruments that are designated none of the above-mentioned categories are classified as financial assets at FVPL. These instruments are initially recognised at fair value, with no transaction costs taken into consideration.

Financial assets are subsequently recognised at fair value; changes in the fair value are presented in profit and loss. These instruments are not assessed in the ECL calculation.

Financial assets included in this category are debt securities, equities and short positions that have been acquired principally for the purpose of selling or repurchasing in the near term or holds as part of a portfolio that is managed together for short-term profit or position taking.

5.2.14 Financial assets measured mandatory at fair value through profit or loss

The Group classifies loans as financial assets measured mandatory at fair value through profit or loss, where the contractual characteristics does not meet the criteria of SPPI test.

The Group has exposures generated by the Housing Subsidy Scheme for Families (CSOK), which instruments does not meet the SPPI test criteria and accordingly are measured mandatory at fair value through profit or loss.

Interest of these mortgage loans are subsidized until a certain term of the loan, the subsidy depends on family conditions. The interest cash flow of these instruments does not meet the criteria of the SPPI test.

Regarding this product (CSOK), the interest subsidy is calculated on the basis of 130% of the Government Debt Management Agency reference yield, while the transaction interest rate is fixed at 3%. Due to the different conditions in the transaction, the product is placed in the SPPI failed category and should be measured at fair value through profit or loss.

The Group has exposures generated by the program of Hungarian Development Bank for small and medium businesses.

There is a mismatch regarding the interest characteristics of these special loans, as the interest reference rate is not in line with the disbursed currency, therefore the criteria of the SPPI test is not met.

5.2.15 Derecognition

5.2.15.1 Derecognition due to substantial modification of terms and conditions

The Group derecognises a financial asset, when the terms and conditions are renegotiated to the extent that, substantially, it becomes a new loan. An assessment of the "substantial nature" of the modification shall be

made, both in regard to qualitative and to quantitative elements. The qualitative and quantitative analyses designed to determine the "substantial nature" of the contractual modifications made to a financial asset will have to consider:

- the purposes for which modifications were made
- the presence of specific objective elements ("triggers") that affect the characteristics and/or the contractual cash flows of the financial instrument

(5) Significant accounting policies (continued)

Assessing the derecognition of a financial asset, the Group considers the following changes as significant change in cash flow:

- Change in currency
- Change in counterparty
- If the modification results in an instrument that would no longer meet SPPI test

The difference is recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded.

Where the modification does not indicate significant change in cash flows, the modification does not result in derecognition. In this case the EIR is not modified and the relating gain or loss is recognised in the statement of comprehensive income as other operating expense or income.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

5.2.15.2 Derecognition other than for substantial modification

The Group qualifies a financial asset for derecognition where:

- The rights to receive cash flows form the asset expires
- The Group transfers its contractual rights to receive cash flows from the asset or if the Group retains the rights to the cash flows, but has assumed to pay the received cash flows in full without delay to a third party
- The Group has transferred substantially all the risks and rewards of the asset, or if the Group retains the risk and rewards of the asset, but has transferred control of the asset

Financial liability is derecognised when the obligation is cancelled or expires.

5.2.16 Impairment of financial assets

From 1 January 2018, the Group applies the expected credit loss model for all financial assets measured at amortized cost or FVOCI, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The Group's ECL calculations are outputs of complex models, elements of the ECL models that are considered accounting judgements and estimated include:

- The Group's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a life time expected credit loss (LTECL)
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs.
- Selection of forward looking macroeconomic information included in the calculation of ECL.

Loans and advances to customers are classified to the non-performing loan category if the receivable is individually impaired. Evidence of impairment may include that the borrower is experiencing significant financial difficulties (is under liquidation), the probability that they will become insolvent (probability of default is 100%) or there is a material delinquency in interest or principal payments (more than 90 days material past due amount) and where observable data indicates that there is a change in economic conditions that correlate with default (managed by work-out department). For more information on non-performing loans see Note (46) on Risk Management.

Non-performing loans are considered as credit-impaired assets.

Exposure are fully written-off, when it can be supported by documents that all recovery options (including legal procedures against the debtor and the guarantor for the guarantor) are exhausted and no further recovery is expected. Exposures can also be written-off partially, when considering the supporting documents, usually at a late stage of legal proceedings, that part of the exposure to the debtor is unlikely to be recoverable.

5.2.16.1 Overview of Expected Credit Loss principles

Expected credit loss allowance is based on the credit losses expected to arise over the life of the asset (LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL).

An entity may determine that a financial asset's credit risk has not increased significantly if the asset has low credit risk at the reporting date.

(5) Significant accounting policies (continued)

The Group has significant amount of low credit risk financial assets. These are mainly intercompany items (receivables from subsidiaries and related parties) related to account of loans to banks and loans to customers.

For some exposures (clearly identified and performing government debt securities measured at fair value through other comprehensive income), the IFRS 9 low credit risk exemption is adopted, according to which exposures that, at the date of transition to the new Standard, are rated as investment grade, or above (and similar) is recognized as bearing low credit risk and treated as Stage 1. Investment grade can be allocated only to exposures with pd lower than 2% or to exposures that has "Investment grade" published by external financial rating company.

Simplified method of impairment requirements is applied on financial assets subject to IFRS 15 (trade receivables) based on IFRS 9.

The Group classifies its financial assets into Stage 1, Stage 2, Stage 3 and POCI as described below:

- Stage 1: When loans are first recognized, the Group recognizes an allowance based on the 12mECLs.
- Stage 2: When a loan has a significant increase in credit risk determined by a comparison of the Probability of Default art first recognition and that at reporting date.

  The following criteria is used to classify exposures to Stage 2:

  - Performing exposures with more than 30 days past due over the materiality threshold
  - Forborne exposures
  - Performing exposures with early warning signals
  - Performing exposures with significant increase in PD or other risk indicators similar to PD which can be used to assess the increase in credit risk
- Stage 3: Credit impaired assets are classified to Stage 3 during staging.
- POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired assets on initial recognition. POCI assets are recorded at fair value at original recognition and the stage assignment can not be lower than Stage 2.

5.2.16.2. The calculation of ECLs

The mechanism of ECL calculation considers the following key elements:

- *Exposure at default (EAD).* The exposure consists of on-balance sheet assets and off-balance sheet liabilities, where off-balance sheet exposure represents the amount of contingent off-balance sheet liabilities of the Group adjusted by a credit conversion factor (CCF) to convert off-balance sheet exposure into an on-balance sheet equivalent and is added to the actual on-balance sheet exposure. The credit conversion factor is defined at the level of loan facilities and is calculated using the simplified statistical methods adopted for Internal Capital Adequacy Assessment (ICAAP) purposes. In case of financial instruments classified as stage 2, EAD is determined on a yearly basis.
- *Probability of default (PD).* PD component determines probability of default, i.e. the probability of transition from the performing portfolio to the non-performing portfolio on debtor level. The PD component is the result of a combination of objective and subjective information about the debtor's credit-worthiness. The PD component for the retail (private individuals and entrepreneurs), small business, corporate (SME and large corporate) and project segments is calculated with statistically developed models. For each mentioned segment the Group is using a separate, segment-specific model for the calculation of PDs and internal ratings. The models were developed with the point-in-time method.
- *Loss given at default (LGD). LGD calculated by portfolio segments is the measure of losses incurred on facilities* that have defaulted. Assuming that the process of collection of the existing and future non-performing facilities of the Group will be equally or similarly efficient as the historical collection, LGD also represents the assessment of future losses on each facility that will default. For the purpose of the assessment of impairment / provision, the Group uses the results of a simplified statistical method that was approved for Internal Capital Adequacy Assessment (ICAAP) purposes with downturn adjustments. Until the Advanced Internal Rating Based approach (AIRB) compliant LGD models are under development the Group keeps using the ICAAP LGDs for impairment / provision calculation.
- Including forward-looking information in the calculation of Expected Credit Losses (ECL), also connected to changes in the macro-economic scenario. Macro-economic inputs comprise both EU and domestic data, e.g. GDP, unemployment data.

When estimating the ECLs, the Group considers three scenarios: a best case, a worst case, a most likely. Each of these is associated with different risk parameters.

When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset.

(5) Significant accounting policies (continued)

All individually significant loans and advances are assessed for specific impairment. The individual component of the total allowance for impairment is based on 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 debtor's financial situation and the net realizable value of any underlying collateral similarly to IAS39.

Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by Credit Risk function.

A collective component of the total allowance is established for:

- groups of homogeneous loans that are not considered individually significant, and
- groups of assets that are individually significant but that were not found to be individually impaired (loss incurred but not reported).

In assessing the need for collective loss allowance, management considers factors such as credit quality, portfolio size, concentration and economic factors.

Parameters used in the collective assessment are calculated with statistical methodologies and models which are to the largest extent possible aligned or identical to those used in the processes of approval of facilities or calculation of capital adequacy.

For the portfolio segments with insufficient homogeneous set of data for statistical assessment of loss, the Group uses risk parameters provided by ISP group calculated on the whole ISP group portfolio for:

- central governments and central banks;
- public sector entities treated as institutions;
- municipalities;
- institutions.

The parameters used in the impairment / provision calculation is subject to regular internal reviews in order to ensure that those always reflect a best estimate for expected credit risk losses.

Management can apply judgment to ensure that the estimate of loss arrived at on the basis of historical information is appropriately adjusted to reflect the economic conditions and product mix at the reporting date.

5.2.16.3 Debt instruments measured at fair value through OCI

The ECLs for debt instruments measured at fair value through OCI do not reduce the carrying amount of these financial assets, it remains at fair value. The amount equal to the allowance is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss in recognised in OCI is recycled to the profit and loss upon derecognition.

These instruments largely comprise assets that had previously been classified as financial investments available-for- sale under IAS 39.

5.2.16.4 Purchased originated credit impaired financial assets (POCI)

The Group considers the change in currency of the contract and the change in customer as significant change in the contractual cash flows. If this change is due to financial difficulties, the exposure is classified as purchased originated credit impaired financial asset. Credit impaired financial assets can also be purchased, occasionally.

The Group only recognises the cumulative changes in LTECL since initial recognition in loss allowance.

Interest income is recognised using a credit-adjusted effective interest rate.

5.3 Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central bank and highly liquid financial assets with original maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in the fair value and are used by the Group in the management of its short-term commitments.

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

5.4 Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralized by securities or cash. The transfer of the securities to counterparties is only reflected on the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Securities borrowed are not recognized on the statement of financial position, unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gains or losses included in net trading income.

(5) Significant accounting policies (continued)

5.5 Fair values

IFRS 13 Fair Value Measurement seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market price or dealer price quotations, without any deduction for transaction costs. For equities traded in organized financial markets, fair value is determined by reference to Stock Exchange quoted market closing prices at the close of business on the reporting date.

The fair value of interest-bearing items not traded on an active market is estimated based on discounted cash-flows using interest rates for items with similar remaining maturity. The carrying value of demand deposits is considered to be the fair value.

For equities where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same, or is based on the expected discounted cash flows.

Classification is based on a hierarchy that reflects the significance of unobservable inputs used in the measurement. An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 42.

5.6 Repurchase and reverse repurchase agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognized in the statement of financial position and are measured in accordance with accounting policies for non-trading investments. The liability for amounts received under these agreements is included in deposits from banks. The difference between sale and repurchase price is treated as interest expense in the respective period.

Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognized in the statement of financial position.

Amounts paid under these agreements are included in due from banks and other financial institutions. The difference between purchase and resale price is treated as interest income in the respective period.

5.7 Finance lease receivables

Leases where the Group transfers substantially all the risks and rewards incidental to ownership of an asset are classified as finance leases. The net investment in finance leases provided by the Group is included in loans and advances to customers. A receivable is recognized over the leasing period of an amount equaling the present value of the lease payment using the implicit rate of interest at the inception of the lease and including any residual value that has been guaranteed whether by the lessee, a party related to the lessee, or an independent third party. All income resulting from the receivable is included in interest income in the statement of comprehensive income, except for the residual value accounted as other operating income (expense) when closing the contract.

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

A reassessment is made after inception of the lease only if one of the following applies:

- there is a change in contractual terms, other than a renewal or extension of the arrangement;
- a renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
- there is a change in the determination of whether fulfilment is dependent on a specified asset; or
- there is substantial change to the asset.

5.8 Intangible assets, property, plant and equipment

All items of property, plant and equipment are initially recorded at cost. Premises that are operational buildings are subsequently carried at the revalued amount. Premises are revalued annually and whenever their carrying amounts are likely to differ materially from their revalued amounts. When an asset is revalued, any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset. The net amount is then restated to the revalued amount of the asset.

(5) Significant accounting policies (continued)

Increases in carrying amounts arising from revaluation are recognized in the asset revaluation reserve and revaluation reserve on the other comprehensive income in equity, unless they offset previous decreases in the carrying amounts of the same asset, in which case, they are recognized in profit or loss.

Decreases in carrying amounts that offset previous increases of the same asset are recognized against the asset revaluation reserve. All other decreases in carrying amounts are recognized as loss in profit or loss.

Depreciation is provided on a straight-line basis over the estimated useful lives of all property, plant and equipment, except operational buildings.

Cost incurred after initial recognition is capitalized, except for tangible assets measured at fair value.

The following depreciation rates and residual values are applied:

	Depreciation rate	Residual value
Premises – head quarters	3%	30% of gross value
Premises – branches	5%	30% of gross value
Leasehold improvements	5%	individually assessed
Electronic equipment's and office furniture	14.5%	individually assessed
Computer equipment	33%	individually assessed
Software	20%	individually assessed
Motor vehicles	20%	20% of gross value

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising from de-recognition of the asset is included in profit or loss as operating income in the year the asset is derecognized. The assets residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each reporting date.

5.9 Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquirer's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the 'value in use' of the cash-generating units to which the goodwill is allocated.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and goodwill is recognized in profit or loss.

5.10 Repossessed properties

Repossessed properties are usually repossessed under lease contracts or real estate developments/projects or construction contracts.

The Group keeps all repossessed real estates with the intent to dispose of the asset in the reasonable short period of time. Repossessed assets shall be measured at the lower of cost or fair value less cost to sell (FVLCTS) and shall not be amortised but only subject to the impairment test.

Repossessed properties are derecognised when either they have been disposed or when the repossessed property is permanently withdrawn from use and no future economic benefit is expected from its disposal.

5.11 Other assets

Other assets are recognized at cost, which comprise all costs of purchase, costs of conversion and other costs. The balance of other assets includes those balances which have not been disclosed separately in the statement of financial position (e.g. trade receivables, inventories). After initial recognition they are measured at the lower of cost and net realizable value.

5.12 Non-current assets held for sale

Non-current assets and disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded and met only when the sale is highly probable and the asset is available for immediate sale in its present condition.

(5) Significant accounting policies (continued)

Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Property, equipment and intangible assets once classified as held for sale are not depreciated or amortised.

5.13 Revenue recognition

The Group has initially adopted IFRS 15 *Revenue from Contracts with Customers* from 1 January 2018, the standard replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts* and the related interpretations.

A contract with a customer recognised financial instrument which may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Group first applies IFRS 9 to separate and measure the part of the contract that is in scope of the IFRS 9 and then applies IFRS 15 to the residual.

A five-step model is applied to determine when to recognise revenue, and at what amount. The revenue is recognised when the Group transfers goods or services to a customer, measured at the amount at which the Group expects to be entitled.

The Group earns fee and commission income from a diverse range of services it provides to its customers.

Fees earned for providing services - such as servicing fee, account turnover fee, card fee, investment services fee, documentary fee and cash management fee - are recognised over time. Fees arising from negotiating or participating in the negotiation of a transaction for a third party are recognized on completion of the underlying transactions. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria. Loan syndication fees are recognized in profit or loss when the syndication has been completed and the Group retains no part of the loans for itself or retains part at the same effective interest rate as for the other participants.

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with costumers and the related assets and liabilities recognized by the Group. Accordingly, the impact on the comparative information is limited to new disclosure requirements.

Dividend income is recognised when the Group's right to receive the payment is established.

5.14 Taxation

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the tax authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

Local business tax and Innovation contribution are both revenue driven taxes, thus considered income tax.

Deferred tax

Deferred tax is recognised for temporary difference in relation with corporate tax expense.

Deferred tax is provided on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for the financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences, except:

- Where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that is probable that taxable profit will be available against which the deductible temporary differences and the carry forward for unused tax credits and unused tax losses can be utilised, except:
- Where the deferred tax asset relating to the deductible temporary difference arises from initial recognition of an asset or liability in a transaction that is not a business combination and at the time of transaction affects neither the accounting profit nor taxable profit or loss.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Recognised and unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on the tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

(5) Significant accounting policies (continued)

Current tax and deferred tax items are recognised in profit or loss as income tax expense.

Deferred tax asset and deferred tax liabilities are offset if legally enforceable rights exist to set off current tax assets against current tax liabilities and the deferred taxes relates to the same taxable entity and the same tax authority.

Bank tax

For 2018 the basis and rates are based on statutory reported financial data of the reporting entity for the period ended 31 December 2016. For 2017 the basis and rates are based on statutory reported financial data of the reporting entity for the period ended 31 December 2015.

The tax rates for credit institutions were 0.15% of adjusted total asset value for the first HUF 50 billion; and 0.21% had been applied for the amount exceeds HUF 50 billion for 2018, and for 2017, respectively.

Bank tax is presented as operating expense in the comprehensive income as it does not meet the definition of income tax under IFRS and presented on a separate line on the face of the comprehensive income.

Financial transaction duty

Financial transaction duty is presented as operating expense in profit or loss.

5.15 Offsetting financial assets and liabilities

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

5.16 Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and accordingly are not included in the statement of financial position.

5.17 Financial guarantees

In the ordinary course of business, the Group provides financial guarantees consisting of letters of credit, letters of guarantees and acceptances. Financial guarantees are initially recognized in the statement of financial position at fair value, and the fair value is recognized in other liabilities.

Subsequent to initial recognition, the Group’s liabilities under such guarantees are each measured at the higher of

the loss allowance in accordance with IFRS 9 and the amount initially recognised (before 1 January 2018 at the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee). Any change in the liability relating to financial guarantees is recorded in profit or loss.

5.18 Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

When the Group expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in profit or loss net of any reimbursement.

For details please refer to Note 32.

5.19 Operating profit

Operating profit represents profit from business operations and is defined as profit before tax connected to non-financial operations.

5.20 Employee benefits

Employee benefit is a consideration paid to employees for their services, which may be short-term employee benefits, post-employment benefits, other long-term employee benefits and severance payments.

Short term employee benefits are recognized as a current expense in the period when employees render their services. These include wages, social security contributions, bonuses, paid holidays and other fringe benefits and the tax charges thereon.

Payments to defined contribution pension and other welfare plans are recognized as an expense in the period in which they are earned by the employees.

There are no long-term employee benefits at the Group.

(5) Significant accounting policies (continued)

5.21 Standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of the Group's financial statements are listed below. The list contains standards and interpretations issued and expected to be relevant to the Group and to be adopted when they become effective.

The following amended standards and interpretations are not expected to have a significant impact on the Group's financial statements:

The Group is required to adopt IFRS 16 *Leases* from 1 January 2019. The new standard replaces existing guidelines of IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transaction Involving the Legal Form of a Lease*. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019.

IFRS 16 introduces single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. During the IFRS16 adoption the Group reviewed all supplier contracts to determine if the contract is subject to IFRS16.

Short term leases and low value assets are still accounted as rental costs:

- Low value asset threshold is HUF 1,6 million
- Any lease contracts not longer than 12 months are considered short-term leases

Intangible assets (such as software licences) are excluded from the IFRS16 scope. Neither deductible nor non-deductible VAT were taken into consideration in the calculations.

As at 31 December 2018 the future minimum lease payment under non-cancellable operating leases amounted to HUF 9.427 million which the Group estimates to recognize as additional lease liabilities connected to the following asset types:

- Real estates
- Information technology
- Motor vehicles
- Other

The actual impact of adopting the standard on 1 January 2019 may change because:

- the Group has not finalized the testing and assessment of controls over its new IT system
- the new accounting policies are subject to change until the Group presents its first financial statements that include the date of initial application.

The Group applies a modified retrospective approach. The Group expects not to recognise any adjustment any adjustment in the opening balance of retained earnings as the cumulative effect of adopting IFRS 16.

The standard does not affect the accounting treatment regarding the leasing receivables, for which the current rules applies.

Other changes and amendments endorsed by the European Union

- IFRIC 23 *Uncertainty over Income Tax Treatments* (issued on 7 June 2017)
- Amendments to IFRS 9: *Prepayment Features with Negative Compensation* (issued on 12 October 2017)

Other changes and amendments but not yet endorsed by the European Union

- Amendments to IAS 28: *Long-term Interests in Associates and Joint Ventures* (issued on 12 October 2017)
- Annual Improvements to IFRS Standards 2015-2017 Cycle (issued on 12 December 2017)
- Amendments to IAS 19: *Plan Amendment, Curtailment or Settlement* (issued on 7 February 2018)
- Amendments to References to the Conceptual Framework in IFRS Standards (issued on 29 March 2018)
- Amendment to IFRS 3 *Business Combinations* (issued on 22 October 2018)
- Amendments to IAS 1 and IAS 8: *Definition of Material* (issued on 31 October 2018)
- IFRS 17 *Insurance Contracts* (issued on 18 May 2017)

(6) Significant accounting estimates and judgements

In preparing these annual financial statements management has made judgements, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

The most significant cases for which judgments and estimates are required to be made by the management include:

- the use of measurement models for determining the fair value of financial instruments not listed on active markets,
- recognition of deferred tax assets: availability of future taxable profit against which carry forward tax losses can be used,
- the measurement of impairment on non-financial assets,
- the measurement of impairment losses on financial assets,
- the measurement of provisions,
- the measurement of impairment on repossessed assets.

Sometimes it is impracticable to disclose the extent of the possible effects of an assumption or another source of estimation uncertainty at the end of the reporting period. In such cases, it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from the assumption could require a material adjustment to the carrying amount of the asset or liability affected. In all such cases, the Group would disclose the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.

6.1 Fair value of financial instruments

Where the fair values of financial assets and liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. For details please refer to Note 42.

6.2 Recognition of deferred tax assets: availability of future taxable profit against which carry forward tax losses can be used

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Management estimation is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

The Group had unused tax loss carry forwards as of 31 December 2018 and 2017. Due to the current market and economic conditions the management considered whether the Group will have tax planning opportunities available that could support the recognition of these losses as deferred tax assets.

6.3 Impairment on non-financial assets

Impairment exists when the carrying value of an asset or a cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing the asset. The value in use calculation is based on discounted cash flow model.

Impairment losses are recognised in profit or loss. An impairment loss for non-financial assets is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

6.4 Impairment on financial assets

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

Elements of the ECL models that are considered accounting judgements and estimates include:

- The Group's internal credit grading model, which assigns PDs to the individual grades
- The Group's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment

(6) Significant accounting estimates and judgements (continued)

- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models

6.5 Provisions for risk and charges

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. In assessing and determining the amount of obligation the Group considers whether a reliable estimate can be made of the amount of outflow of economic benefits.

Provisions are recognized and measured based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

The Group is involved in ongoing legal disputes; provision is made based on the best estimate of the expenditure required to settle the obligation.

The Group is committed to close branches; provision is made based on the landlord’s agreement for the obligation to be settled.

Provision on personal type expenses and other obligations are measured based on the best available estimation.

For details please refer to Note 32.

6.6 Impairment on repossessed properties

Repossessed assets shall be measured at the lower of cost and fair value less cost to sell (FVLCTS).

Subsequent to initial recognition repossessed properties are annually tested for impairment and stated at the lower of cost and FVLCTS. The Group regards the market value determined by external valuations as the FVLCTS for its repossessed real estates.

The basis of the impairment calculation is the market value determined by an external valuation dated less than 90 days from the relevant year end date. External valuation should be prepared for all commercial assets, and for residential assets above or equal net book value of HUF 50 million. For residential assets below net book value of HUF 50 million external valuations should be prepared in every 3 years and during the intervening period statistical revaluation could be applied.

(7) Transition disclosures

The Group has initially adopted IFRS 9, which replaced IAS 39 concerning the rules for the classification and measurement of financial instruments, as well as the related impairment process from 1 January 2018.

In schedules below, the accounting balances of financial assets as at 31 December 2017 (figures determined according to IAS 39) are reconciled to the new accounting captions, according to the reclassifications required because of the new classification criteria introduced by IFRS 9, but without the application of the new measurement criteria and, therefore, with the same amount of total financial assets. Accordingly, the information presented for 2017 is not comparable to the information presented for 2018 under IFRS 9.

Adopting IFRS 9 does not effect the reclassification of financial liabilities, therefore no such reconciliation is disclosed regarding the financial liabilities.

(million HUF)

IFRS 9 / IAS 39	Due from banks	Financial assets at fair value through profit or loss excl. derivatives	Derivative financial assets	Net loans and advanced to customers	Financial investments – Available-for-sale	Financial investments – Held-to-maturity	**Total financial assets**
Financial assets measured at fair value through profit or loss	-	63,717	18,454	5,145	398	-	**87,714**
a) securities held for trading	*-*	*63,717*	*-*	*-*	*398*	*-*	***64,115***
b) trading derivatives	*-*	*-*	*18,454*	*-*	*-*	*-*	***18,454***
c) financial assets mandatorily measured at fair value	*-*	*-*	*-*	*5,145*	*-*	*-*	***5,145***
Financial assets measured at fair value through other comprehensive income	-	-	-	-	247,255	-	**247,255**
Financial assets measured at amortised cost	459,736	-	-	757,124	-	28,906	***1,245,766***
a) loans to banks	*459,736*	*-*	*-*	*-*	*-*	*-*	***459,736***
b) loans to customers	*-*	*-*	*-*	*757,124*	*-*	*-*	***757,124***
c) debt securities	*-*	*-*	*-*	*-*	*-*	*28,906*	***28,906***
Hedging derivatives	-	-	1,151	-	-	-	**1,151**
Fair value change of financial assets in hedged portfolios (+/-)	-	-	-	332	-	-	**332**
Total financial assets	**459,736**	**63,717**	**19,605**	**762,601**	**247,653**	**28,906**	**1,582,218**

(7) Transition disclosures (continued)

The schedules below show the reconciliation between the balance sheet as at 31 December 2017 (which incorporates the new IFRS 9 presentation rules) and the balance sheet as at 1 January 2018 (which incorporates the new IFRS 9 measurement and impairment rules). In these schedules, the accounting balances as at 31 December 2017 (amounts determined in accordance with IAS 39) have been modified because of the application of the new measurement and impairment rules, to determine the IFRS 9 compliant opening balances.

(million HUF)

	31/12/2017	Measure-ment	01/01/2018
Cash and current accounts with central bank	38,876	-	38,876
Financial assets measured at fair value through profit or loss	87,714	20	87,734
Financial assets measured at fair value through other comprehensive income	247,255	-	247,255
Financial assets measured at amortised cost	1,245,766	(833)	1,244,933
Hedging derivatives	1,151	-	1,151
Fair value change of financial assets in hedged portfolios (+/-)	332	-	332
Property, plant and equipment	15,602	-	15,602
Intangible assets	9,620	-	9,620
Repossessed properties	25,261	-	25,261
Tax assets	1,079	-	1,079
Non-current assets held for sale	339	-	339
Other assets	10,235	-	10,235
Total assets	**1,683,230**	**(813)**	**1,682,417**

(million HUF)

	31/12/2017	Measure-ment	01/01/2018
Financial liabilities measured at amortised cost	1,404,611	-	1,404,611
Trading derivatives	16,557	-	16,557
Hedging derivatives	4,033	-	4,033
Tax liabilities	331	-	331
Other liabilities	18,618	-	18,618
Provisions for risk and charges	10,562	-	10,562
Subordinated debts	9,311	-	9,311
Share capital	50,000	-	50,000
Reserves	203,223	(813)	202,410
Retained earnings	(34,016)	-	(34,016)
Total liabilities and shareholder's equity	**1,683,230**	**(813)**	**1,682,417**

(million HUF)

01/01/2018	First time adoption reserve
Impairment on performing loans	(412)
Impairment on performing debt securities	(274)
Impairment on non-performing loans	(272)
Impairment on low credit risk portfolio	(82)
Reclassification of loans (SPPI failed)	20
Reclassification of available for sale instruments to financial assets measured at fair value through profit or loss	(37)
Total	**(1,057)**

(7) Transition disclosures (continued)

The reconciliation of the closing impairment allowance under IAS 39 as at 31 December 2017 to the opening ECL allowance determined under IFRS 9 as at 1 January 2018 is presented in Note 21 and Note 36.

First time adoption reserve comprises effects of reclassification from other comprehensive income regarding available for sale financial instruments with an amount of HUF 244 million. This reclassification plus the First time adoption reserve of HUF (1,057) million adds up the total impact of IFRS9 application to reserves in amount of HUF (813) million.

As it is reflected in this section the transformation from IAS39 to IFRS9 does not have a material impact neither to the financial position nor to the equity position of the Group. Consequently, the Group is presenting the comparative 2017 data on the statement of financial positions according to IFRS9 terminology as it presented in the classification and measurement tables.

Part B Information on the consolidated statement of comprehensive income

(8) Interest income and interest expense

(million HUF)

Interest income	2018	2017
Loans to customers	23,579	23,740
Financial assets measured at fair value through other comprehensive income	2,790	2,622
Loans to banks	490	584
Financial assets measured at amortised cost	511	163
Securities held for trading	565	938
Hedging derivatives	(2,043)	345
Total	**25,892**	**28,392**

Interest income on financial assets classified as stage 3 is HUF 1,371 million during 2018.

Interest income on impaired assets was HUF 3,136 million during 2017.

Interest income on liabilities was HUF 112 million during 2018, and HUF 19 million during 2017.

Interest regarding hedging derivatives are presented as other interest income, causing a negative balance in the profit or loss and other comprehensive income.

(million HUF)

Interest expenses	2018	2017
Deposits from customers	4,039	4,321
Deposits from banks	1,843	1,597
Issued securities	114	143
Hedging derivatives	(478)	988
Total	**5,518**	**7,049**

Interest expense on financial asset was HUF 1,181 million during 2018, and HUF 1,037 million during 2017.

Interest income remains stable as a controversy effect of increasing new financing together with the extremely low interest rate environment that kept customer deposit spreads under pressure.

(9) Fee and commission income and expense

(million HUF)

Fee and commission income	2018	2017
Account turnover fee income	12,163	11,404
Investment services fee income	6,496	7,261
Card fee income	6,186	5,795
Servicing fee income from loans	3,595	4,021
Cash management fee income	1,335	1,356
Documentary fee income	1,277	1,214
Agent fee income	913	877
Other fee income	2,344	1,779
Total	**34,309**	**33,707**

(9) Fee and commission income and expense (continued)

(million HUF)

Fee and commission expense	2018	2017
Card fee expense	3,750	3,087
Account turnover fee expense	1,782	1,308
Investment services fee expense	278	247
Documentary fee expense	567	534
Servicing fee expenses for loans	50	34
Agent fee expense	194	146
Other fee expense	916	849
Total	**7,537**	**6,205**

Net commission income increased, mainly due to increasing account turnover on the retail segment compensated with the increase of card fee expense due to the increasing number of card issued.

(10) Income from trading activities

(million HUF)

	2018	2017
Net revaluation gains/(losses) from trading derivatives and trading with foreign currencies	8,118	5,373
Net realised gains/(losses) from trading derivatives	2,410	1,650
Net revaluation gains/(losses) on hedging derivatives	156	112
Net gains/(losses) from financial assets measured at fair value through other comprehensive income	(845)	2,391
Net realised gains/(losses) from securities held for trading	636	31
Net revaluation gains/(losses) on securities held for trading	(367)	274
Total	**10,108**	**9,831**

Increase in trading income was the consequence of revaluation gain realized on trading derivatives, especially on IRS deals.

(11) Other operating income and expense

(million HUF)

	2018	2017
Net gain/(loss) from selling of tangible and intangible assets	39	6
Dividend and similar income	44	35
Income from property management	369	893
Result on disposal of inventories	4	8
Net result on non-current asset held for sale	45	(31)
Fair value adjustment on premises	-	(264)
Other operating income / (expenditures)	809	1,870
Total	**1,310**	**2,517**

(12) Impairment losses, provisions and net loan losses

(million HUF)

	2018	2017
Individual impairment expense/(reversal) for loan losses	415	(8,087)
Collective impairment expense/(reversal) for loan losses	(1,803)	(3,611)
Impairment expense/(reversal) for losses on loans subtotal	**(1,388)**	**(11,698)**
Impairment expense/(reversal) for losses on securities	181	-
Provision expense/(reversal) for financial guarantees	(252)	(24)
Provision expense/(reversal) for other commitments and contingencies	201	82
Net losses/(gain) on sale of loans	(7,780)	(5,479)
Net losses/(gain) on repossessed properties	(1,369)	(3,656)
Other impairment expense/(reversal) for other receivables	9	(110)
Other provision expense/(reversal)	2,123	3,628
Other impairment losses and provisions subtotal	**(6,887)**	**(5,559)**
Total	**(8,275)**	**(17,257)**

The positive result was mainly the effect of lower impairment need of the retail portfolio and the positive result of selling of project loans.

Net losses/(gain) on repossessed properties comprises impairment and result on sales. The result on sales was HUF 2,838 million during 2018 and HUF 5,212 million during 2017, respectively.

(13) Operating expenses without bank tax

(million HUF)

	2018	2017
Personnel expenses	21,235	21,794
of which salaries	*15,415*	*15,319*
of other benefits	*1,865*	*1,878*
of social contributions	*3,955*	*4,597*
Depreciation and amortisation	3,739	3,686
Office and information technology maintenance	5,956	5,405
Financial transaction duty	4,325	4,272
Other taxes and obligatory fees	3,658	3,729
Material expenses	1,337	1,437
Rent and leasing	1,919	2,069
Communications	1,417	1,327
Advertising	656	976
Expert fees	140	94
Other expenses	2,459	2,766
Total	**46,841**	**47,555**

(14) Bank tax

(million HUF)

	2018	2017
CIB Bank Ltd.	3,166	3,209
CIB Leasing Co. Ltd.	262	491
CIB Real Estate Leasing Ltd.	-	20
CIB Factor Ltd.	-	42
Total	**3,428**	**3,762**

The change in the basis of bank tax is presented in the 5.14 Taxation section of the significant accounting judgements and estimates.

(15) Income taxes

The current income tax expense is based on the corporate income tax payable on the results for the year determined in accordance with Hungarian taxation rules.

For the year 2018, the corporate tax rate of 9% is applicable to the Group for the profit before tax. For the year 2017, the applicable corporate tax rate was also 9%.

For deferred tax calculation purposes, the Group applied the tax rates that are expected to apply in the year when the asset is realised or the liability is settled.

(million HUF)

Amounts recognised in profit or loss	2018	2017
Current income tax charge	2,803	3,090
of which corporate income tax	*651*	*1,165*
of which local business tax	*1,874*	*1,926*
of which innovation contribution	*278*	*291*
of which investment services tax	*-*	*(292)*
Deferred income tax	29	(520)
of which origination and reversal of temporary differences	*29*	*(520)*
Total	**2,832**	**2,570**

Reconciliation of income tax expense to profit before tax	2018		2017	
	million HUF	%	million HUF	%
Profit before tax	16,567		27,133	
Theoretical income tax expense at the statutory rate	1,491	9.00	2,442	9.00
Tax base amending items according to the local regulations	(704)	(4.25)	(1,194)	(4.40)
of which use of deferred losses	*(587)*	*(3.55)*	*(1,182)*	*(4.36)*
of which non-deductible provision	*87*	*0.52*	*(10)*	*(0.04)*
of which non-deductible expenditure	*180*	*1.09*	*411*	*1.51*
of which IFRS conversion effect	*(384)*	*(2.32)*	*(413)*	*(1.52)*
Tax allowances	-	-	(45)	(0.17)
Change on not recognised tax asset	(138)	(0.83)	(886)	(3.27)
Recognised tax assets	31	0.19	328	1.21
Effect of change in deferred tax rate	-	-	-	-
Other income type taxes	2,152	12.99	1,925	7.09
Income tax at effective tax rate	**2,832**	**17.09**	**2,570**	**9.47**

(15) Income taxes (continued)

(million HUF)

Deferred tax assets and liabilities comprise	2018		2017	
	Assets	Liabilities	Assets	Liabilities
Carry forward losses	297	-	328	-
Properties	-	209	-	210
Total deferred tax to profit or loss	**297**	**209**	**328**	**210**
Financial assets measured at other comprehensive income	-	72	-	93
Total deferred tax through OCI	**-**	**72**	**-**	**93**
Total	**297**	**281**	**328**	**303**

The management assess whether sufficient taxable profit will be available at the Group to allow the benefit of all deferred tax asset to be utilized. The management decided to recognize deferred tax asset as at 31 December 2018 based on the budget plan.

The balance of carry forward unused tax losses was HUF 415,062 million as at 31 December 2018 and HUF 423,824 million as at 31 December 2017.

(16) Dividend paid

There were no dividends, declared or paid in either 2018 or 2017. During 2019, HUF 10,000 million dividend is proposed to be paid based on the 2018 year's result.

(17) Other comprehensive income

(million HUF)

	2018	2017
Net gain/(loss) from changes in fair value on investments in debt instruments	(3,277)	3,230
Amortization of debt securities measured at fair value through OCI	-	11
Hedge accounting adjustment on debt securities measured at fair value through OCI	2,871	(1,990)
Reclassification adjustment to profit or loss	-	(1,653)
Deferred tax	17	(93)
Items that may be reclassified to profit or loss	**(389)**	**(495)**
Net gain/(loss) from changes in fair value on investments in equity instruments	352	483
Fair value adjustment on premises	(7)	2,534
Items that may not be reclassified to profit or loss	**345**	**3,017**
Total (net of tax)	**(44)**	**2,522**

Further information about hedge accounting is presented in Note 23.

Fair value adjustment on premises is the valuation difference of the Group's buildings.

Regarding first time-adoption effect on Other comprehensive income, please refer to Note 7.

Part C Information on the consolidated statement of financial position

(18) Cash and current accounts with central bank

Cash and current accounts with the central bank comprise notes and coins of various currencies and nostro accounts with the central bank kept in Hungarian Forint. Both in 2018 and 2017, the Bank is required to maintain a minimum average balance as a restricted deposit for the month equivalent to 1% of the Bank's total resident customer deposits, foreign customer HUF and currency (less than one year) deposits with the National Bank of Hungary.

(million HUF)

	Note	31/12/2018	31/12/2017
Cash		21,347	13,502
Current HUF account with the National Bank of Hungary		25,761	25,374
of which compulsory reserve		*12,199*	*10,131*
Total		**47,108**	**38,876**
of which included in cash and cash equivalents	*43*	*47,108*	*38,876*

(19) Financial assets measured at fair value through profit or loss

Securities held for trading

(million HUF)

	Note	31/12/2018	31/12/2017
Hungarian Government securities – HUF		24,169	63,473
of which included in cash and cash equivalents	*43*	*200*	*2,000*
Hungarian Government securities – NON-HUF		134	31
Bank and corporate bonds – HUF		16	17
Shares listed on stock exchange – HUF		365	195
Other securities– NON-HUF		1	1
Total		**24,685**	**63,717**

Income on investments and other non-fix yield assets are recognized in other operating income.

Financial derivatives designated as held for trading: breakdown by product

(million HUF)

31/12/2018	Positive fair value		Negative fair value	
	Fair value	Notional value	Fair value	Notional value
Interest rates	9,692	1,041,403	5,977	762,487
Currencies	4,507	322,205	2,216	191,921
Equities and stock indexes	1,280	90,070	1,295	76,708
Total	**15,479**	**1,453,678**	**9,488**	**1,031,116**

(19) Financial assets measured at fair value through profit or loss (continued)

(million HUF)

31/12/2017	Positive fair value		Negative fair value	
	Fair value	Notional value	Fair value	Notional value
Interest rates	9,021	461,178	9,010	347,219
Currencies	7,701	427,211	5,825	454,453
Equities and stock indexes	1,732	82,387	1,722	82,012
Total	**18,454**	**970,776**	**16,557**	**883,684**

Financial assets mandatorily measured at fair value

Financial assets mandatorily measured at fair value comprises loans to customers, which do not meet the criteria of SPPI test. Presentation of financial assets mandatorily measured at fair value is included in Note 21.

(20) Loans to banks

(million HUF)

	Note	31/12/2018	31/12/2017
Nostro accounts		16,903	9,893
of which included in cash and cash equivalents	*43*	*16,903*	*9,893*
Due from banks		527,452	449,843
of which loans to Hungarian banks		*259,424*	*325,660*
of which loans to banks in Intesa Sanpaolo Group		*265,709*	*120,335*
of which included in cash and cash equivalents	*43*	*356,922*	*387,091*
Total		**544,355**	**459,736**

The majority of the exposures of loans to banks are classified as Stage 1 in the ECL modul for impairment calculation.

(21) Loans to customers measured at amortised cost and at fair value through profit or loss

Analysis by sector

The gross loan portfolio may be analysed by sector as follows:

Sector	31/12/2018		31/12/2017	
	million HUF	%	million HUF	%
Private customers	314,072	34.11	288,110	34.88
Other, mostly service industries	108,169	11.74	108,718	13.16
Real estate investments	64,698	7.03	104,188	12.62
Heavy industry	111,677	12.13	67,818	8.21
Trading	69,420	7.54	64,523	7.81
Transportation and communication	54,291	5.90	50,007	6.05
Light industry	69,557	7.55	46,881	5.68
Food processing	40,224	4.37	33,622	4.07
Agriculture	34,040	3.70	31,094	3.77
Financial activities	50,025	5.43	20,345	2.46
Chemicals and pharmaceuticals	4,580	0.50	10,666	1.29
Total	**920,753**	**100.00**	**825,972**	**100.00**

(21) Loans to customers at amortised cost and at fair value through profit or loss (continued)

Loans and advances to customers comprise also the transactions related to factoring activities as the Bank took over CIB Factor's activity as of 1 January 2017.

Neither as at 31 December 2018, nor as at 31 December 2017 the Bank had no active repurchase agreement.

Analysis of leasing sector

The leasing subsidiary of the Bank operates in the domestic leasing market and provide finance lease products to customers. The term of the leasing contracts is usually between 3 months and 10 years.

The following tables indicate the key amounts of this activity for the receivables not past due.

(million HUF)

Future minimum lease payments	31/12/2018	31/12/2017
Within one year	21,732	23,315
One to five years	44,233	43,287
More than five years	10,068	14,319
Total	**76,033**	**80,921**

(million HUF)

The present value of minimum lease payment receivables comprises	31/12/2018	31/12/2017
Within one year	19,511	20,749
One to five years	40,786	39,052
More than five years	8,892	12,768
Total	**69,189**	**72,569**
Unearned finance lease income	6,844	8,351
Accumulated allowance for uncollectible minimum lease payments receivable	2,967	2,322

Analysis of impairment allowance for loans to customers as at 31 December 2018

(million HUF)

Gross carrying amount	Stage 1	Stage 2	Stage 3	*of which POCI assets[1]*	SPPI failed	Total
Balance at 31/12/2017	**620,751**	**110,433**	**89,203**	***8,661***	**5,253**	**825,640**
FTA	-	-	-	-	(88)	**(88)**
Increase	305,833	126,822	28,690	*8,788*	4,990	**466,335**
Decrease	(104,383)	(138,200)	(18,287)	-	(2,871)	**(263,741)**
Transfers to Stage 1	-	20,671	328	-	-	**20,999**
Transfers to Stage 2	(20,671)	-	1,133	-	-	**(19,538)**
Transfers to Stage 3	(328)	(1,133)	-	-	-	**(1,461)**
Amounts recover	(67)	(24)	(14,754)	*(127)*	-	**(14,845)**
FX adjustments	11,855	1,571	1,460	*151*	-	**14,886**
Other adjustments	(63,139)	(12,263)	(32,032)	*(3,007)*	-	**(107,434)**
Balance at 31/12/2018	**749,851**	**107,877**	**55,741**	***14,466***	**7,284**	**920,753**

[1] purchased or originated credit-impaired assets

(21) Loans to customers at amortised cost and at fair value through profit or loss (continued)

(million HUF)

ECL allowance	Stage 1	Stage 2	Stage 3	*of which POCI assets*[(1)]	SPPI failed	Total
Balance at 31/12/2017	**(7,344)**	**(6,187)**	**(49,840)**	***(2,616)***	**-**	**(63,371)**
FTA	2,056	(2,437)	(285)	-	-	**(666)**
Increase	(3,002)	(933)	(9,806)	*540*	-	**(13,741)**
Decrease	2,651	3,323	10,635	-	-	**16,609**
Transfers to Stage 1	-	(102)	(69)	-	-	**(171)**
Transfers to Stage 2	102	-	(77)	-	-	**25**
Transfers to Stage 3	69	77	-	-	-	**146**
Amounts recover	78	26	22,152	-	-	**22,256**
FX adjustments	(163)	(187)	(943)	-	-	**(1,293)**
Other adjustments	(336)	(221)	(2,905)	*(1,972)*	-	**(3,462)**
Balance at 31/12/2018	**(5,889)**	**(6,641)**	**(31,138)**	***(4,048)***	**-**	**(43,668)**

[(1)] *purchased or originated credit-impaired assets*

Analysis of allowance for loan losses as at 31 December 2017

(million HUF)

	31/12/2017
Opening balance	116,404
Increase of allowance during the year	36,365
Decrease of allowance during the year	(55,698)
Write-off	(33,700)
Closing balance	**63,371**

(million HUF)

Allowance for loan losses comprise	**31/12/2017**
Individual allowance	49,918
Collective allowance	13,453
Total	**63,371**

The revaluation gains on loans specified as hedged items is presented in Note 23.

The liquidation value of collateral that the Bank holds relating to loans at 31 December 2018 amounts to HUF 864,589 million and HUF 852,332 million as at 31 December 2017, respectively.

(22) Financial investments

Financial assets measured at fair value through other comprehensive income comprises

(million HUF)

	Note	31/12/2018	31/12/2017
Government securities – HUF		281,286	242,324
of which included in cash and cash equivalents	*43*	*10,476*	-
Bank and corporate bonds – HUF		2,663	3,561
Shares listed on stock exchange – NON-HUF		1,699	1,745
Equity investment – HUF		84	23
Total		**285,732**	**247,653**

All of the financial assets measured at fair value through other comprehensive income are classified as Stage 1.

Financial assets measured at amortized cost / Debt securities

(million HUF)

	31/12/2018	31/12/2017
Bank and corporate bonds – HUF	46,408	28,906
Bank and corporate bonds – other currency	6,459	-
Total	**52,867**	**28,906**

All of the financial assets measured at amortized cost are classified as Stage 1.

(23) Hedging derivatives

Financial derivatives designated as fair value hedge: breakdown by hedged instrument

(million HUF)

31/12/2018	Positive fair value		Negative fair value	
	Fair value	Notional value	Fair value	Notional value
Interest rate derivatives - hedge of debt securities	656	81,175	1,167	83,030
Interest rate derivatives - hedge of loans	335	21,345	1,355	27,938
Interest rate derivatives - hedge of financial liabilities	849	36,205	246	24,108
Total	**1,840**	**138,725**	**2,768**	**135,076**

(million HUF)

31/12/2017	Positive fair value		Negative fair value	
	Fair value	Notional value	Fair value	Notional value
Interest rate derivatives - hedge of debt securities	-	-	3,424	149,400
Interest rate derivatives - hedge of loans	-	-	515	5,900
Interest rate derivatives - hedge of financial liabilities	1,151	39,476	94	16,862
Total	**1,151**	**39,476**	**4,033**	**172,162**

(23) Hedging derivatives (continued)

Accumulated change of fair value of hedged instruments

(million HUF)

	31/12/2018	31/12/2017
Debt securities	233	3,079
Loans	1,317	332
Financial liabilities	180	410

Accumulated amount of fair value hedge adjustment is included in the carrying amount in case of loans and financial liabilities. In case of debt securities the fair value adjustment is recognised in profit or loss.

(24) Repossessed properties

(million HUF)

Net book value	31/12/2018	31/12/2017
Opening balance	25,261	47,720
Additions	329	765
Sale	(11,134)	(21,669)
Reclassification	(2,560)	-
Net loss from impairment charges	(1,479)	(1,555)
Closing balance	**10,417**	**25,261**

(million HUF)

	Gross value		Impairment	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Building	12,091	24,585	(7,279)	(8,055)
Land	11,083	17,732	(5,478)	(9,001)
Total	**23,174**	**42,317**	**(12,757)**	**(17,056)**

Repossessed properties are located in several regions in Hungary. The closing balance includes HUF 6,656 million properties located in Budapest as at 31 December 2018, while it was HUF 9,684 million as at 31 December 2017.

(25) Property, plant and equipment

(million HUF)

	Land, premis-es	Lease-hold improve-ments	Elec-tronic equip-ment, office furniture	IT equip-ment	Motor vehicles	Other	Total
Cost							
Balance at 01/01/2017	**17.819**	**4,944**	**9,236**	**7,652**	**386**	**120**	**40,157**
Additions	90	49	234	163	-	-	**536**
Disposals	(26)	(210)	(187)	(37)	(23)	(2)	**(485)**
Other changes	2,270	-	-	-	-	-	**2,270**
Balance at 31/12/2017	**20,153**	**4,783**	**9,283**	**7,778**	**363**	**118**	**42,478**
Additions	91	20	292	241	-	-	**644**
Disposals	(260)	(422)	(879)	(219)	(106)	-	**(1,886)**
Other changes	-	-	-	-	-	-	**-**
Balance at 31/12/2018	**19,984**	**4,381**	**8,696**	**7,800**	**257**	**118**	**41,236**
Accumulated depreciation and impairment losses							
Balance at 01/01/2017	**6,035**	**4,279**	**8,442**	**7,226**	**263**	**-**	**26,245**
Depreciation for the year	289	278	282	240	24	-	**1,113**
Disposals	(33)	(210)	(186)	(35)	(18)	-	**(482)**
Balance at 31/12/2017	**6,291**	**4,347**	**8,538**	**7,431**	**269**	**-**	**26,876**
Depreciation for the year	338	197	170	219	19	-	**943**
Disposals	(44)	(422)	(960)	(217)	(85)	-	**(1,628)**
Balance at 31/12/2018	**6,585**	**4,122**	**7,848**	**7,433**	**203**	**118**	**26,191**
Net book value							
Balance at 31/12/2017	**13,862**	**436**	**745**	**347**	**94**	**118**	**15,602**
Balance at 31/12/2018	**13,399**	**259**	**848**	**367**	**54**	**118**	**15,045**

The other changes in the amount of land and premises is the fair value adjustments on the Bank’s the buildings. Impairment recognized on property, plant and equipment during 2017 on property, plant is HUF 120 million.

During 2018 there was no significant change regarding the fair value of the premises, accordingly no additional fair value adjustment was recognized.

Leasehold improvements include improvements on leased branches.

(26) Intangible asset

(million HUF)

	Software licenses and develop-ment	Other	Total
Cost			
Balance at 01/01/2017	**41,467**	**383**	**41,850**
Acquisition	3,978	-	**3,978**
Disposals	(758)	(1)	**(759)**
Other changes	-	-	**-**
Balance at 31/12/2017	**44,687**	**382**	**45,069**
Additions	4,345	-	**4,345**
Disposals	(20)	(54)	**(74)**
Other changes	-	-	**-**
Balance at 31/12/2018	**49,012**	**328**	**49,340**
Accumulated depreciation and impairment losses			
Balance at 01/01/2017	**33,380**	**292**	**33,672**
Depreciation for the year	2,521	14	**2,535**
Disposals	(758)	-	**(758)**
Other changes	-	-	**-**
Balance at 31/12/2017	**35,143**	**306**	**35,449**
Depreciation for the year	2,759	36	**2,795**
Disposals	(1)	(54)	**(55)**
Balance at 31/12/2018	**37,901**	**288**	**38,189**
Net book value			
Balance at 31/12/2017	**9,544**	**76**	**9,620**
Balance at 31/12/2018	**11,111**	**40**	**11,151**

The net book value of internally developed software is HUF 5,144 million as at 31 December 2018, and HUF 5,034 million as at 31 December 2017, respectively.

(27) Other assets

(million HUF)

	31/12/2018	31/12/2017
Accrued assets	2,328	1,778
Items in transit	291	190
Trade receivables	1,533	685
Inventories	262	351
Non-income tax receivables	1,783	3,881
Other items	8,215	3,550
Total	**14,412**	**10,235**

Other items include the balance of settlement accounts which contains those items in transit which are unsettled as at period end. As at 31 December, 2018 other items contains settlement account related to value date differences on branch account with an amount of HUF 4,899 million.

(28) Deposits from banks

(million HUF)

	31/12/2018	31/12/2017
Deposits from National Bank of Hungary	40,106	56,082
Deposits from other banks in Hungary	91,616	76,083
Deposits from banks in other countries	120,459	78,082
Total	**252,181**	**210,247**
of which related party items	*99,570*	*57,027*

(29) Deposits from customers

(million HUF)

	31/12/2018	31/12/2017
Deposits from customers in Hungary	1,325,475	1,163,984
Deposits from customers in other countries	36,933	27,771
Total	**1,362,408**	**1,191,755**
of which related party	*375*	*109*

The revaluation gains on deposits specified as hedged items is presented in Note 23.

(30) Securities issued

(million HUF)

	31/12/2018	31/12/2017
Gross amount of issued securities	-	5,008
Repurchased amount of issued securities	-	(2,911)
Accrued interest payable from the net amount of issued securities	-	512
Net amount of liabilities from issued securities	**-**	**2,609**

The result from repurchase of issued securities was HUF 8 million gain for the year 2018 and HUF 7 million gain for the year 2017, respectively.

(million HUF)

Issued securities listed on the Budapest Stock Exchange comprise the following set of securities	31/12/2018	31/12/2017
CIB 2018/B bonds were issued in HUF since 8 August 2013 and matured on 28 December 2018. The bonds pay fix interest of 30.0% at maturity.	-	2,601
CIB Kincsem bonds	-	8
Total	**-**	**2,609**

At the year-end 2018 the Group does not recognize any listed issued securities, because they matured.

The liability regarding CIB Kincsem bonds, not yet settled, is presented as other liability.

(31) Other liabilities

(million HUF)

	31/12/2018	31/12/2017
Accrued liabilities	6,204	5,299
Suppliers	3,957	2,824
Items in transit	283	193
Financial guarantees	253	538
Non-income tax liability	3,353	4,963
Deferred government grant	98	195
Other items	9,461	4,606
Total	**23,609**	**18,618**

The balance of other items contains those items in transit which are unsettled as at period end. As at 31 December 2018 other items contains settlement account related card account with an amount of HUF 3,907 million.

(million HUF)

Financial guarantees comprise	31/12/2018	31/12/2017
Opening balance	538	575
IFRS 9 first time adoption	(33)	-
Increase during the year	192	134
Decrease during the year	(444)	(171)
Closing balance	**253**	**538**

Concerning financial guarantees see Note 36 on Commitments and contingencies.

(32) Provision

(million HUF)

	Commit-ments and contingen-cies	Other	Total
Balance at 01/01/2017	**1,265**	**5,603**	**6,868**
Increase of provision during the year	1,116	5,749	**6,865**
Decrease of provision during the year	(1,038)	(2,133)	**(3,171)**
Balance at 31/12/2017	**1,343**	**9,219**	**10,562**
IFRS 9 first time adoption effect on loan commitment provision	(278)	-	**(278)**
Increase of provision during the year	852	3,927	**4,779**
Decrease of provision during the year	(637)	(1,838)	**(2,475)**
Balance at 31/12/2018	**1,280**	**11,308**	**12,588**

Provisions for commitment and contingences were created for future credit obligations (see also Note 36 on Commitments and contingencies). For all booked provisions, the Bank expects out-flows / payments in a period longer than 1 year from reporting date.

Other provision established to cover the Group's 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.

Other provision includes litigation provision with an amount of HUF 8,260 million as of 31 December 2018 and HUF 5,781 million as of 31 December 2017, respectively.

Other provision includes the Group's future obligations relating to rationalising the branch network.

Other provisions include provision on personal type expenses based on our best available estimation.

The discount effect on provisions is not material.

Majority of the decrease of other provision means utilizing provision recognised in current and previous periods.

(33) Subordinated debt

(million HUF)

	31/12/2018	31/12/2017
From Intesa Bank Ireland plc. for 30 million EUR. The debt's expiry date is 26 November 2021 with interest payable at 3 months EURIBOR plus 0.37%.	9,652	9,311
Total	**9,652**	**9,311**

In the event of the winding-up of the issuer, the above liabilities would be subordinated to the claims of depositors and all other creditors of the issuer.

(34) Share capital

During 2018 there was no change regarding the share capital.

During 2017 Intesa Sanpaolo S.p.A. increased the share capital of the Bank with HUF 1 issuing 1 pieces of ordinary share of HUF 1. There were no significant incremental costs directly attributable to the issue of shares.

At 31 December 2018 the fully paid share capital consisted of 50,000,000,003 ordinary shares of HUF 1 each.

At 31 December 2017 the fully paid share capital consisted of 50,000,000,003 ordinary shares of HUF 1 each.

(35) Reserves

Capital reserve

Capital reserve contains the shareholders total capital contributions that connecting to the issue of new shares.

In the first half of 2018, the negative retained earnings of the Bank was reclassified to capital reserve, with an amount of HUF 46,103 million.

During December of 2018, the negative retained earnings of the Recovery was reclassified to capital reserve, with an amount of HUF 80,700 million.

In the first half of 2017 Intesa Sanpaolo S.p.A. issued new shares for the Bank by HUF 15,000 million. HUF 1 was recorded as share capital increase, the difference between the face value of the new shares and the paid in capital contribution is recognized in the capital reserve.

During 2017, according to the Hungarian Accounting Law, reclassification of HUF 265,891 million was made between retained earnings and capital reserve upon CIB Factor merge into the Bank.

Revaluation reserve

Revaluation reserve comprises the cumulative net change in the fair value of available-for-sale financial assets, until the assets are derecognised or impaired.

Furthermore, the revaluation reserve comprises the cumulative, positive change in fair value of those tangible asset for which the revaluation model is applied, until the assets are derecognized or the change in fair value becomes negative.

Other reserve

Other reserve comprised the additional payment by shareholders to cover financial losses in the amount of HUF 36,000 million as at 31 December 2013. The Bank reclassified the additional payment made by the shareholder from equity to liabilities in 31 March 2017. During May 2017 the entire amount of the additional payment made by the shareholder was repaid.

Other reserve comprises the Bank's income from transaction under common control in the amount of HUF 4,164 million. Income from transaction under common control contains the income from the sale of CIB Investment Fund Ltd during 2013.

In addition to the above other reserve includes proceed received on sale of loan portfolio to the shareholder in amount of HUF 49,137 million. This equity contribution increased the other reserves during 2014.

General reserve

Under section 83 of Act No. CCXXXVII of 2013, an amount equal to 10% of net profit after tax must be transferred to a non-distributable general reserve from the retained earnings. If there is a loss in the current financial year, the general reserve may be released insofar as to cover any such losses, but is not to exceed the amount set aside in the general reserve.

Reserves classified as capital reserve, revaluation reserve, other reserve and general reserve can not be paid as dividend.

(35) Reserves (continued)

Reserves classified as capital reserve, revaluation reserve, other reserve and general reserve can not be paid as dividend. The Group expects not to recognise any adjustment in the opening balance of retained earnings as the cumulative effect of adopting IFRS 16.

(36) Commitments and contingencies

Letters of credit, guarantees (including standby letters of credit) commit the Group to make payments on behalf of customer's contingent upon the failure of the customers to perform under the terms of contract. Guarantees and standby letters of credit carry the same credit risk as loans. Credit guarantees can be in the form of bills of exchange or in the form of irrevocable letters of credit, guarantees, and endorsement liabilities from bills rediscounted.

Commitment to extend credit represents contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses.

The amount of long term financial guarantees and commitments with a remaining maturity over one year is HUF 22,862 million as at 31 December 2018 and HUF 12,218 million as at 31 December 2017, respectively.

The amount of the securities in custody is HUF 1,063,431 million at 31 December 2018 and HUF 985,427 million at 31 December 2017, respectively.

(million HUF)

31/12/2018	Gross amount	Other liability	Provision
Guarantees	37,825	(243)	-
Letters of credit	5,605	(9)	-
Total financial guarantees	**43,430**	**(252)**	**-**
Commitments	399,848	-	(1,280)
Total	**443,278**	**(252)**	**(1,280)**

(million HUF)

31/12/2017	Gross amount	Other liability	Provision
Guarantees	30,871	(527)	-
Letters of credit	4,738	(11)	-
Total financial guarantees	**35,609**	**(538)**	**-**
Commitments	375,940	-	(1,344)
Total	**411,549**	**(538)**	**(1,344)**

The following tables set out information about the gross carrying amount and the corresponding ECLs in relation to financial guarantees and commitments

(million HUF)

Outstanding exposure	Stage 1	Stage 2	Stage 3	Total
Balance at 31/12/2017	**407,006**	**3,209**	**1,335**	**411,550**
FTA	-	-	-	**-**
Increase	1,329,737	88,187	8,648	**1,426,572**
Decrease	(1,285,129)	(91,540)	(9,701)	**(1,386,370)**
Transfers to Stage 1	-	3,537	171	**3,708**
Transfers to Stage 2	(3,537)	-	50	**(3,487)**
Transfers to Stage 3	(171)	(50)	-	**(221)**
Amounts written off	-	-	-	**-**
Other adjustments	(8,354)	(117)	(3)	**(8,474)**
Balance at 31/12/2018	**439,552**	**3,226**	**500**	**443,278**

(36) Commitments and contingencies (continued)

(million HUF)

ECLs	Stage 1	Stage 2	Stage 3	Total
Balance at 31/12/2017	**(1,165)**	**(140)**	**(577)**	**(1,882)**
FTA	298	2	12	**312**
Increase	(687)	(7)	(311)	**(1,005)**
Decrease	463	93	487	**1,043**
Transfers to Stage 1	-	1	2	**3**
Transfers to Stage 2	(2)	-	1	**(1)**
Transfers to Stage 3	(1)	1	-	**-**
Amounts written off	-	-	-	**-**
Other adjustment	(2)	(1)	-	**(3)**
Balance at 31/12/2018	**(1,096)**	**(51)**	**(386)**	**(1,533)**

(37.a) Carrying amount of financial assets and liabilities at 31 December 2018 by earlier of contractual repricing or maturity date

(million HUF)

	Current	Under 1 month	From 1 to 3 months	3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest sensitive	Total
Assets								
Cash and current accounts with central bank	25,762	-	-	-	-	-	21,346	**47,108**
Effective interest rates	*0.90*	-	-	-	-	-	-	***0.49***
Securities held for trading	-	1,044	2,069	20,840	226	141	365	**24,685**
Effective interest rates	-	*0.82*	*0.13*	*0.07*	*1.41*	*3.11*	-	***0.13***
Derivative financial assets	-	4,688	5,082	6,952	597	-	-	**17,319**
Financial assets measured at fair value through OCI	-	49,566	46,607	33,640	138,901	15,235	1,783	**285,732**
Effective interest rates	-	*1.70*	*1.15*	*0.11*	*1.23*	*2.44*	-	***1.22***
Loans to banks	17,023	447,630	78,702	1,000	-	-	-	**544,355**
Effective interest rates	-	*0.08*	*0.40*	-	-	-	-	***0.12***
Loans to customers at amortised cost and at fair value through profit or loss (including portfolio hedge adjustment)	44,260	286,112	244,308	185,074	79,502	39,145	-	**878,401**
Effective interest rates	*3.95*	*1.77*	*2.18*	*3.39*	*2.80*	*3.68*	-	***2.51***
Debt securities at amortised cost	-	46,408	-	-	-	6,459	-	**52,867**
Effective interest rates	-	*2.31*	-	-	-	*6.90*	-	***2.87***
Liabilities								
Deposits from banks	1,749	165,363	9,499	19,367	44,437	11,766	-	**252,181**
Effective interest rates	-	*0.45*	*0.14*	*0.12*	*0.16*	*0.02*	-	***0.34***
Deposits from customers	1,049,502	18,111	33,353	55,717	175,733	29,992	-	**1,362,408**
Effective interest rates	-	*0.28*	*1.26*	*1.02*	*1.23*	-	-	***0.23***
Derivative financial liabilities	-	1,972	3,848	5,931	505	-	-	**12,256**
Subordinated debts	-	-	-	9,652	-	-	-	**9,652**
Effective interest rates	-	-	-	*0.71*	-	-	-	***0.71***
Net repricing gap	**(946,206)**	**650,002**	**330,068**	**156,839**	**(1,449)**	**19,222**	**23,494**	**213,970**

(37.b) Carrying amount of financial assets and liabilities at 31 December 2017 by earlier of contractual repricing or maturity date

(million HUF)

	Current	Under 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest sensitive	Total
Assets								
Cash and current accounts with central bank	25,374	-	-	-	-	-	13,502	**38,876**
Effective interest rates	*0.90*	-	-	-	-	-	-	***0.59***
Financial assets measured at amortised cost / Loans to banks	9,942	429,468	20,326	-	-	-	-	**459,736**
Effective interest rates	-	*(0.15)*	*(0.06)*	-	-	-	-	***(0.14)***
Financial assets measured at amortised cost / Securities held for trading	-	14,050	40,759	8,001	540	171	196	**63,717**
Effective interest rates	-	*0.00*	*0.00*	*0.03*	*1.39*	*3.00*	-	***0.02***
Derivative financial assets	-	3,287	7,061	8,030	1,227	-	-	**19,605**
Financial assets measured at amortised cost / Loans to customers	42,648	264,639	194,244	157,389	69,906	33,775	-	**762,601**
Effective interest rates	*3.93*	*1.37*	*1.73*	*3.04*	*2.31*	*3.32*	-	***2.21***
Financial assets measured at fair value through other comprehensive income	-	-	10,254	24,550	211,080	-	1,746	**247,630**
Effective interest rates	-	-	*0.23*	*0.33*	*0.44*	-	-	***0.42***
Financial assets measured at amortised cost / Debt securities	-	-	-	-	28,906	-	-	**28,906**
Liabilities								
Financial liabilities measured at amortized cost / Deposits from banks	852	106,574	10,998	18,838	56,495	16,490	-	**210,247**
Effective interest rates	-	*0.22*	*0.13*	*0.32*	*0.13*	*0.01*	-	***0.18***
Derivative financial liabilities	-	3,586	5,872	9,913	1,219	-	-	**20,590**
Financial liabilities measured at amortized cost /Deposits from customers	873,612	32,963	40,822	62,114	180,058	2,186	-	**1,191,755**
Effective interest rates	-	*0.37*	*0.61*	*1.43*	*1.37*	-	-	***0.31***
Financial liabilities measured at amortized cost / Securities issued	-	8	-	2,601	-	-	-	**2,609**
Effective interest rates	-	-	-	*1.38*	-	-	-	***1.37***
Subordinated debts	-	-	-	9,311	-	-	-	**9,311**
Effective interest rates	-	-	-	*0.70*	-	-	-	***0.70***
Net repricing gap	**(796,500)**	**568,313**	**214,952**	**95,193**	**73,887**	**15,270**	**15,444**	**186,559**

(38.a) Carrying amount of assets and liabilities by maturity date as at 31 December 2018

(million HUF)

	Under 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and current accounts with banks [1]	47,108	-	-	-	-	**47,108**
Securities held for trading	980	1,657	20,846	972	230	**24,685**
Trading and hedging derivatives	3,788	1,416	2,281	4,106	5,728	**17,319**
Financial assets measured at fair value through OCI	9,320	2,855	42,974	212,601	17,982	**285,732**
Loans to banks	349,550	28,861	115,968	49,976	-	**544,355**
Loans to customers at amortised cost and at fair value through profit or loss [2]	76,975	65,555	176,685	350,214	208,972	**878,401**
Debt securities at amortised cost	-	-	-	-	52,867	**52,867**
Intangible assets, property, plant and equipment, repossessed properties	-	-	-	36,613	-	**36,613**
Tax assets	-	-	-	821	-	**821**
Non-current asset held for sale	-	-	2,768	-	-	**2,768**
Other assets	2,328	-	429	11,655	-	**14,412**
Total assets	**490,049**	**100,344**	**361,951**	**666,958**	**285,779**	**1,905,081**
Liabilities						
Deposits from banks	9,441	4,425	21,989	196,258	20,068	**252,181**
Deposits from customers	1,067,221	32,997	56,059	176,086	30,045	**1,362,408**
Trading and hedging derivatives	547	2,042	2,190	2,741	4,736	**12,256**
Tax liabilities	-	-	-	300	-	**300**
Other liabilities	6,204	-	283	17,122	-	**23,609**
Provisions for risk and charges	-	-	-	12,588	-	**12,588**
Subordinated debts	-	-	7	9,645	-	**9,652**
Total liabilities	**1,083,413**	**39,464**	**80,528**	**414,740**	**54,849**	**1,672,994**
Net position	**(593,364)**	**60,880**	**281,423**	**252,218**	**230,930**	**232,087**

[1] The balance comprises restricted deposits, as the Bank is required to maintain a compulsory reserve set by the National Bank of Hungary, please refer to Note (18).

[2] Including portfolio hedge adjustment

(38.b) Carrying amount of assets and liabilities by maturity date as at 31 December 2017

(million HUF)

	Under 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and current accounts with banks [(1)]	38,876	-	-	-	-	**38,876**
Loans to banks	392,543	20,672	46,521	-	-	**459,736**
Financial assets at fair value through profit or loss	4,759	21,803	36,417	377	361	**63,717**
Derivative financial assets	4,184	3,242	2,823	6,352	3,004	**19,605**
Loans to customers	68,776	51,427	118,304	317,219	206,875	**762,601**
Financial investments – Available-for-sale	1,746	-	34,803	211,081	23	**247,653**
Financial investments – Held-to-maturity	-	-	-	28,906	-	**28,906**
Investment in subsidiaries	-	-	339	-	-	**339**
Tax assets	-	-	-	1,079	-	**1,079**
Other assets	1,778	-	236	8,221	-	**10,235**
Intangible assets, property, plant and equipment	-	-	-	50,483	-	**50,483**
Total assets	**512,662**	**97,144**	**239,443**	**623,718**	**210,263**	**1,683,230**
Liabilities						
Deposits from banks	8,919	4,721	20,314	148,244	28,049	**210,247**
Derivative financial liabilities	4,154	2,460	1,855	8,707	3,414	**20,590**
Deposits from customers	906,000	40,014	62,929	180,592	2,220	**1,191,755**
Securities issued	-	-	2,609	-	-	**2,609**
Tax liabilities	-	-	-	331	-	**331**
Other liabilities	5,300	-	193	13,125	-	**18,618**
Provisions for risk and charges	-	-	-	10,562	-	**10,562**
Subordinated debts	-	-	6	9,305	-	**9,311**
Total liabilities	**924,373**	**47,195**	**87,906**	**370,866**	**33,683**	**1,464,023**
Net position	**(411,711)**	**49,949**	**151,537**	**252,852**	**176,580**	**219,207**

[(1)] The balance comprises restricted deposits, as the Bank is required to maintain a compulsory reserve set by the National Bank of Hungary, please refer to Note (18).

(39) Analysis of financial liabilities' gross contractual cash flows by remaining contractual maturities

The following table summarize the maturity profile the Bank's financial liabilities' gross contractual cash flows – together with future interest income - as at 31 December 2018 and 2017. Repayments which are not subject to notice are treated as if notice were to be given immediately.

Carrying amount of the undiscounted financial liabilities is disclosed in the Note 38.

(million HUF)

31/12/2018	Under 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Deposits from banks	9,487	4,559	22,589	197,947	20,165	**254,747**
Deposits from customers	1,067,254	33,294	57,941	177,027	30,045	**1,365,561**
Trading and hedging financial derivative instruments	547	2,041	2,190	2,741	4,736	**12,255**
Subordinated debts	-	-	71	9,788	-	**9,859**
Financial guarantees	3,888	8,532	15,656	9,810	5,545	**43,431**
Total undiscounted financial liabilities	**1,081,176**	**48,426**	**98,447**	**397,313**	**60,491**	**1,685,853**

(million HUF)

31/12/2017	Under 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Deposits from banks	8,938	4,785	20,598	149,000	28,273	**211,594**
Derivative financial liabilities	4,154	2,460	1,855	8,707	3,414	**20,590**
Deposits from customers	906,033	40,211	64,661	182,574	2,220	**1,195,699**
Securities issued	-	-	2,609	-	-	**2,609**
Subordinated debts	-	-	66	9,502	-	**9,568**
Financial guarantees	3,503	6,690	14,076	7,554	3,786	**35,609**
Total undiscounted financial liabilities	**922,628**	**54,146**	**103,865**	**357,337**	**37,693**	**1,475,669**

Part D Additional information

(40) Related party transactions

Companies (Intesa Sanpaolo Group)

For the purpose of the consolidated financial statements, related parties include all the enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with the reporting enterprise (this includes parents, subsidiaries and fellow subsidiaries), associated companies and key management personnel.

Intesa Sanpaolo S.p.A /Italy, Torino/ (ultimate parent) is regarded as a related party that has significant control over the Group.

The Group also has entered into several transactions with companies controlled by Intesa Sanpaolo Group.

The most significant transactions with related parties are loan deposits and derivatives (foreign exchange swap deals and interest rate swap transactions).

(million HUF)

	31/12/2018			31/12/2017		
	Parent	ISP Group Compa-nies	Total	Parent	ISP Group Compa-nies	Total
Assets						
Due from banks and due from customers	244,306	50,418	**294,724**	114,891	12,636	**127,527**
Financial investments	276	-	**276**	398	-	**398**
Derivative financial assets	293	9,064	**9,357**	330	9,398	**9,728**
Other assets	-	16	**16**	-	152	**152**
Liabilities						
Due to banks and due to customers	97,420	2,525	**99,945**	55,254	1,882	**57,136**
Subordinated debts	-	9,652	**9,652**	-	9,311	**9,311**
Derivative financial liabilities	64	7,158	**7,222**	151	10,662	**10,813**
Commitments						
Guarantees	-	2,432	**2,432**	-	84	**84**
Loan commitments	59,994	22,505	**82,499**	60,000	2	**60,002**
Interest rate derivatives	4,000	1,885,685	**1,889,685**	4,000	889,890	**893,890**
Currency derivatives	58,192	-	**58,192**	65,406	326	**65,732**
Equity derivatives	-	29,507	**29,507**	-	42,628	**42,628**
Net interest income/(expense)	**(482)**	**(1,388)**	**(1,870)**	**(843)**	**(630)**	**(1,473)**
Other operating income/(expense)	**75**	**56**	**131**	**-**	**58**	**58**
Operating expense	**5**	**(353)**	**(348)**	**-**	**25**	**25**

All transaction with companies in the Intesa Sanpaolo Group are priced on an arm's length basis and are to be settled in cash. None of the transactions is secured. No provision and allowance has been recognized for the year 2017 regarding the related party transactions.

Key management personnel

The key management personnel, who have authority and responsibility for planning, directing and controlling the activities of the entity, are the members of the Bank's Management Board and Supervisory Board. They receive conditions generally provided to the employees of the CIB Group.

(40) Related party transactions (continued)

(million HUF)

Exposures to / from Boards members	31/12/2018	31/12/2017
Assets		
Loans	63	69
Equity instruments	79	69
Liabilities		
Current accounts and deposits	141	222
Commitments		
Loans and overdraft facilities not disbursed	1	5
Compensation		
Salaries and other short-term benefits including contribution paid on compensation	878	939

There is no termination benefit or other long-term employee benefit in place.

There were changes in the Bank's key management members during 2018 and 2017.

(41) Average balances

Averages carrying amounts and average interest rates (where appropriate) are set out in the table below. The amounts are calculated by using a simple average of daily balances for trading instruments and monthly balances for other instruments. The average interest rates disclosed are the weighted average effective yields of interest-bearing financial instruments for the reporting period.

(million HUF)

31/12/2018	Average carrying amount	Average interest rate (%)
Financial assets		
Cash	12,836	0.00
Securities held for trading	69,794	0.77
Financial assets measured at fair value through OCI	303,551	0.94
Loans to banks	491,459	(0.11)
Loans to customers measured at amortised cost and at fair value through profit or loss	822,359	2.82
Debt securities measured at amortised cost	39,105	1.25
Financial liabilities		
Deposits from banks	251,183	0.30
Deposits from customers	1,282,059	0.30
Securities issued	2,616	4.38
Subordinated debts	9,584	0.71

(41) Average balances (continued)

(million HUF)

31/12/2017	Average carrying amount	Average interest rate (%)
Financial assets		
Cash	9,415	0.00
Loans to banks	427,398	(0.11)
Financial assets measured at fair value through profit or loss	57,522	1.32
Loans to customers	758,674	3.13
Financial investments – Available for sale	239,898	1.16
Financial investments – Held to maturity	26,420	0.62
Financial liabilities		
Deposits from banks	206,399	0.23
Deposits from customers	1,134,601	0.38
Securities issued	5,086	2.82
Subordinated debts	9,289	0.80

(42) Fair value of financial assets and liabilities

The following tables comprise the book value and the fair value of those financial assets and liabilities, which are not presented at fair value in the consolidated statement of financial position.

(million HUF)

31/12/2018	Variable rate instruments		Fix rate instruments	
	Book value	Fair value	Book value	Fair value
Financial assets				
Loans to banks	167,193	164,750	377,162	377,379
Loans to customers	706,968	718,286	162,833	161,564
Debt securities at amortised cost	52,867	51,713	-	-
Financial liabilities				
Deposits from banks	174,110	176,864	78,071	77,072
Deposits from customers	1,050,456	1,050,457	311,952	308,420
Subordinated debts	9,652	9,928	-	-

(million HUF)

31/12/2017	Variable rate instruments		Fix rate instruments	
	Book value	Fair value	Book value	Fair value
Financial assets				
Loans to banks	58,008	58,228	401,728	401,708
Loans to customers	613,487	621,916	149,114	149,582
Financial investments – Held to maturity	28,906	29,253	-	-
Financial liabilities				
Deposits from banks	128,326	129,828	81,921	80,432
Deposits from customers	1,071,171	1,071,574	120,584	124,858
Securities issued	-	-	2,609	2,184
Subordinated debts	9,311	9,676	-	-

(42) Fair value of financial assets and liabilities (continued)

The methods of the fair value calculations are detailed in the following paragraphs.

The estimated fair value of loans to banks and loans to customers is based on the discounted amount of the estimated future cash flows.

In the case of debt securities at amortised cost and liabilities from issued securities are measured with the actual market price or by applying broker price quotations.

Deposits from banks and customers have been estimated using discounted cash flows.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: inputs that are quoted marked prices (unadjusted) in active markets for identical instruments.
- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly or indirectly.
- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. Unobservable input is used for instruments with conditions not closely connected to active markets. Unobservable input data for determining fair value of level 3 instruments is the credit adjusted discount rate is between 0% and 17%. (for intercompany exposures 0% is applied)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

(million HUF)

31/12/2018	Level 1	Level 2	Level 3	Total
Financial assets				
Securities held for trading	24,684	1	-	**24,685**
Trading derivative financial instruments	-	15,479	-	**15,479**
Financial assets measured at fair value through OCI	283,949	1,783	-	**285,732**
Hedging derivative financial instruments	-	1,840	-	**1,840**
Financial liabilities				
Trading derivative financial instruments	-	9,488	-	**9,488**
Hedging derivative financial instruments	-	2,768	-	**2,768**

(million HUF)

31/12/2017	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	-	19,605	-	**19,605**
Financial assets measured at fair value through profit or loss	63,716	1	-	**63,717**
Financial instruments – Available for sale	246,283	1,348	-	**247,631**
Financial liabilities				
Derivative financial instruments	-	20,590	-	**20,590**

During the reporting period ending 31 December 2018 and 2017 there were no transfers between Level 1 and Level 2 fair value measurements or any transfers into Level 3 fair value measurement.

(42) Fair value of financial assets and liabilities (continued)

The following table shows an analysis of financial instruments not measured at fair value by level of the fair value hierarchy:

(million HUF)

31/12/2018	Level 1	Level 2	Level 3	Total fair value	Total book value
Financial assets					
Cash and current account with central banks	47,108	-	-	**47,108**	**47,108**
Loans to banks	-	-	542,129	**542,129**	**544,355**
Loans to customers at amortised cost			879,850	**879,850**	**869,801**
Debt securities at amortised cost	57,713	-	-	**57,713**	**52,867**
Financial liabilities					
Deposits from banks	-	-	253,936	**253,936**	**252,181**
Deposits from customers	-	-	1,358,877	**1,358,877**	**1,362,408**
Subordinated debts	-	-	9,928	**9,928**	**9,652**

(million HUF)

31/12/2017	Level 1	Level 2	Level 3	Total fair value	Total book value
Financial assets					
Cash and current account with central banks	38,876	-	-	**38,876**	**38,876**
Loans to banks	-	-	459,936	**459,936**	**459,736**
Loans to customers	-	-	771,498	**771,498**	**762,601**
Debt securities at amortised cost	29,253	-	-	**29,253**	**28,906**
Financial liabilities					
Deposits from banks	-	-	210,261	**210,261**	**210,247**
Deposits from customers	-	-	1,196,432	**1,196,432**	**1,191,755**
Securities issued	-	2,184	-	**2,184**	**2,609**
Subordinated debts	-	-	9,676	**9,676**	**9,311**

Where available, the fair value of loans and advances is based on observable market transactions. Where observable market transactions are not available, fair value is estimated using valuation models, such as discounted cash flow techniques. The fair value of deposits from banks and customers is estimated using discounted cash flow techniques. The fair value of deposits on demand is the amount payable at the reporting date.

(43) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalent comprises the following balances with less than three months maturity from the date of acquisition.

(million HUF)

	Note	31/12/2018	31/12/2017
Cash and cash equivalents	18	47,108	38,876
Loans to banks	20	356,922	396,984
Financial assets measured at fair value through profit or loss	19	200	2,000
Financial assets at fair value through other comprehensive income	22	10,476	-
Total		**414,706**	**437,860**

(44) Business combinations

There was no business combination in 2018 nor in 2017.

(45) Events after the reporting period

There no adjusting or non-adjusting event after the reporting period.

E. Information on risks

(46) Risk management

Risk is inherent in the Group's activities, but it is carefully managed through a process of ongoing identification, measurement and monitoring, subject to prudent risk limits and strong control. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities.

The most significant risks to which the Group is exposed are credit-, operational-, liquidity- and market risk, including interest rate, foreign exchange risks and other price risk.

The Management Board of the Bank, within the rules as established by the National Bank of Hungary and Intesa Sanpaolo S.p.A, sets risk management policies. The Management Committees of the Group implement the execution of these policies. Besides to the Management Committees, an independent Risk Assumption and Risk Management Committee has been established according to the legislative requirements in order to further strengthening the risk control.

Credit policies department within the Chief Risk Officer area is responsible for implementing and maintaining risk related procedures to ensure an independent control process. Bank Treasury is responsible for managing the Group's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and manages daily liquidity of the Bank. Activity of Treasury is supervised on a daily basis by the Market Risk Department and strategic Asset-Liability Management decisions are made by Assets and Liabilities Committee.

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal audit discusses the results of all assessments with management. Risk management framework is also comprehensively examined yearly by the National Bank of Hungary in the course of the Supervisory Review and Evaluation Process.

The Group has established reporting systems, which permit the continuous monitoring of risk exposures. The risks are measured and quantified according to different methods, both statistical and non-statistical. Each method is based on different levels of uncertainty. The combination of methods makes it possible for the Group to assess the behaviour of its exposure in different risk scenarios in order to capture all the aspects of the risk. This reflects both the expected loss likely to arise in normal circumstances and unexpected loss, which is an estimate of the ultimate actual loss based on statistical models.

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and any exposures arising from forecasted transactions. The Group actively uses collaterals to reduce its credit risks.

(a) Credit risk

Credit risk is the risk that a customer or counter party will be unable or unwilling to meet a commitment that they have entered into with the Group. It arises from lending, trade finance, treasury and other activities undertaken by the Group. Credit risk on loans and receivables is managed by the Management Board through the Credit Committee, the Credit Risk Governance Committee and the Problem Asset Committee, which establish credit regulations including the approval processes, discretionary credit limits, standards for the measurement of credit exposures, risk ratings of clients and assessments of management quality and financial performance.

Each significant outstanding loan is reviewed at least monthly. Loans are classified based on a point rating system, which incorporates qualitative and quantitative factors.

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the Statement of Financial Position. Credit risk on trading instruments is managed by the Management Board through the Assets and Liabilities Committee. The Group maintains strict control on open net positions, i.e. the difference between purchase and sale contracts, by both amount and term.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The table below shows the maximum exposure (gross carrying amount without any impairment losses) to credit risk. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

(46) Risk management (continued)

(million HUF)

31/12/2018	Maximum exposure	Maximum exposure to credit risk
Cash and current account with central banks	47,129	47,108
Securities held for trading	24,685	24,685
Trading derivatives	15,479	15,479
Financial assets measured at fair value through OCI	285,732	285,732
Loans to banks	544,709	544,355
Loans to customers at amortised cost and at fair value through profit or loss	920,753	877,086
Debt securities measured at amortised cost	53,114	52,867
Hedging derivatives	1,840	1,840
Other assets	12,313	11,531
Financial guarantees	43,430	43,178
Commitments	399,848	398,568
Total maximum exposure	**2,349,032**	**2,302,429**

(million HUF)

31/12/2017	Maximum exposure	Maximum exposure to credit risk
Cash and current account with central banks	38,879	38,876
Loans to banks	459,782	459,736
Financial assets measured at fair value through profit or loss	63,717	63,717
Derivative financial assets	19,605	19,605
Loans to customers	825,972	791,630
Financial investments – Available for sale	247,630	247,630
Financial investments – Held to maturity	28,906	28,906
Other assets	9,647	7,916
Financial guarantees	35,609	35,071
Commitments	375,940	374,596
Total maximum exposure	**2,105,687**	**2,067,683**

The fair values of derivatives shown on the statement of financial position represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of the change in values.

The Group's loans and advances to customers before taking into account any collateral held or other credit enhancement can be analysed by the following geographical regions:

(million HUF)

	31/12/2018	31/12/2017
Hungary	822,165	784,679
Euro Zone countries	28,041	23,847
of which PIGS countries [1]	*173*	*194*
EU - non-Euro Zone countries	69,865	16,759
Other regions	682	687
Total	**920,753**	**825,972**

[1] *PIGS' countries include the followings: Greece, Portugal, Ireland and Spain.*

(46) Risk management (continued)

An industry sector analysis of the Group's financial assets, before taking into account collateral held or other credit enhancements is provided in Note 21.

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For securities lending and reverse repurchase transactions, cash or securities;
- For commercial lending, mortgage pledges over real estate properties, inventory and trade receivables;

The Group also obtains guarantees from parent companies for loans to their subsidiaries. The Group monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Effect of Credit Risk Mitigation on the exposure to credit risk:

(million HUF)

	31/12/2018	31/12/2017
Financial collateral	(37,887)	(22,750)
Guarantees	(53,186)	(60,044)
Total	**(91,073)**	**(82,794)**

The Group assesses the loans with internal rating system, which differentiates the quality of non-overdue loans. The table below shows the credit quality of the loans and advances to customers excluding allowances based on the Group's credit rating system.

(million HUF)

Gross carrying amount 31/12/2018	Stage 1 Collec-tive	Stage 2 Collec-tive	Stage 3 Indi-vidual	Stage 3 Collec-tive	*of which POCI assets[(1)]*	SPPI failed	Total
Performing loans							
A – Excellent	47,517	10,545	-	-	-	135	**58,197**
B – Stable	203,214	8,558	-	-	*282*	2,604	**214,376**
C – Acceptable	406,867	36,028	-	-	*1,663*	3,703	**446,598**
D – High Risk	86,915	48,942	-	-	*1,672*	743	**136,600**
Other	5,341	3,804	-	-	*2,196*	100	**9,245**
Total performing loans	**749,854**	**107,877**	**-**	**-**	***5,813***	**7,285**	**865,016**
Non-performing loans							
Corporate loans	-	-	27,468	4,956	*2,888*	-	**32,424**
Retail loan	-	-	924	22,389	*5,260*	-	**23,313**
Total non-performing loans	**-**	**-**	**28,392**	**27,345**	***8,148***	**-**	**55,737**

(1) purchased or originated credit-impaired assets

(46) Risk management (continued)

(million HUF)

	31/12/2018	31/12/2017
Performing loans		
A – Excellent	58,197	86,673
B – Stable	214,376	156,660
C – Acceptable	446,598	347,923
D – High Risk	136,600	136,337
Other	9,245	8,905
Total performing loans	**865,016**	**736,498**
Non-performing loans		
Corporate loans	32,424	61,048
Retail loan	23,313	28,426
Total non-performing loans	**55,737**	**89,474**

The „Other" rating refers to clients, which were assessed with not the latest, but a previous rating model.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. These facilitates focused on management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The attributable risk ratings are assessed and updated regularly.

The Group does not recognize any credit risk in relation with held to collect or sell, as the majority of the held to collect or sell portfolio consisted of government bonds.

Thanks to portfolio cleaning efforts the credit quality of the portfolio started to improve in the previous periods and the positive tendency reflected in declining NPL volumes and improving cost of risk.

The table below shows the credit quality of the due from banks portfolio, based on the external rating system.

(million HUF)

	AAA/ AA-	A+/ A-	BBB+/ BBB-	BB+/ BB-	B+/ B-	Less than B-	Not rated	Total
31/12/2018	396	22,834	272,043	66	315	-	248,701	**544,355**
31/12/2017	227	3,550	443,526	5,172	1,501	-	5,760	**459,736**

The table below shows the aging analysis of past due but not individually impaired loans by segment.

(million HUF)

31/12/2018	Under 1 month	31 to 60 days	61 to 90 days	Over 91 days	Total
Corporate loans	3,150	451	145	83	**3,829**
Retail loan	9,668	1,013	250	183	**11,114**
Total	**12,818**	**1,464**	**395**	**266**	**14,943**

(million HUF)

31/12/2017	Under 1 month	31 to 60 days	61 to 90 days	Over 91 days	Total
Corporate loans	7,684	578	93	236	**8,591**
Retail loan	14,220	1,684	602	205	**16,711**
Total	**21,904**	**2,262**	**695**	**441**	**25,302**

Of the total aggregate amount of gross past due but not individually impaired loans and advances to customers, the liquidation value of collateral that the Group held as at 31 December 2018 HUF 14,941 million and 17,176 million as at 31 December 2017.

(46) Risk management (continued)

The Group addresses impairment into two types: individually assessed allowances and collectively assessed allowances.

The following table shows the credit quality of the non-performing loans and advances to customers based on the Group's rules:

(million HUF)

	31/12/2018	31/12/2017
Doubtful loans	**4,574**	**8,873**
Individually assessed	1,770	1,651
Collectively assessed	2,804	7,222
Unlikely to pay loans	**19,858**	**30,571**
Individually assessed	11,410	23,225
Collectively assessed	8,448	7,346
Past due loans	**168**	**112**
Individually assessed	-	-
Collectively assessed	168	112
Total	**24,600**	**39,556**

The Group determines the impairment for each individually significant credit risk exposure on an individual basis. Items considered when determining impairment include for example the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, its ability to recover outstanding amounts, the availability of other financial support and the realisable value of collateral.

Collectively assessed allowances are assessed for credit risk exposures that are not individually significant. Impairment losses are estimated by taking into consideration historical losses on the portfolio.

Collective allowances are calculated based on the PD and LGD parameters of the client, which are modelled within the IFRS9 framework.

Counterparty credit risk of derivatives is calculated on a counterparty basis over the entire life of the exposure.

(b) Liquidity risk

Liquidity risk is defined as the risk that the Group will not be able to meet its payment obligations due to its inability to obtain funds on the market (funding liquidity risk) or to liquidate its assets (market liquidity risk).

The Management Board is responsible for maintaining a level of liquidity and the definition of control policies and management processes relating to the specific risk profile. Financial Risk Committee monitors the implementation of the Liquidity Policy of the Bank and delegates day-to-day activities to the most appropriate offices and departments of the Bank. In the day-to-day liquidity management, the Head of Treasury and Capital Markets is responsible for implementing the liquidity strategy and maintaining adequate liquidity within the limits described below. The Financial and Market Risk Management measures and monitors the liquidity position and controls liquidity limits on a daily basis, and also in charge of reporting to the management bodies and to the Parent Company with regard to liquidity conditions and limits.

The key elements of the Grou0070's liquidity strategy are as follows:

- increase Self Financing Capacity in all segments;
- improve Structural Liquidity Position through matched funding (shareholder or market driven);
- focused approach to short-term, medium-term, long-term product definitions in each business line;
- in line with new regulations recently introduced in Hungary, the Bank will always strictly respect all regulatory liquidity ratios.

Through active participation in monetary and financial markets, the Treasury and Capital Markets ensures integrated management of the Bank's liquidity in local currency as well as in foreign currencies ; optimizes the liquidity portfolio, guaranteeing efficient collateral management; and with regard to the other CIB group companies, the Treasury and Capital Markets coordinates and facilitates intragroup cash flows, favouring organised, efficient development in compliance with internal and external regulations. It also acts to resolve any liquidity imbalances of the subsidiaries, in cooperation with the Financial and Market Risk Management, and promotes all operating activities deemed suitable to return or keep the subsidiaries within the limits set forth by internal or external rules.

(46) Risk management (continued)

The Liquidity Policy includes to the Contingency Funding Plan which is to clearly set out the strategies for addressing liquidity shortfalls in emergency situations and describing the liquidity early warning system in operation.

The liquidity ratio is calculated as the ratio of liquid assets to total assets where liquid assets consists of cash, nostro balances and – maximum 30 day remaining maturity – bonds that are categorized by the National Bank of Hungary as eligible for its repo facility.

The liquidity ratio during the year was as follows:

Liquidity ratio [1]	31/12/2018	31/12/2017
31 December	35.1%	39.7%
Daily average during the period	36.4%	31.1%
Highest	47.5%	41.2%
Lowest	28.5%	22.8%

[1] The liquidity of the Group depends on the Bank stand-alone liquidity; the above table includes the CIB Bank only liquidity ratios.

The maturity profile of the Group's financial liabilities at 31 December 2018 is presented in Note 39.

(c) Market risk - Trading

Market risk is the risk of loss due to fluctuations in market variables such as interest rates, foreign exchange rates and equity prices. The Group classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored through applying methodology that reflects the interdependency between risk variables.

The market risk for the trading portfolio is managed and monitored based on a VaR (Value at Risk) methodology which reflects the interdependency between different risk factors. VaR is a method used in measuring financial risk by estimating the potential negative change in the market value of a portfolio at a given confidence level and over a specified time horizon.

The Group uses simulation models to assess possible changes in the market value of the trading portfolio based on historical data from previous years. The VaR models are designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The factors of the distribution are calculated by using exponentially weighted historical data. The use of VaR has limitation because it is based on historical correlation and volatilities in market prices and assumes that future price movements will follow a statistical distribution.

Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under – or over-estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments.

Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99% confidence level.

Since VaR is an integral part of the Group's market risk management, VaR limits have been established for all trading operations with separate limit amounts for foreign exchange, interest rate, equity and total VaRs. Exposures are reviewed daily against the limits by management.

(46) Risk management (continued)

(million HUF)

VaR 2018 [(1)]	Foreign exchange	Interest rate	Equity	Correla-tion effect	Total
31 December	12	27	0	(14)	**25**
Daily average during the period	21	36	0	(13)	**44**
Highest	53	80	2	(41)	**94**
Lowest	6	6	0	2	**14**

(million HUF)

VaR 2017 [(1)]	Foreign exchange	Interest rate	Equity	Correla-tion effect	Total
31 December	16	9	1	(10)	**16**
Daily average during the period	24	22	1	(13)	**34**
Highest	60	63	4	(35)	**92**
Lowest	6	7	1	(3)	**11**

[(1)] *As the market risk trading book is managed at the Bank level, the tables include the amounts on a Bank level basis.*

In addition to the VaR limits, position and stop-loss limits have been set up in line with the internal regulations of Intesa Sanpaolo Group.

Position limits enables the monitoring of exposures real time, and as a robust measurement technique, can be relied upon in case of error in the VaR model. Separate position limits and sub-limits are in place for foreign exchange, equity and interest rate positions.

Stop-loss limits are designed to control the down side movement of the profit and loss in a particular position. Separate stop-loss limits have been established both on a month-to-date and year-to-date horizon for the individual Treasury desks.

(d) Market risk – Non-trading

Interest rate risk– Non-trading

Interest rate risk is measured by the extent to which changes in market interest rates impact on equity and on net interest income. Gaps in the value of assets, liabilities and off balance sheet instruments that mature or reprice during a given period generate interest rate risk. The Group reduces this risk by matching the repricing of assets and liabilities using pricing/maturity techniques, including the use of derivative products.

Interest rate risk is managed by the Treasury in the Group day-to-day operation supervised by the senior management, by Risk Management, and by the Parent Company. Risk tolerance limitation and the related policy are set by the Bank's Management Board. On the tactical horizon interest risk is managed by the Financial Risk Committee, which proposes position and sensitivity limits, and monitors such limits to restrict the effect of movements in interest rates on current earnings and on the value of interest sensitive assets and liabilities.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the statement of profit or loss and other comprehensive income.

The sensitivity of equity economic value is calculated on the changes of the net present value (NPV) of all non-trading financial assets, liabilities and derivatives on 31 December 2018 on the basis of the effects of standard shock scenarios. The sensitivity of the net interest income is the effect of the standard shock scenarios on the net interest income within one-year time horizon, based on the floating and fixed rate non-trading financial assets and financial liabilities and derivative instruments as of 31 December 2018. The Bank uses for the sensitivity calculations NPV calculations with admitting negative value on interest rates for the year 2018 and applying zero floor on interest rates for the year 2017. A threshold of zero is implemented in the calculation for those cases when the decrease of basis points would indicate a negative interest income. This method amends the symmetry of the sensitivity analysis

A threshold of zero is implemented in the calculation for those cases when the decrease of basis points would indicate a negative interest income. This method amends the symmetry of the sensitivity analysis.

(46) Risk management (continued)

The following table indicates the changes at the end of 2018 and 2017:

(million HUF)

2018	Shock scenarios in basis points (+)	Sensitivity of net interest income	Sensitivity of equity				
			Under 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
HUF	100	**4,150**	(681)	(388)	1,043	714	**688**
EUR	100	**803**	(195)	(160)	228	569	**442**
USD	100	**8**	(10)	36	27	20	**73**
CHF	100	**(10)**	(33)	41	180	(8)	**180**
Other	100	**29**	1	1	3	3	**8**

(million HUF)

2018	Shock scenarios in basis points (-)	Sensitivity of net interest income	Sensitivity of equity				
			Under 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
HUF	100	**(2,527)**	169	390	(392)	(809)	**(642)**
EUR	100	**(1)**	(40)	(190)	(65)	(595)	**(890)**
USD	100	**(8)**	11	(37)	(27)	(25)	**(78)**
CHF	100	**0**	(30)	20	73	(64)	**(1)**
Other	100	**(28)**	(1)	(1)	(3)	(4)	**(9)**

(million HUF)

2017	Increase in basis points	Sensitivity of net interest income	Sensitivity of equity				
			Under 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
HUF	200	**5,583**	(484)	(186)	1,664	(254)	**740**
EUR	100	**1,187**	(215)	91	431	529	**836**
USD	25	**32**	1	16	1	7	**25**
CHF	25	**7**	(60)	3	(23)	(21)	**(101)**
Other	25	**(2)**	1	1	(18)	1	**(15)**

(million HUF)

2017	Decrease in basis points	Sensitivity of net interest income	Sensitivity of equity				
			Under 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
HUF	(200)	**(5,443)**	11	7	(927)	1,230	**321**
EUR	(100)	**(1,061)**	18	41	(50)	(307)	**(298)**
USD	(25)	**(32)**	(1)	(8)	-	(5)	**(14)**
CHF	(25)	**(24)**	8	(4)	(44)	(6)	**(46)**
Other	(25)	**-**	-	-	10	(1)	**9**

(46) Risk management (continued)

Foreign exchange risk– Non-trading

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in FX rates.

The Group has assets and liabilities, both on and off balance sheet, denominated in various foreign currencies. Foreign exchange risk arises when the actual or forecasted assets in a foreign currency are either greater or less than the liabilities in that currency.

Any non-trading foreign exchange risk is transferred through internal hedges to trading book and is therefore reflected and managed via the value-at-risk figures in the trading books described under section (c) Market risk – Trading, with the exception of strategic and residual foreign FX positions.

The following table demonstrates the sensitivity of the statement of comprehensive income to reasonable possible changes in exchange rates, with all other variables held constant:

(million HUF)

2018	Sensitivity of net income			
	EUR	USD	CHF	Total
5% strengthening of currencies vs. HUF	1,799	(163)	(127)	**1,509**
5% weakening of currencies vs. HUF	(1,799)	163	127	**(1,509)**

(million HUF)

2017	Sensitivity of net income			
	EUR	USD	CHF	Total
5% strengthening of currencies vs. HUF	1,366	385	506	**2,257**
5% weakening of currencies vs. HUF	(1,366)	(385)	(506)	**(2,257)**

Sensitivity of net income was reviewed and therefore the presented data for 2017 has been modified.

Changes in exchange rates does not have any effect on equity.

(46) Risk management (continued)

The currency structure of the Group's financial assets, liabilities as follows:

(currency equivalents in million HUF)

31/12/2018	HUF	EUR	CHF	USD	Other	Total
Cash and current account with central banks	45,602	1,082	25	305	94	**47,108**
Securities held for trading	24,274	276	-	135	-	**24,685**
Financial assets measured at fair value through OCI	284,033	-	-	1,699	-	**285,732**
Loans to banks	340,270	179,799	209	18,415	5,662	**544,355**
Loans to customers at amortised cost and at fair value through profit or loss	548,533	281,249	13,914	33,389	1	**877,086**
Debt securities at amortised cost	46,408	6,459	-	-	-	**52,867**
Total financial assets	**1,289,120**	**468,865**	**14,148**	**53,943**	**5,757**	**1,831,833**
Deposits from banks	110,737	123,908	16,667	720	149	**252,181**
Deposits from customers	1,077,965	228,660	4,020	40,540	11,223	**1,362,408**
Subordinated debts	-	9,652	-	-	-	**9,652**
Total financial liabilities	**1,188,702**	**362,220**	**20,687**	**41,260**	**11,372**	**1,624,241**
Net on-statement of financial positon	**100,418**	**106,645**	**(6,539)**	**12,683**	**(5,615)**	**207,592**
FX position of derivatives	**103,514**	**(101,389)**	**5,380**	**(12,698)**	**7,244**	
Off-balance						
Guaranteed	*26,955*	*10,459*	*-*	*44*	*124*	***37,582***
Letters of credit	*-*	*5,263*	*-*	*333*	*-*	***5,596***
Commitments	*283,784*	*107,469*	*94*	*7,221*	*-*	***398,568***

(46) Risk management (continued)

(currency equivalents in million HUF)

31/12/2017	HUF	EUR	CHF	USD	Other	Total
Cash and current account with central banks	37,760	811	24	219	62	**38,876**
Loans to banks	320,521	129,657	581	2,383	6,594	**459,736**
Financial assets measured at fair value through profit or loss	63,685	4	-	28	-	**63,717**
Loans to customers	493,401	230,778	23,897	13,336	1,189	**762,601**
Financial assets measured at fair value through other comprehensive income	245,884	398	-	1,348	-	**247,630**
Debt securities measured at amortised cost	28,906	-	-	-	-	**28,906**
Other assets	6,699	1,011	60	91	55	**7,916**
Total financial assets	**1,196,856**	**362,659**	**24,562**	**17,405**	**7,900**	**1,609,382**
Deposits from banks	107,883	84,409	17,514	434	7	**210,247**
Deposits from customers	896,288	239,523	4,229	44,320	7,395	**1,191,755**
Securities issued	2,609	-	-	-	-	**2,609**
Other liabilities	9,897	2,147	6	489	50	**12,589**
Subordinated debts	-	9,311	-	-	-	**9,311**
Total financial liabilities	**1,016,677**	**335,390**	**21,749**	**45,243**	**7,452**	**1,426,511**
Net on-statement of financial positon	**180,179**	**27,269**	**2,813**	**(27,838)**	**448**	**182,871**
FX position of derivatives	**(3,571)**	**(19,232)**	**(2,872)**	**27,594**	**(481)**	
Off-balance						
Guaranteed	*17,569*	*10,623*	*-*	*2,152*	*-*	***30,344***
Letters of credit	*16*	*4,368*	*-*	*343*	*-*	***4,727***
Commitments	*233,761*	*113,922*	*43*	*26,870*	*-*	***374,596***

(e) Operational risk

Operational risk is defined as the risk of suffering losses due to inadequacy or failures of internal processes, human resources and internal systems, or as a result of external events. Operational risk includes:

- legal risk, meaning the risk of losses resulting from the breach of laws or regulations, contractual or other liability or from other disputes;
- model risk, defined as the potential loss an institution may incur, as a consequence of decisions that could be principally based on the output of internal models, due to errors in the development, implementation or use of such models;
- compliance risk, defined as the risk to incur judicial or administrative penalties, significant financial losses or damage to reputation as a result of the violation of mandatory rules or self-governance regulation;
- conduct risk, defined as the risk of incurring judicial or administrative sanctions, material financial losses or reputational harms as a result of behaviours unfair towards customers, jeopardising the integrity and orderly functioning of financial markets, constituting an infringement of regulations in financial crimes area (e.g. anti-money laundering, counter terrorism, embargoes, anti-corruption, tax crimes, cyber crimes);
- ICT risk (Information and Communication Technology risk), defined as the risk of economic, reputational and market share losses related to the use of information and communication technology. (IT security risk is part of the ICT risk);

(46) Risk management (continued)

- cyber risk is the risk of disruption to business processes and/or financial loss and/or damage to reputation deriving from improper use and/or dissemination of digital data and information, any actual or attempted unauthorised access to the Bank's ICT or to the digital data and information contained therein and any malicious or involuntary activity that compromises or uses it inappropriately, jeopardising business processes and/or supporting critical infrastructures;
- information Security risk, defined as the risk of sustaining economic loss, or reputational harm, including those arising from the failure to comply with rules as a result of the loss of confidentiality, integrity and/or availability of corporate information favoured or caused by the use of technology or related to it.
- financial reporting risk, defined as the possibility that quantitative or qualitative accounting or financial information contained in company communications disclosed to the public is not true, correct or complete due to the inadequacy of administrative processes or the ICT applications used to produce it.

Strategic and reputational risks are excluded.

In the Group, Operational Risk Management measures and monitors the exposure to operational risk and reports thereon to the senior management corporate bodies of the Bank, such as the Management Board, Supervisory Board, Audit Committee, Risk Assumption and Risk Management Committee and Operational Risk Committee. Operational Risk Management is also responsible for the consistent application and operation of the Intesa Sanpaolo Group's operational risk management framework, also taking into account the local idiosyncrasies.

In the Group, the governing committee responsible for overviewing operational risk management activities is the Operational Risk Committee (ORC). The primary purpose of the Committee is to propose, advise on and investigate matters related to operational risk, thereby support the Management Board of the Bank. The Committee meets quarterly when it reviews and discusses the Bank's operational risk exposure and the ongoing risk mitigation actions.

In managing the Group's operational risk exposure, both qualitative and quantitative tools are being applied.

One of the qualitative tools is the annual operational risk self-diagnosis where operational criticalities are identified and mitigating actions are defined in response to those criticalities. A set of operational key risk indicators is also used as a qualitative measure aiming at conveying an easily understandable overall picture to the senior management about the operational risk profile of the Group, and in the meanwhile, enabling the Group to react in a timely manner to adverse changes in that risk profile.

As a quantitative measure historical operational risk loss data have been collected and analysed in a systematic way since 2004. On the basis of the analyses performed by Operational Risk Management, mitigating actions are initiated to avoid the re-occurrence of similar losses or prevent the materialisation of potential risks.

In 2018, the Group detected and recorded in its internal loss database 614 operational risk events which caused HUF 1,624 million effective operational loss (excluding losses boundary with credit risk and specific provisions). In 2017, the corresponding numbers were 992 events with HUF 1,379 million loss.

Since January 2008 the Group have been calculating the regulatory capital requirement of the operational risk on the basis of The Standardised Approach (TSA). For ICAAP purposes, the Group quantifies the operational risk capital requirement using the ISP Group's Advanced Measurement Approach (AMA) model.

Part F Information on capital

(47) Capital and capital management

The primary objective of the capital management of the Group is to ensure the prudent operation, the entire compliance with the prescriptions of the regulator for a persistent business operation and maximising the shareholder value, accompanied by an optimal financing structure.

The basis of the capital management of the Group members in the short run is the continuous monitoring of their capital position, in the long run the strategic and the business planning, which includes the monitoring and forecast of the capital position.

Capital adequacy

The Capital Requirements Directive package (CRDIV/CRR) transposes the global standards on banking regulation (known as the Basel III agreement) into the EU legal framework. The rules have been being applied from 1 January 2014. The framework aims at making institutions in the EU more solid and strengthing their capacity to adequately manage the risks linked to their activities, and creating capital bases adequate to absorb any losses they may incur in doing business, with special focus on the liquidity risk management tools and the capital requirements.

The capital adequacy of the Bank is supervised based on the financial statements data prepared in accordance with IFRS applying the current directives, rulings and indicators from 1 January 2014.

The Bank has entirely complied with the regulatory capital requirements in 2018 as well as in 2017.

The Bank quantifies the regulatory and ICAAP capital requirements. Both the risk management processes and the capital requirement comprehensively cover the Bank.

Internal Capital Adequacy Assessment Process (ICAAP)

The second pillar of Basel II capital framework prescribes how supervisory authorities and banks can effectively assess the appropriate level of capital. The assessment must cover all the risks incurred by the Group, their sensitivity to crisis scenarios, and how they are expected to evolve in light of changes in the Group's business going forward.

The Group not only reviews its capital ratios, but it also assesses and continuously monitors its risk bearing capacity. The Group's primary internal measure to assess the impact of very severe unexpected losses across the different risk types is economic capital, which is also planned as part of the risk and capital strategy.

The Group continuously focusing on the following risks:

Credit Risk

Risk that customers may not be able to meet their contractual payment obligations.

Operational Risk

The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Market Risk

The risk that arises from the uncertainty concerning changes in market prices and rates (including interest rates, equity prices, foreign exchange rates and commodity prices), the correlations among them and their levels of volatility.

Residual Risk

The risk that arises from the recognized risk measurement and mitigation techniques used by the credit institution proves less effective than expected.

Model Risk

Model risk is the risk of losses relating to the development, implementation or improper use of any other models by the institution for decision-making (e.g. product pricing, evaluation of financial instruments, monitoring of risk limits, etc.)

Concentration Risk

Concentration risk is a banking term denoting the overall spread of a bank's outstanding accounts over the number or variety of debtors to whom the bank has lent money. This risk is calculated using a "concentration ratio" which explains what percentage of the outstanding accounts each bank loan represents.

(47) Capital and capital management (continued)

Banking book – Interest Rate Risk

Risk of losses on the fair value of the portfolio of banking assets and liabilities, not including trading assets and liabilities, resulting from changes in interest rates.

Interest rate risk is taken to be the current or prospective risk to both the earnings and capital of institutions arising from adverse movements in interest rates. In the context of Pillar 2, this is in respect of the banking book only, given that interest rate risk in the trading book is already covered under market risk regulations.

Liquidity Risk

The risk arising from the Group's potential inability to meet all payment obligations when they come due or only being able to meet these obligations at excessive costs.

Country Risk

The risk that the Group may suffer a loss, in any given country, due to deterioration in economic conditions, political and social unrest, nationalization and expropriation of assets, government repudiation of external indebtedness, exchange controls and currency depreciation or devaluation.

Settlement Risk

Settlement risk is the risk that a transaction executed is not settled as expected through a settlement system. Settlement risk comprises credit risk and liquidity risk elements. Treasury transactions, trading book items (deals) and capital market dealings concluded as part of investment services convey a settlement risk that is a specific mix of credit and liquidity risk. The credit institution or the investment firm bears the risk that while it fulfils its contractual obligations (payment or delivery), the counterparty fails or defaults to do so.

Reputational Risk

The reputation risk is defined as a risk of a drop in profits or capital due to a negative perception of the image of the bank by customers, counterparties, shareholders, investors or supervisory authorities

Strategic Risk

Present or prospective strategic risk is defined as the risk linked to a potential drop in profits or capital due to changes in the operating context or erroneous corporate decisions, inadequate implementation of decisions or poor reactions to changes in the competitive environment.

High Risk Portfolio

In line with the National Bank of Hungary's (MNB) requirement the Bank identifies the portfolio meeting the criteria defined by the MNB for high risk portfolios and allocates additional capital for such portfolios. Repossessed assets are forming part of the high risk portfolios.

Applied methodologies

Under Pillar 1 the Group applies Standardized Methodologies (STA) for quantifying the regulatory capital requirement of Credit risk, Operational risk and Market risk. Under Pillar 2 the Bank implemented and use advanced methodologies for ICAAP purposes.

Capital management

The Group's regulator, National Bank of Hungary sets and monitors capital requirements for the Group in the so called SREP supervisory review and evaluation process.

The Group's regulatory capital consists of the sum of the following elements:

- Tier 1 (all qualifies as Common Equity Tier 1 (CET1) capital), which includes ordinary share capital, related share premiums, retained earnings, reserves and deductions for intangible assets and deferred tax other than temporary differences
- Tier 2 capital, which includes qualifying subordinated liabilities

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, specific limits, risk measures, the rules and ratios.

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder value based on total capital ratio.

(47) Capital and capital management (continued)

(million HUF)

Regulatory capital	31/12/2018	31/12/2017
Share capital	50,000	50,000
Reserves	168,349	144,644
Current year's profit or (loss)	3,738	24,563
Total shareholder's equity	**222,087**	**219,207**
Deduction item: intangible assets	(11,151)	(9,620)
Deduction item: prudential valuation	(344)	-
Tier 1 capital	**210,592**	**209,587**
Subordinated capital	5,610	7,270
Tier 2 capital	**5,610**	**7,270**
Total capital	**216,202**	**216,857**
Risk weighted assets for Credit risks	896,032	761,747
Risk weighted assets for Market risks	21,487	28,202
Risk weighted assets for Operating risks	111,296	107,661
Credit Valuation Adjustment	1,652	693
Risk weighted assets	**1,030,467**	**898,303**
Tier 1 capital ratio (%)	**20.44%**	**23.33%**
Total capital ratio (%)	**20.98%**	**24.14%**

Current year's profit or (loss) includes the proposed dividend payment with an amount of HUF 10,000 million for the year 2018.

The minimum capital requirement is 8% under Pillar1. The Group also meet the requirement of SREP.

SREP requirements for 2019 are already available, and the Group meets the relating requirements according to the expectations.

CIB BANK LTD.
and its subsidiaries

Business and management report
based on the audited consolidated financial statements
for the year ended 31 December 2018
prepared in accordance with
International Financial Reporting Standards
as adopted by EU

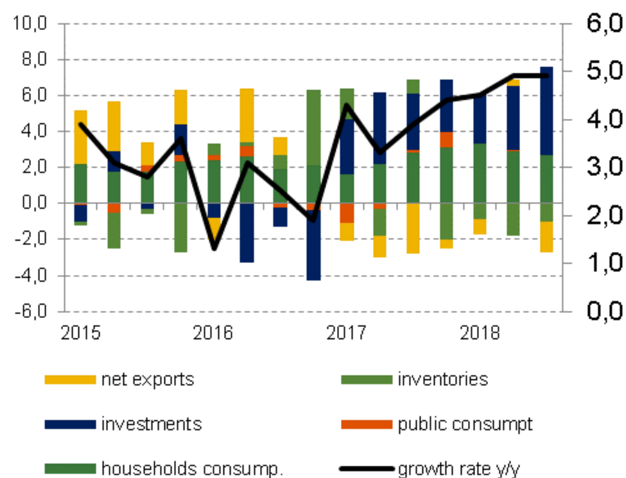
I. Macro and microeconomic environment

1. GDP

Hungarian economic growth accelerated further in 2018 following an already strong momentum shown in 2017. Growth rate nearly doubled in 2017 compared to 2016, reaching 4.1%. In 2018, even this strong dynamics was outperformed, at around 4.6%. GDP growth probably peaked in Q3 2018, reaching a multi-year record of 4.9%, even hitting 5.2% in terms of the seasonally- and working-day-adjusted figure.

The speed of the revival of the Hungarian economy exceeded expectations. The market consensus for the projected full-year 2018 GDP figure had been increasing throughout the entire year. GDP growth in Q1 2018 was at 4.5% year-on-year, while Q2 and Q3 delivered a surge to 4.9% year-on-year. The better-than-expected rise to multi-year record levels was boosted primarily by domestic demand, which lifted services too and was supported by rising wages. Detailed data of Q4 will probably show some signs of decelaration, which will continue in 2019. For the whole of 2019 the National Bank of Hungary projected a GDP growth by 3.5%, while most market participants project a moderately more pronounced slowdown to 3.2-3.3%.

During 2018 EU-funded projects gave a strong boost to the economy, investment dynamics became more broad-based. While private investments are still relatively weaker, investments in construction, machinery and equipment rose significantly. On the production side, the primary contributors to economic growth were market services. The automotive industry recorded a relatively weaker performance, while all sectors accounting for a more significant weight within the processing industry showed growth. From the absoprtion side households' demand was a key factor in growth, supported by double-digit wage increase. Fiscal policy also provided some support to growth.



2. Budget and external balance

The 2018 fiscal performance was twin-faced, especially due to the effect of the domestic pre-financing of EU-funded projects and programmes. Last year's annual data showed that the overall state budget produced an annual cash-based deficit of HUF 1,445 billion, above the plan (especially during the middle of the year before a major inflow of EU-financing in December), but below the 2017 gap. The jump was primarily driven by a strong wave of EU-financed programs and their pre-financing without sufficient inflow of the related EU financing. In 2018 EU fund inflow amounted to around HUF 1430bn, covering among others the Széchényi 2020 programme, while EU-programme related expenses reached more than HUF 1886bn. However, the ESA-based balance (calculated in accordance with the EU-methodology) came better than the plan of -2.4% of GDP, eventually close to 2%. The balance was supported by larger-than-expected tax proceeds, with an especially strong performance from the side of VAT. In addition to strong GDP growth and high wage growth, the tax income boom was also supported by the enhanced efficiency of tax collection. The above-plan cash-based deficit naturally created a jump in state financing needs, but the favorable interest rate environment provided new bond releases with low yields, close to zero in the case of in-year maturities.

External balance indicators showed an ongoing favourable development in 2018 though with a gradual melting of the preceding years' huge surpluses. Both export and import growth lagged behind the preceding year's

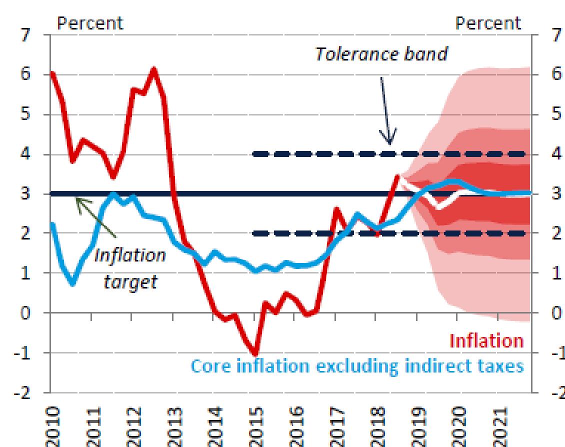
dynamics in euro terms and imports remained the faster of the two sides. Hence both the trade balance and current account balance showed a smaller (though still sizable) surplus in 2018. Current account balance came at less than 3% of GDP, primarily a result of the trade balance which showed a positive balance of nearly EUR 2bn smaller than in the preceding year. These developments also indicated an ongoing strong net financing capacity and a strong but diminishing support to the forint's exchange rate.

3. Inflation

The December 2018 inflation figure came close to market expectations at 2.7% y/y, down more than 1pp in November and December combined. The outcome implied an annual average CPI of 2.8% for 2018, up from 2.4% in 2017. In Q1 2018 inflation was lower-than-expected (average 2.0%), while in Q2 it surged above 3.1%. Inflation in Q3 and in October was boosted by higher oil prices and partly by rising food prices. Regarding the whole of 2018, it was the category of alcohol and tobacco prices that rose the most on a year-on-year basis.

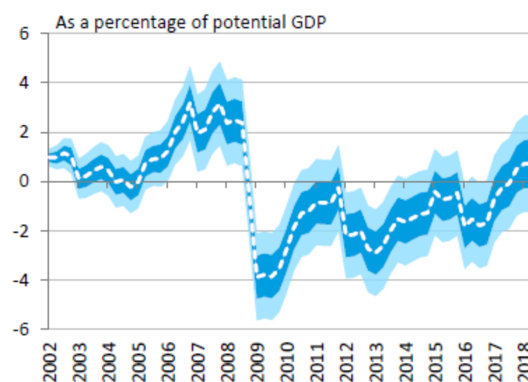
While headline inflation showed several turns in 2018, core inflation showed a gradual upward trend from 2.4% to 2.8% in December. In the trend of inflation, the intensification of domestic demand and the effect of wage increases appeared slower than expected, primarily due to the demand emerging in the housing market. However, the ongoing rise of wages and the recent rise of global oil prices still represents a source of upward risk. In 2019, the central bank projects only modest rise in average headline inflation, while core inflation may shift to above 3% persistently.

INFLATION HISTORY AND NBH FORECAST



Note: Based on seasonally unadjusted data.
Source: HCSO, MNB

INDICATORS OF OUTPUT GAP



Note: The blue area shows the estimation uncertainty band.
Source: MNB

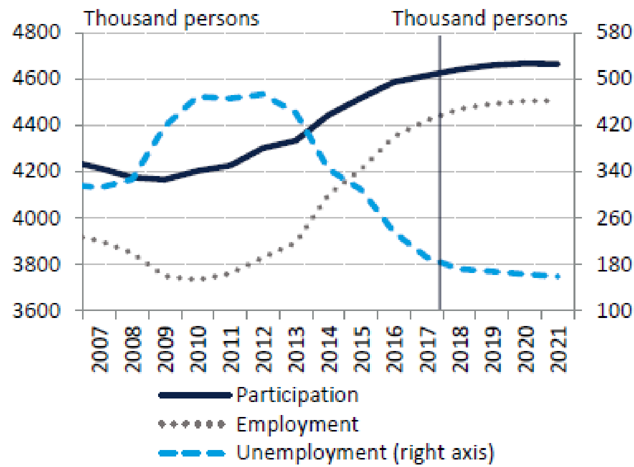
4. Labour market

Following the drop of the unemployment rate to below 4% in Q4 2017, the labour market maintained sub-4% levels throughout 2018. The figure fluctuated at 3.6-3.9%, returning to the lowest point of the range by the end of 2018. At the same time the number of the employed rose further during most of the year before it stabilised close to 4.5 million in Q4 2018. This path was characteristic of both the private and the state sector. However, the number of employees in the public employment programme dropped by 53 thousand compared to one year ago. The latest wave of further rise was fuelled especially by the manufacturing sector and construction.

Such stability of low unemployment was supported by the maintaining of relatively high level of employment coupled with some rise of the activity rate. However, this remained strongly affected by employees working abroad and to a smaller extent by state subsidized employment. Structural inequilibrium has been on the rise, with reports of labour shortages in essentially all areas of the economy, to an even greater extent compared to 2017 and 2016. In addition to the state programme, labour market processes are still affected by earlier changes in pension rules and the introduction of stricter rules of unemployment benefits.

Wage rise has remained in double-digit territory in 2018 as did during most of 2017. Up to October, the dynamics reached 10.2%, already showing some moderation compared to the middle of the year. There was also a trend of dynamic growth regarding real wages in tandem with low inflation environment.

LABOUR MARKET

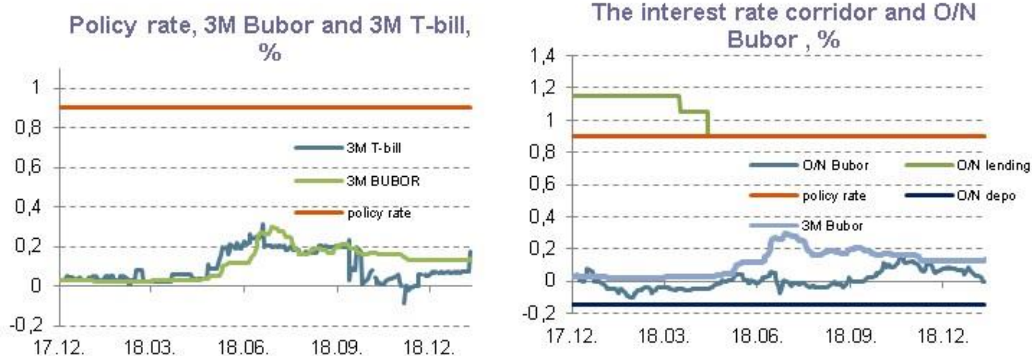


Source: HCSO, MNB

5. Monetary policy

The Central Bank's main policy rate was unchanged at 0.90% throughout the entire last year. However, the Monetary Council remained active in applying non-conventional measures to extend monetary easing. Also, the focus of interest rate policy shifted towards the O/N rate from the official policy rate (i.e. the 3M depo rate).

While low inflation and the ongoing QE (quantitative easing) programme by the European Central Bank (ECB) supported the maintainance of low interest rates and the extension of the series of unconventional easing measures in 2018, the May-June wave of emerging market selloff and the ECB's decision to conclude QE at the end of 2018 brought the issue of domestic CPI risks to the forefront. In June the Hungarian Central Bank revised its 2019 average CPI forecast to 3.1% (above the 3% target, but well within the 3%+1pp range). In September, initial guidance was communicated suggesting that monetary normalisation would start in 2019 and focus had shifted to watching core inflation measures due to the high role of oil and food price fluctuation in headline CPI developments. Also, the new measures announced with the aim of pushing the long-end of the yield curve lower (forint swap programme (MIRS) and a mortgage bond buying programme) were announced to be concluded at the end of 2018.



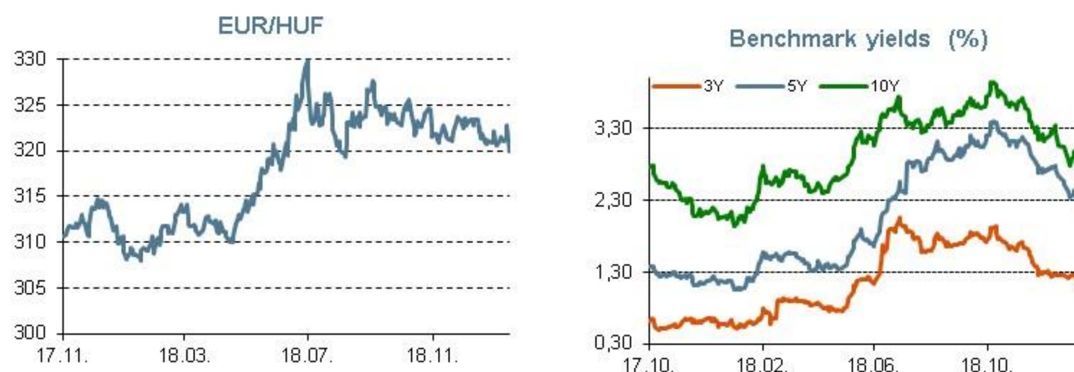
Data source: NBH, Reuters

The forint's exchange rate was supported by favourable external conditions (including strong global risk appetite) and, on the domestic side by the massive external (trade and current account) surplus in Q1 2018. With this background even with the low interest rate premium the Hungarian forint's vulnerability to external shocks was limited in 2017, especially on the back of earlier measures of eliminating most CHF-risk in 2014 and boosting the self-financing programme in 2015-6. As a result, the Hungarian currency fluctuated in a stable manner in Q1 2018, mostly in the EUR/HUF 305-315 range and even appreciating versus the US dollar.

FX market stability was shattered in Q2 2018 by a wave of global and regional emerging market sell-off. Despite the ongoing supportive nature of domestic fundamentals (including strong growth, decreasing external debt, high trade surplus and government bonds in investment-grade category) the forint weakened more than 6% versus the

euro in the first half of 2018, with most of the weakening concentrated in Q2. The EUR/HUF cross rate moved from below the 310-11 level at the end of 2017 to the vicinity of 330 by the end of June. The second half of 2018 delivered a gradual consolidation mostly within the EUR/HUF 320-325 range.

Regarding foreign demand for Hungarian (forint denominated) government bonds in H1 2018 the upward correction of the stock of non-residents' holdings continued to above 3,600 billion by the end of June. Following a few months of stagnation the upward trend revived to reach the 4000-4200 range by the end of 2018.Yields on government bonds remained increasingly influenced by external market pressures.



Data source: Reuters

6. Banking environment

The Hungarian banking sector was characterised by solid profitability and solvency in 2018 as well. Customer loan volume continued to grow, while the liquidity and capital position of the banks is solid.

Operating environment for the domestic banking sector improved further. Rising consumption and investment demand is generating steadily increasing credit demand in both the corporate and household sectors.

Corporate lending increased by more than 10% in 2017 and the growth is expected to outpace that evel in 2018 with a rate over 15%. The end of the Funding for Growth Scheme (FGS) did not result in a decrease in credit supply. On the other hand credit demand moved from long term fixed-rate investment loans to short term floating rate lending.

The growing trend of new loan disbursements continued in the household sector, mortgages and personal loans were the main drivers. The pick-up in the housing market and the continued rise in real wages project a further expansion in credit demand, which is strongly supported by the low interest rate environment. The introduction of Certified consumer-friendly housing loans also contributed to the increase, while there is a shift from variable rates to 5-10 years fixing.

Besides the increase in new loan volumes, year 2018 was also characterized by improving loan portfolio quality, thanks to portfolio cleaning (sale and write-off) and recovery. For the near future there seems to be smaller room for improvement in corporate, but additional measures are needed to solve the problem of household NPL-s.

Profitability of the banking sector remained in the positive territory in 2018, supported by the reversal of loan impairments. Without this effect though the profitability of the sector is low, due to shrinking interest margins that call for improvement in efficiency.

Total assets and liabilities

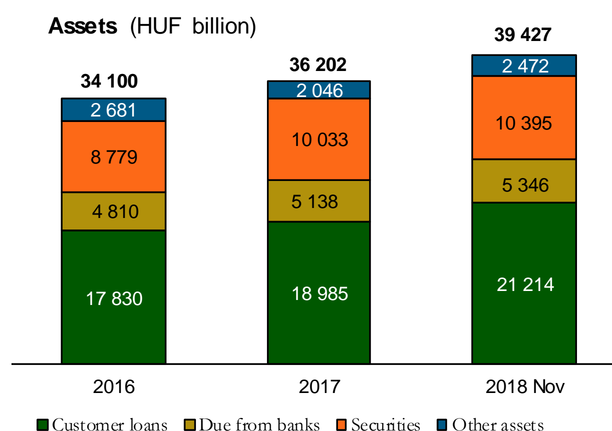
Based on the most recent available figures (as of November, 2018) the banking sector's overall total assets increased by 8.9% compared to prior year-end and amounted to HUF 39,427 billion.

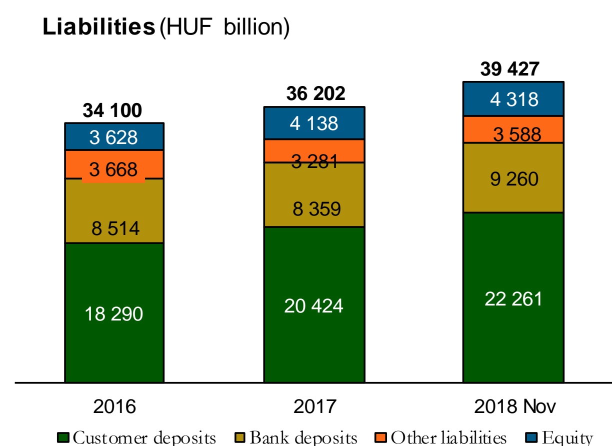
The gross loan portfolio increased by 11.7% (HUF 21,214 billion) compared to December 2017 (+10.5% excluding the foreign exchange effect). The lending capacity of Hungarian banks remained under pressure due to market liquidity constraints and low profitability.

The decline in loans outstanding to households stopped since the new disbursements more than offset the volume of repayments, thus pushing retail loans up by +5,8% compared to the end of the previous year. Demand for new loans was at very low level in the years following the financial crisis, however both in 2015 and 2016, growth was above 30% and this tendency continued in 2017 and 2018.

There was 37.4% increase in retail new disbursements as of November 2018 compared to the same period last year. The volume of foreign currency loans significantly decreased from 58.1% as of December 2014 to 34.8% as of November 2018, largely due to the conversion of the foreign currency mortgage portfolio.

The volume of deposits from customers increased by 9.0% compared to the end of 2017, reaching HUF 22,261 billion at the end of November 2018. Retail deposits increased by 11.3%, while corporate deposit showed 16.2% increase compared to December 2017. At the same time the net asset value of investment funds totalled HUF 5,414 billion at the end of November 2018. While government bond portfolio of consumer customers increased by 12.3% as of October 2018 from the beginning of the year.



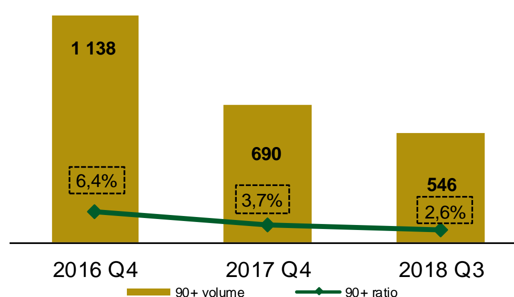


Data source: NBH, HAS – IFRS

Credit quality

90+ past due loan ratio (non-performing loans) decreased significantly to 2.6% as of September 2018 thanks to the portfolio cleaning.

Volume of corporate loans with more than 90 days past due within total loan showed a significant decrease and the 90+ ratio was 2.8% at the end of September 2018. The retail segment's portfolio quality has also improved with a 90+ ratio decreased to 5.3% as of Q3 2018, which is further 2.3% point improvement compared to the 2017 year-end.



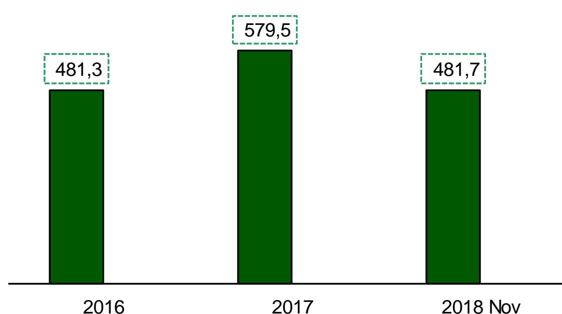
Data source: NBH; HAS-IFRS, Q4 2018 data is not available

Profitability

The profitability of the banking sector decreased as of November 2018 compared to the same period of last year, mainly due to the lower provision release.

The increased Net Operating Margin was partly offset by higher Operating Cost. The banking sector's profit after tax totalled to HUF 482 billion as of November 2018.

Net Interest Income decreased by 0.8%, Net Commission income increased by 7.6%, Profit from Trading Activities increased by 35.0% and Other Income / Expense decreased by 4.9% compared to the same period last year. The cost / income ratio was 59.0% at the end of November 2018.



Data source: NBH; HAS-IFRS

Liquidity and Capital

The amount of liquid assets (securities and interbank receivables) increased by HUF 570 billion (+3.8%) while the sector's loan to deposit ratio (net customer loan / customer deposits) increased by 3.1% points (92.4% as of November 2018).

The capital position of the banking sector is adequate, with a Capital Adequacy Ratio (CAR) at 21.2% as of September 2018 (includes Co-operative credit institutions).

II. Business strategy and priorities

In 2018, CIB Bank, hand in hand with its parent company, Intesa Sanpaolo, established the fundamental strategic directions and objectives of the period until 2021. In line with this, as a universal service provider, CIB will continue to operate serving all customer segments in the coming years by substantially improving its operational efficiency, while holding on to long-term profitable operation, through increased business volumes, digitalisation covering the full spectrum of banking operations and the optimisation of sales channels.

The pillars of the strategy – in line with the key strategic objectives of Intesa Sanpaolo 2018-2021 business plan – are as follows:

- The implementation of the **digital transition** permeating the whole of the bank parallel to the transformation of the role and tasks of the physical network.
- **Increasing revenues** in an increasingly competitive environment in the interest of sustainably profitable operation, by ensuring that an increasing proportion of revenues is derived from the fees and commissions of additional services provided to customers.
- **Improving cost efficiency** by way of digitalisation and the optimisation of sales channels. In this context, process transformations related to digitalisation, the increasing of the ratio of online sales, the simplification of sales activities and certain other activities supporting sales through the increased involvement of third partners and agents, as well as the directing of released capacities to the performance of greater added-value activities will be implemented.
- The conclusion of the process aimed at **reducing the portfolio of non-performing loans**, and maintaining loan quality.

In its growth strategy, CIB has set itself the goal of being the primary bank for its customers. The main component in this approach is to simplify bank processes, improve customer satisfaction, and digitalisation, which is set to have a crucial role in sales and the service model.

In the retail segment, the Bank aims at boosting the volume of loan disbursement by introducing new processes and developing its commercial channels, in particular the mobile application and the online bank. In terms of savings products, CIB places a strong emphasis on offering alternative savings solutions in the extremely low interest environment. In respect of premium banking services, the objective is to continuously expand the range on offer, and to provide high-standard asset management and insurance products and excellent, standardised banking services through electronic channels and the branch network. Serving the millennial generation is a primary focus of the strategy, were CIB is looking to increase its activity by developing new digital products and services and through cooperation with institutions of higher education.

CIB's business strategy also comprises the reinforcement of its corporate market position through customer acquisitions and increased business volumes. Through the renewal of the corporate online bank and front-end system and the simplification of processes, the bank's objective is to ensure that SME and large corporate customers execute an increased ratio of their transactional, deposit and foreign exchange turnover at CIB. The strengthening of treasury services is also assigned significant emphasis. Beyond the above, in the years ahead CIB would like to take even greater advantage of the synergies that exist with its parent company, Intesa Sanpaolo, with a view to strengthening its presence in the multinational corporate sector.

As part of the strategy, CIB Group - together with VUB Bank, the Slovakian subsidiary of Intesa Sanpaolo Bank Group - has launched a new strategic cooperation called "Central European Hub" which aims at utilising cross-border synergies by sharing best practices, increasing operational efficiency and by exploiting the banks' complementary strengths. The objective of the initiative is ultimately to improve the financial performance and enhance the business performance of the two banks, and to solidify their respective market positions by way of the better utilisation of business opportunities pertaining to common corporate customers.

III. Outlook for the banking sector

Increasing lending activity

Growing economy and increasing demand for bank financing will provide favourable conditions for lending. Retail loans will increase further, supported by the pick-up in the housing market, the continued rise in real wages and the easing conditions to access consumer credit. The two main products will be mortgages and personal loans. Corporate lending will grow as well, driven by investments and favourable interest rates and targeting the extension of the customer base. The new Funding for Growth fix facility of MNB to be introduced in 2019 will also support lending to SME-s.

Margins remain under pressure

Although some increase is expected from current extreme low money market interest rates in 2019, margins will be under pressure both on the active and on the passive side. Negative interest rate on short term placement will cause further losses. Growing lending and transactional activity could mitigate the negative effect, however strong competition and digitalization will drive the fees down.

Improvement in credit quality

As a result of continuous portfolio cleaning and decreasing new inflows (thanks to solid underwriting processes and preventive credit risk assessment methodologies), the NPL portfolio of the sector and of CIB show a declining tendency. However, the high ratio of distressed household mortgage loans continues to be a risk in the financial system. Increased investor demand for non-performing mortgages helps to clean the book of banks. The wind down of Corporate NPL portfolio will keep going and is supported by the increasing demand on the commercial real estate market.

IV. Evaluation on the performance of CIB Bank including net assets, financial and earning position

Assets

The balance sheet total of CIB Group amounted to HUF 1,905,081 million (+13.2% compared to December 2017) as of December, 2018. The higher total assets was primarily a consequence of the increase in deposits.

Customer loans

At the end of December, 2018 CIB Group's consolidated gross loan portfolio was HUF 922,068 million (+11.6%), with an annual improvement that is even higher if we take into consideration the decrease of non-performing portfolio recorded during the year. Within the total portfolio the proportion of consumer loans (mortgage, car financing and others) levelled at 35.0% by the end of December (-0.8%), as the increase of corporate loans was higher than that of retail. The share of large corporate loans grew by 1.5%, to 43.9%, while that of SME and Small Business financing remained close to the level of last year. Demand for new financing increased compared to the same period of 2017, especially in the retail mortgage and unsecured markets, where new disbursements rose by 48% and 33%.

Loan portfolio quality

The credit quality of CIB Group's loan portfolio improved in 2018, and the share of 90 days past due loans decreased to 2.4% (-1.4%) thanks to limited new inflow and portfolio cleaning activities. The improvement is connected mainly to large corporate (-2.6%), thanks to the sale of non-performing loans, but there was improvement in the consumer segment as well (-0.8%). Improving portfolio quality also reflected in the reversal of HUF 9,169 million loan impairment over the year.

Securities

The Group held securities portfolio of HUF 363,284 million by December, 2018 (+6.8%) of which trading portfolio amounted to HUF 24,685 million; held to collect and sell portfolio reached HUF 285,732 million, while held to collect investments amounted to HUF 52,867 million. Most of the security portfolio (84% of total securities held) consisted of domestic government bonds.

Interbank receivables

CIB Group's liquid assets portfolio – cash and equivalents and interbank loans – amounted to HUF 591,463 million (+18.6%) by the end of December 2018. 47.2% of interbank receivables was placed within Intesa Sanpaolo Group, while 45.2% was short term placement at MNB.

Repossessed properties, tangible and intangible assets

Net book value of repossessed properties, fixed and intangible assets decreased to HUF 36,613 million (-27.5% compared to December 2017), thanks to successful sale of repossessed real estates of HUF 11,061 million. The net book value of repossessed real estates closed at HUF 10,417 million.

Liabilities

Customer Deposits

Total customer deposits amounted to HUF 1,362,408 million (+14.1%) by the end of December, 2018. All business segments contributed to the growth.

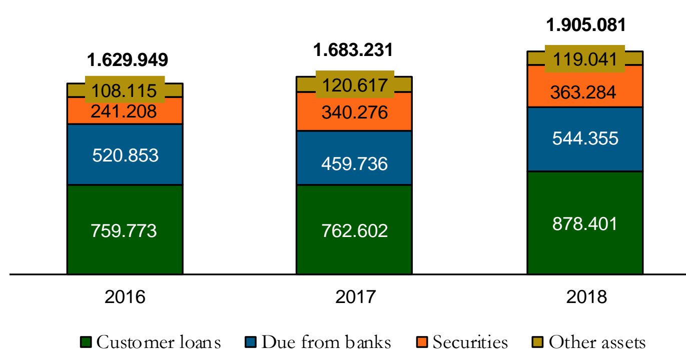
Deposit from banks

Interbank funds – including subordinated deposits – totalled to HUF 261,833 million (+19.3%) as of December 2018. Part of the funds came from the Group's parent company, accounting for 41.7% of the total of interbank deposits, while the remaining part was received from supranational financial institutions, mortgage banks and from the central bank.

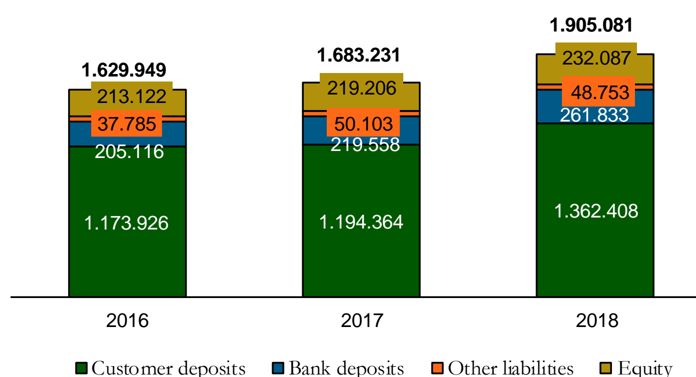
Equity

CIB Group's total shareholders' equity was HUF 232,087 million, 5.9% than 2017 thanks to the the profit for the current year.

Assets (HUF million)



Liabilities & Equity (HUF million)



Data source: CIB Group, IFRS

Profit and loss

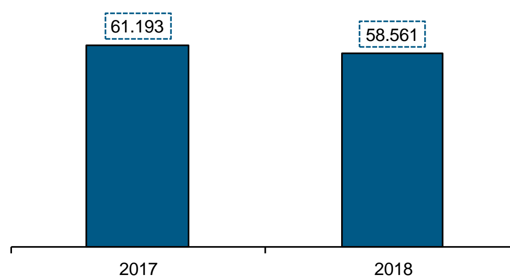
The Group closed year 2018 with a profit of HUF 13,738 million.

Revenues

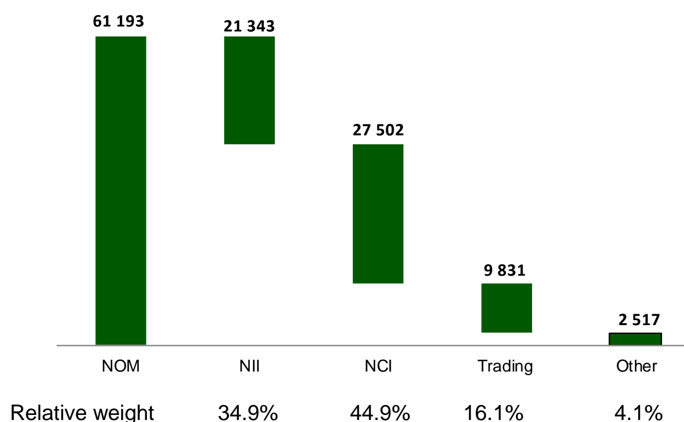
Total revenue of CIB Group amounted to HUF 58,561 million (-4.3% compared to the same period of 2017), out of which Net Interest Income was HUF 20,374 million (-4.5%). Net Commission Income was HUF 26,772 million (-2.7%), while Trading Income totalled to HUF 10,108 million (+2.8%), Other operating income reached HUF 1,310 million (-47.9%).

Revenues decreased compared to 2017, due to the low interest rate environment and because of the cut of agent fees for the sale of government bonds.

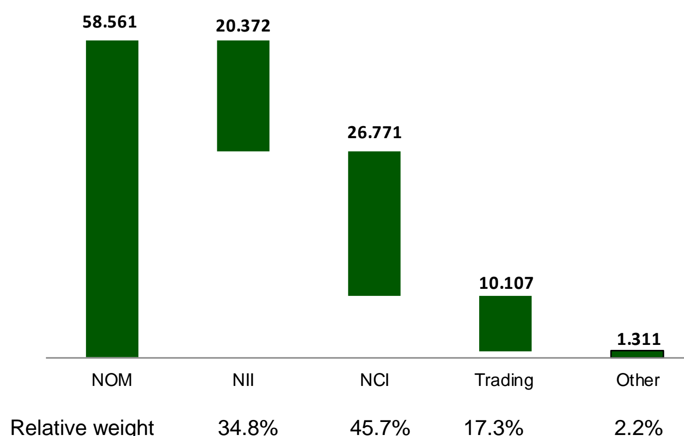
Revenues (HUF Mln)



Breakdown of revenues - 2017



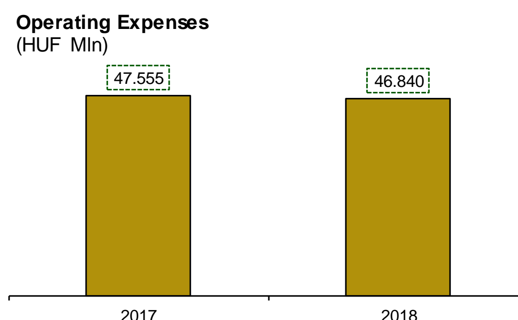
Breakdown of revenues - 2018



Data source: CIB Group, IFRS

Operating Expenses

Total operating expenses decreased by 1.5% compared to 2017 and amounted to HUF 46,841 million without the bank tax. Personnel expenses as well as the bank's other administrative expenses reflected in cost savings.



Data source: CIB Group, IFRS

Banking sector taxes and duties

Total extraordinary bank tax of the Group amounted to HUF 3,428 million in 2018. Transactional duty expense for the year reached HUF 11,674 million.

Allowances and impairments

The cumulated amount of new allowances, impairments and provisions showed a reversal of HUF 8,275 million. Out of the total, loan impairment reversal amounted to HUF 9,169 million. The positive result was mainly the effect of the improving rating of corporate customers, releases from sale of corporate (especially real-estate project finance) portfolio, but the improvement in the quality of the mortgage book also contributed to the release.

Net result on repossessed real estates was also positive, HUF +1,369 million, thanks to the gain on real estate sales.

V. Operations of the subsidiaries in 2018

The Group structure was the following at each 31 December:

(number of companies)	2018	2017
Companies for providing services and products to Group's customers	3	4
Companies responsible for the management of repossessed assets	1	1
Companies under unwinding procedure	1	1
Total	**5**	**6**

Companies for providing services and products to Group's customers

CIB Leasing Ltd.

The business profile of the company, founded in 2000, is closed-end financial lease – primarily related to motor vehicles – and to provide financing to the purchase of vehicles and machinery. At the end of 2010 CIB Credit Ltd, CIB Property Ltd, and CIB Residential Property Ltd merged into CIB Leasing Ltd making the company the only entity in CIB Group providing financial leasing services. Continuing the simplification of the Group structure at the end of 2017 CIB Real Estate Leasing Ltd. merged to CIB Leasing Ltd, who records a market share of 3.5% as of September 2018. The total assets of the company in December 2018 were HUF 87,249 million. Net results for year 2018 was HUF +234 million.

CIB Rent Ltd.

The company is specialized in operative leasing transactions. The total assets of the company at the end of 2018 were HUF 483 million, while annual result was a loss of HUF 33 million.

CIB Insurance Broker Ltd.

The company was founded in 2001 to deal with insurance brokerage activities. At the end of 2018 total assets of CIB Insurance Broker Ltd. amounted to HUF 915 million, while its profit after tax was HUF 346 million.

Company responsible for the management of repossessed assets

Recovery Ltd.

Recovery Ltd. (previously Expert Ltd.) is the main vehicle for the repossession of real estates. On 31 December 2011 CIB REAL Ltd. (a company dealing with the management of Group's operating premises) merged with Recovery Ltd. The sole legal successor of the merged entities is Recovery Ltd. Total assets of the company closed the year at HUF 20,922 million. The company closed the year with a loss of HUF 1,006 million.

Company under unwinding procedure

CIB Factor Ltd.

The company became part of CIB Group in 2004. Its main activity is the factoring of receivables and the cross-selling of products with the SME division of the Bank. CIB Factor merged its business activities into the Bank as of 31. December 2016, its activity has been terminated and its winding up procedure is in progress.

VI. Key events and processes occurring after the balance sheet date

No significant events or processes occurred after the balance sheet date, during the period prior to the preparation of the financial statements and the approval thereof that could have a material impact on the Bank financial or earnings position.

VII. Utilisation of financial instruments in the Group

The Group holds a substantial quantity of liquid financial instruments.

The purpose of the substantial cash and short-term bank placements is to ensure immediate liquidity on top of the unencumbered high quality security portfolio. The portfolio of securities held for trading, serves several purposes at the same time: buffer to serve customers' investment needs, provide a short-term opportunity to realise profit, while also as a secondary source of liquidity.

The derivative transactions are FX forward deals, futures dealt on the stock-exchange and OTC contracts, FX swaps, FX options, interest rate swaps and forward rate agreements. The Group performs such transactions mainly for hedging purposes. In the latter case the primary objective is not to hedge individual transactions for profit taking, but to reduce the bank's FX and interest rate risk exposure.

VIII. Risk-management and hedging policy of the Group

ISP Group's regulations pertaining to the various significant types of risk are approved, and reviewed at least once a year, by the Management Board of the mother company. The Group has credit risk management, market risk management, liquidity and liquidity crisis management, interestrate risk, country risk - counterparty risk management and operational risk management policies. These regulations serve to define the framework of its activities related to the specific areas of risk management along unified principles across the entire Group.

CIB Group's credit risk management policy defines fundamentals of credit risk management across the Group, risk appetite of the Group both on general level and on an annual basis adjusted to the changing business environment. Basic roles and responsibilities, clear segregation of duties and major tools of credit risk measurement and management are unambiguously defined in the policy.

The financial portfolio policy y includes the guiding principles related to currency and interest risk, the regulations containing methodology of sensitivity analyses and value-at-risk calculations, as well as the limits for the risk exposures.

The liquidity policy determines the fundamental principles, goals, and procedures for liquidity management, maximum liquidity exposure limits, as well as the organizational framework for monitoring them. In the frame of the liquidity strategy, the bank's senior management takes into consideration the likely future development of business volumes, and the cost of funds. The liquidity policy includes the liquidity contingency plan, which specifies the procedures to be followed in case of an unexpected crisis scenario, and defines the order the

liquidation of assets which may depend on the nature of the crisis. In these regulations, the bank also defines the maximum tolerance related to Basel 3 regulatory liquidity ratios, the LCR and the NSFR.

The Group applies hedge accounting to some specific assets hedged by interest rate swaps in order to mitigate the interest rate risk in the Banking Book. The P&L calculation method depends on the purpose of the transaction wether trading or hedging. The effect of the changes in the fair value is immediately recognized on the income statement in case of the derivative transactions for trading purposes. The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument. The Group in accordance with IFRS and Intesa Sanpaolo Group policies designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). In the case of derivatives that do not qualify for hedge accounting, changes in the fair value of such derivative instrument are recognised immediately through profit and loss.

The country risk management policy regulates the method for establishing limits for individual countries and specifies the extent of the regularly reviewed limits as well.

The operational risk management guidelines define the events that are grouped into this risk category, and the methods for measuring the risks of this type borne by the Group.

IX. Price, credit, interest, liquidity and cash-flow risks of the Group

In the course of its business operations, the Group is primarily and mainly exposed to credit risk. The mitigation of this type of risk is achieved partly through compliance with the statutory requirements and internal limits, and partly through prudent lending and loss-provisioning practices.

Legal requirements as well as best practices of risk management are transformed into daily operations of the Group by internal regulations. The internal regulations treat in detail the procedures related to debtor rating, deal approval, limit-setting, the recognition and evaluation of collateral, loan and customer monitoring, and risk management, applicable to the various customers and customer groups. They also specify the lending-related responsibilities and duties of the individual organizational units. In keeping with the requirements of the supervisory bodies and its owner, the Group pursues a prudent policy in terms of assumption of risk.

Lending process is managed along structured principles in its entire complexity from customer request via credit approval and monitoring until full repayment of the loan or, if unavoidable, until work-out management. Basis of any credit-risk related decision is the exposure of the group of connected clients towards CIB Group.

In the frame of the core business activity the Group is actively managing the interest rate risk . by defining the maximum accepted level of interest rate risk exposure held in the banking book and the expected net interest income. Each year, the Management Board, under the supervision of the Supervisory Board and in line with the group level risk tolerance of the parent company, determines the risk appetite and corresponding limits. Reports on the current interest rate risk position are submitted to the respective risk management committees on monthly basis and regulated in the banking book interest rate risk management policy.

Special emphasis is also placed on the management of liquidity and cash-flow risks, due to the high importance of maintaining the Bank's liquidity and disponibility and ensuring the safety of customer deposits constantly.

Among the various price risks, the Group is predominantly exposed to the changes of currency exchange rates, as well as as well as the changes of the market values of securities. The Group aims to hedge its FX positions in the frame of the trading book activities performed by the Treasury.

X. Research and development

In 2018 and 2017 the Bank had no own research and development and did participate in the financing of any research projects.

XI. Employment policy

In 2018 the key focus areas from Human Resource management point of view were reducing the fluctuation of the workforce and strengthening recruitment process considering the unfavorable labor market trends; supporting women career path; and improving the digital knowledge of CIB's colleagues.

The Hungarian labor market was still characterized by labor shortage in 2018, and yet CIB HR could maintain its recruitment effectiveness with the help of the new tools and channels introduced already in 2017. The employee referral program still appears to be a successful recruitment source; our cooperation with the newly contracted headhunter partners has also been fruitful; and HR could also fill several beginner and trainee positions in the frame of partnerships with universities. The IT and business trainee programs closed successfully as well; most of the trainees finishing the programs continued to work in junior positions at CIB Bank. In 2018 autumn CIB launched three new trainee programs aiming to provide source for succession in the most critical areas. In addition, CIB further strengthened their external employer branding communication in the social media.

A new focus area of 2018 was supporting women career path. The aim was to support the career management of women by giving them information, sharing best practices and providing consultancy, with special focus on supporting the reintegration of the maternity leavers. In the frame of the so called Womentoring initiative, CIB HR organized events, hosting guest speakers both from inside and outside the Bank, who inspired women colleagues with their examples. The first CIB Womentoring Day was organized for the maternity leavers, who plan to return to work soon. They got information about the changes in the organization, about the current open positions and they also received useful advice regarding the challenges ahead of them. Additionally, the Bank aimed to promote and expand flexible working, which can be especially important for CIB's colleagues with children. The Bank launched a two-week long, intense Flexibility campaign targeting our managers to initiate a dialogue about how to better meet the needs of our employees for flexibility.

The internal employee engagement programs known as 'CIB Spirit' were continued in 2018, e.g. summer camp contribution to employees' children; sabbatical leave; 'See You In the Branch' program; CIB Spirit Day; Children in the Office; TOP Sales and TOP Support gala event. Besides these new initiatives were started, some of which were initiated at the CIB Idea Campus 'hackaton' event for employees as employee proposals. In 2018 there was the 'Children in the office Club' for the first time, a daycare for our colleagues' children during the Easter and Autumn school holiday.

In 2018, more than 30 colleagues successfully finished the 4th Leadership Talent Program of CIB Bank; and quite a few of the Bank's employees got admitted into the International Talent Program initiated by Intesa Sanpaolo Bank.

One of the main strategic directions of 2018 was to strengthen innovation and digitalization. To improve the employees' digital knowledge and skills, comprehensive initiatives were implemented. Such as trainings and presentations about the hottest trends of financial digitalization, involving guest speakers; during the 'Digital Scene Investigators' program our SME customers hosted CIB colleagues to show their innovative solutions to the colleagues. In the second half of the year, the Bank has launched a special learning program, called „Digital Galaxy" through an online gamification platform. The colleagues have learned about modern technological innovations, the basic definitions of digitalization, the latest developments making everyday life easier, as well as the latest innovations of CIB within this platform.

Regarding other work-related benefits, in 2018 the Bank completed the change of employees' mobile phones to new models, continued the renewal of our car fleet, and signed a contract with GreenGo, a company providing carsharing services with electronic cars.

XII. Sites of operation

The Banks head office is located at 1027 Budapest, Medve u. 4-14.

XIII. Corporate governance policy

In keeping up with the applicable national and EU regulations CIB Bank and its subsidiaries comply, without exception, with the rules set out therein, including those on corporate governance. The national and EU norms are made available to the public via the www.magyarkozlony.hu and the http://eur-lex.europa.eu websites, respectively.

Consistent professional governance within CIB Group takes place in accordance with the "Principles of the professional governance and operation of CIB Group" policy, which defines also the guidelines for the running the organisation.

The Bank's parent company issues group-level policies at predetermined intervals and on specified topics, which are enforced and implemented by the Group in accordance with the applicable "Policy on the Implementation and Issuance of Group Policies".

The Bank operates a responsible internal governance system, in which the individual governance and supervisory functions are clearly separated from one another. The governance functions are carried out by the Management Board and Governance Committees, while the control functions are performed by the Supervisory Board, the Audit Committee, Internal Audit and Validation, as well as through second-level and various built-in process controls. The external control function of the Bank is performed by the Auditor.

The **Sole Shareholder** practices the rights of the General Meeting which is the Bank's supreme decision-making body. The Sole Shareholder makes decisions in writing in the authority of the supreme decision making body, which becomes effective as soon as it is communicated to the Management Board. The Sole Shareholder makes decisions in accordance with the Bank's Statutes and the relevant statutory regulations. The Sole Shareholder chooses the members of the Management Board, as well as the executive entitled to use the title of CEO, from the members of the Management Board. Decisions falling within the Sole Shareholder's exclusive scope of authority are comprised by the Bank's Statutes.

The **Management Board** is the Bank's management body. Its members are chosen by the Sole Shareholder practicing the authority of the supreme decision maker in keeping with the Bank's Statutes. The Management Board has its own rules of procedure. The duties of the Management Board include making all decisions related to the management of the Bank that are outside of the Sole Shareholder's scope of authority, in accordance with the law or the Bank's Statutes.

The **Supervisory Board** is the Bank's highet controlling body. Its members are chosen by the Sole Shareholder practicing the authority of the supreme decision maker. The Supervisory Board has its own rules of procedure. It is the duty of the Supervisory Board to oversee the Bank's executive management and administrative procedures, business management, trading and other relationships, in accordance with the provisions of the Bank's Statutes.

The **Audit Committee** is a body that supports the professional activities of the Supervisory Board with respect to internal audit tasks. The Audit Committee's members and rules of procedure are defined by the Sole Shareholder practicing the authority of the supreme decision maker. The committee's duties include the review of the auditing process, internal and external control and risk management system.

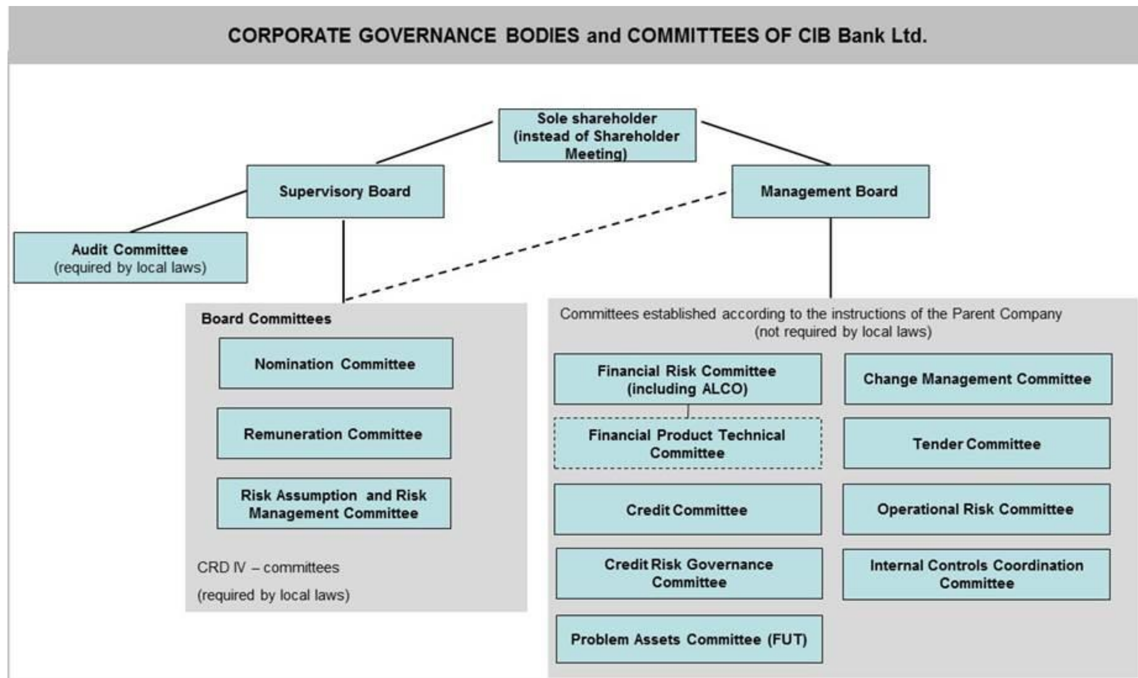
The **Remuneration Committee** operates based on the Constitution and upon 117. § (6) of Act CCXXXVII of 2013 also known as the Hungarian Banking Act (Hpt.). Remuneration Committee's members and rules of procedure are decided by the Supervisory Board. The Committee's duties include overseeing and preparing decisions regarding the remuneration of the members of the management board, Key People (as defined in the Remuneration Policy) performing internal control functions in compliance with the relevant legislation, supervisory guidance and Intesa Sanpaolo Group Remuneration Policies and preparing decisions regarding the remunerations and the Remuneration Policy.

The **Nomination Committee** operates based on the Constitution and upon 112. § of the Hungarian Banking Act (Hpt.). The Committee's duties include recommending the appointments of the members of the Management Board and the Supervisory Board to the Sole Shareholder and also the re-assessment of the suitability of the members.

The **Risk Assumption and Risk Management Committee** operates based on the Constitution and upon 110. § of the Hungarian Banking Act (Hpt.). The Committee's duties include supporting the Management Board and the Supervisory Board to define the risk appetite framework and the risk strategy of the Group and in the implementation of the approved risk strategy.

Other governance committees are established on the basis of the resolution of the Management Board (in line with the Bank's Statutes). The scope of authority and the operating procedures of these committees must be stipulated by a Policy that is approved by the Management Board. Governance Committees are the individual decision-making initiating, proposing and opining bodies depending on the responsibilities assigned by the Management Board. Governance Committees may operate along with Subcommittees and sections.

The members, operation and decision making competencies of governance committees are regulated in a separate policy.



Currently CIB does not have a policy on diversity within the management body of the Bank. Pursuant to the legal requirement, in October 2014 the Nomination Committee discussed the target ratio for the representation of the underrepresented gender in the management body of the Bank. The Parent Company's standard approach applicable to foreign subsidiary banks of ISBD is in the process of elaboration, therefore the Committee decided to revisit the issue subject to the availability of such standard approach.

Internal Audit

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Mission:

- To ensure a continuous and independent supervision over the conduct of business and the processes, in order to prevent or detect any irregular practices or risky behaviors / situations;
- To ensure the efficient and effective management of the Company's processes, the safeguard of assets and protection against losses, reliability and integrity of the accounting and operational information, the compliance of operations with the policies established by corporate governance bodies and internal and external regulations;
- To provide consulting support to the Company and Group functions, also by participating in projects, with the aim of adding value and improving the effectiveness of control, risk management and governance processes of the organization;
- To ensure the supervision over the Internal Control System of subsidiaries, including governance and guidance activities for the relevant Internal Auditing Functions;

XIV. Non-financial statement

CIB Group consist of CIB Bank and its subsidiaries out of which CIB Bank has the determining role. Consequently numerical information in this chapter is largerly applicable to CIB Bank's own operation.

Our sustainability principles, reporting

Since 2005, every year CIB Group has prepared its sustainability report in line with the GRI international reporting guidelines, which is supplemented with the below brief report prepared in conjunction with financial statements.

The CIB Group has organically integrated the fundamental principles of sustainability into its basic operation and corporate culture, and, just like our parent company, we believe that the best practice is for these to be reflected in the processes and day-to-day operation of an organisation.

We performed our activities and the development of our business processes last year based on the targets defined in our strategy that was last overhauled in 2013. We took a firm decision to concentrate on expanding our lending activity, improving the range and quality of services, and growing our customer base. With solid support from our parent bank, the main points of focus continue to include our efforts to be a bank that provides our highly discerning retail and corporate customers with services that always stand out from the crowd. We believe that long-term sustainable growth can only be achieved through the fulfilment of these objectives.

In the course of our operation last year, we continued our projects aimed at retaining our staff and supporting the professional development of exceptionally skilled employees, and aligned our corporate culture with our business objectives. We made significant efforts to strengthen our staff's commitment and motivation and we sought to involve them not only in the implementation of strategy, but also in the social and environmental protection programs and energy saving initiatives of the Bank Group. Through a variety of direct and indirect initiatives, which have been running for many years, we have assisted approximately 65,000 people in need by holding numerous volunteering programmes and as a result of projects organised with the help of our civil-sector partners.

Our sustainability reports have been prepared in compliance with the international guidelines of the Global Reporting Initiative (GRI) The report, which is published during the year as a stand-alone publication, contains the essential topics, examining them primarily from the point of view of our main stakeholder and our report's target group, the customers. For the 9th year running, our report also describes the fulfilment of the principles set out in the UN Global Compact.

Assessment of the business model

With its 40 years of expertise in universal banking, CIB Bank offers the full range of commercial banking and investment services, supplemented by products and solutions offered by its subsidiaries. In addition to offering standard commercial services to almost 425,000 customers through its nation-wide branch network, CIB continues to seek innovative solutions tailored to customer needs. Its services are available to businesses, institutions, municipalities and sole traders, besides retail customers. In addition to the bank's branches, customers also have a wide variety of electronic channels to choose from, to manage their finances quickly and conveniently, such as the revamped official website - where a fully online end-to-end account opening is available - CIB Online, CIB Internet Bank, CIB Mobile Application or eBroker, the Bank's information and securities trading system.

Based on the four-year strategy set out for CIB Group in 2018, our objective is to become the primary financial service provider of larger basis of customers. At the center of the strategy is the simplification of banking processes, the increase of customer satisfaction and the digitalization which becomes core in the future sales and service model.

Ethical norms, rules of conduct

We wish to achieve our goals while observing, and putting into practice, the principles of sustainable development and responsible operation, which is founded on our seven core values, described in detail in the sustainability section of our website. The fulfilment of these requirements is assured by our advanced corporate governance system and decision-making processes.

As a company that operates in compliance with strict ethical norms, we have put in place a number of mechanisms that reveal risks previously undetected, due to their nature, including ethical risks. The purpose of these procedural rules is to enable victims in ethics cases to ask for help, to consult and request advice, before taking action if needs be, and to do so in an anonymous manner. An Ethics Committee operates at the CIB Group, and its chairperson, who also functions as the ethics ombudsman, is the Bank's CSR head. The Code of Conduct is a means of articulating, in the form of regulations, the values enshrined in the Code of Ethics. The rules ensuring ethical conduct, with a special focus on corruption-free and discrimination-free operation, are incorporated into the Bank Group's regulatory system in the form of a policy, the breaching of which may have consequences under labour law. The key areas of our responsible corporate governance also include the efforts

to combat money laundering and financing of terrorism, the avoidance of conflicts of interests, risk management and internal auditing, all of which are overseen by named responsible persons. More details about responsible corporate governance, the operation and diversity of the ethics system, and past complaints can be found on our website.

Stakeholder dialogue

In the course of our stable operation and in implementing our trust-based growth strategy that offers real opportunities, maintaining a continuous dialogue with our stakeholders is essential. We regard as our stakeholders all those who may be affected by the activities and operations of the bank, and/or who may have an effect on our organisation. Of these, the following three groups are of critical importance from the perspective of our operation: employees, customers and the owner. Besides these three priority groups, we have identified further stakeholder groups, which are: suppliers, civic organisations, local communities, professional organisations and supervisory, regulatory institutions. Our definition of community relations includes our relationships with professional organisations (associations, trade federations, chambers) and the third sector (non-profit organisations, foundations, local communities), and the members of the local communities themselves. We come into contact with our stakeholders using various communication tools and via many different channels. The most important of these are also highlighted in this report, while a more comprehensive overview is available on the website.

Human rights

HIGHLIGHTS

- We have made a commitment to protect human rights in accordance with the 1948 Universal Declaration on Human Rights of the UN. We expect all of our Hungarian and foreign partners to do the same.
- In the course of its operation our Bank fully respects the Fundamental Law of Hungary and all other general domestic and international conventions on human rights and ethics.
- We treat protecting the personal data of our customers as a key priority; we investigate complaints related to data handling, and take steps to reduce the number of complaints to a minimum.
- We provide our employees with fair and satisfactory working conditions and pay, as well as a wide range of other benefits. The average starting monthly wage is nearly double the statutory minimum wage.
- In 2018, we continued with the implementation of the Code of Ethics and Rules of Conduct based thereon, and continued operations based on the acceptance of procedures and the system.
- We are committed to eliminating all forms of discrimination from our conduct and to respecting differences in gender, age, race, religion, political and trade-union alignment, and language, and to respecting the rights of those with disabilities.
- Our branches are 100% accessible to persons with disabilities.

Relevant considerations and their detailed explanation

In addition to abiding by the relevant laws, CIB Bank strives to identify, mitigate and prevent – where possible – any human rights abuses related to its activity, in accordance with the recommendations enshrined in the relevant UN guiding principles governing business and human rights. Its parent company, Intesa Sanpaolo, adopted a specific policy on human rights, which was approved by its Board of Directors in December of 2017, takes into consideration the principles already present in the Code of Ethics, specifically declaring that

- it is committed to helping safeguard human rights in accordance with the principles of the Universal Declaration of 1948 and in subsequent international conventions on civil and political rights and on economic, social and cultural rights;
- it recognises the principles set out in the ILO (International Labour Organisation) fundamental conventions, particularly the right of association and collective bargaining, the ban on forced and child labour and the elimination of discrimination at work;
- it contributes to the fight against corruption, supporting the OECD (Organisation for Economic Cooperation and Development) guidelines and the anti-corruption principles issued by the United Nations in 2003, including through a “zero tolerance” approach to any cases of corruption.

The same human rights policy was adopted in CIB Bank during 2018.

CIB Bank is committed to supporting human rights in all cases where it recognises that its activity can have an impact; therefore, it has identified areas of responsibility as regards all the groups – employees, customers, suppliers, communities – that are affected by its activity. Considering that the issue of environmental protection ties in strongly with the issue of human rights, supporting strict environmental regulations can also be regarded

as a key measure leading to the respect and enforcement of human rights. The area of impact is quite wide-ranging, and can be summarised as follows:

- respect for the rights of employees;
- respect for the rights of customers (in particular to privacy, health, security and non-discrimination);
- respect for the rights of suppliers (in particular to health, security and non-discrimination);
- respect for human rights throughout the supply chain (in particular, avoiding trade relationships with suppliers that violate the human rights of their employees or that of their wider communities);
- respect for human rights as regards financing activities, capital investments, and customer services (including the areas of risk assessment, having special regard to high-volume projects and enterprises operating in sensitive sectors).

We are especially mindful of those who are most vulnerable, both through the different forms of community support and through projects targeting financial integration.

Process of monitoring relevant considerations

Ongoing compliance with and application of the protection of human rights are monitored by the Compliance, Human Resources and CSR departments, by way of the below procedures:

- by way of the monitoring of compliance with the Group's Code of Ethics, in accordance with international corporate social responsibility related standard ISO 26000, and in particular the areas related to the topic of human rights;
- by way of the sustainability report that encompasses the inclusion of stakeholders and identifies development goals and the related metrics;
- by analysing the potential areas of risk within human rights, which analysis sheds light on the possible effects that the company's activities can have – in light of the individual principles set out in international conventions – on the stakeholders and the relevant corporate regulations.

The Code of Ethics mailbox (etikaibejelentes@cib.hu), under the jurisdiction of the Ethics Committee, represents another guarantee for all stakeholders, which can be used by all to report any rights violations with the guarantee that any reports made will be treated confidentially and will not result in retaliation.

A few important indicators as at 31 December 2018

- Proportion of male and female employees at the various levels of seniority (%):

	male	female
manager	54.1% (2017: 58.7%)	45.9% (2017: 41.3%)
specialist	47.9% (2017: 45.1%)	52.1% (2017: 54.9%)
colleague	26.8% (2017: 26.5%)	73.2% (2017: 73.5%)

- Workplace accidents and the number of working days lost as a result (days) 10 accidents and 318 days (2017: 15, 267)
- Number of ethics complaints made due to violations of the right to privacy: 0 (2017: 0)
- Donations made to vulnerable and underprivileged groups (Hungarian forints): HUF 14,4 million (2017: 20 million HUF)
- Child financial literacy education activities: Pénz7 (Money Week), World Savings Day (child financial literacy education programme week) (2017: same)

Social and labour affairs

HIGHLIGHTS

- The Bank abides by the laws of the country and the relevant passages of the Fundamental Law of Hungary and complies fully with the Labour Code.
- The organisation regulates matters that affect every employee equally in the Human Resources regulations.
- An employee trade union is in place and in May 2016, the Works Council was formed, which now operates with 10 participants.
- We declared in our Code of Ethics that we are committed to eliminating all forms of discrimination from our conduct and to respecting differences in gender, age, race, religion, political and trade-union alignment, and language, and to respecting the rights of those with disabilities.
- Our organisation is willing to appoint physically disabled staff to certain positions.
- Achieving gender equality is important to us and our objective is to fully comply with the principle of "equal pay for equal work".

Relevant considerations and their detailed explanation

Equal treatment and diversity

The Bank also clearly defines its key principles related to responsible practices in its Organisational and Operational Regulations (OOR). Through this, the Bank rejects all forms of discrimination and corruption in both its internal and external communication, prohibits any form of discrimination and guarantees the general requirements of equal treatment in accordance with the relevant EU guidelines. Besides the above, the regulations governing compliance and risk management activities also proclaim similar principles aimed at supporting responsible operation.

CIB Group ensures equal treatment for its existing and future employees in accordance with the Fundamental Law of Hungary, the effective statutory provisions and the Bank Group's Code of Ethics. This is achieved through the transparency of decision-making processes within the company and the ethical training provided to both managers and employees. The examination of ethical issues associated with this topic and the subsequent preventive changes ensure legal and ethical compliance in this area.

We ensure equal treatment for all existing and prospective employees, but at the same time we also give special consideration to ensuring work opportunities for people with disabilities and disadvantaged workers, and to creating a level playing field for these individuals. In connection with this, as on previous occasions, it was decided that the downsizing should not affect any employees who are in some way disadvantaged or living with a disability. Where necessary, we adapt the hiring process to accommodate the special needs of people with altered abilities. Through these measures, we ensure the diversity of our staff.

Remuneration and Pay

We carry out the classification of salaries based on several criteria. We examine what sort of complex tasks the job entails, we look at the level of demand for the particular job in the labour market, and we also check the salary curve to date by looking at when it was that the employee was hired for the position, what sort of experience he or she has, and what sort of performance he or she has delivered over the course of the work.

The wide-ranging system of fringe benefits is an important part of our remuneration strategy. The sum of the benefits package provided under the Cafeteria system has been raised significantly in 2018. Part-time workers continued to be entitled to Cafeteria benefits on a pro-rata basis.

Trade Unions

A trade union and a Works Council exist in CIB Bank. Representatives of the trade union and the works council make up what is known as the Social Committee, whose task is to manage certain forms of social assistance that we provide to employees. The Works Council and the Employer decide on the utilisation of welfare funds together, the Works Council assesses any planned employer measures that would affect a large group of employees, delegates employee representatives to the Supervisory Board of the Bank, engages in consultations prior to the decision of the Employer to carry out collective redundancies, and consults with the Employer regularly on basic issues affecting workers' economic situation, such as changes in wages.

Health at Work

Participation in all the periodic vocational and professional suitability and fitness tests prescribed by law continued to be compulsory for all of our staff in 2018. In keeping with the practice of previous years, for managers above a

certain grade we continued to provide executive medical screening as part of the annual occupational health examination, due to the higher-risk environment.

Performance Assessment

Since 2012, a new, revised, performance assessment system ("TÉR"), valid in respect of all employees, has been in operation at the Bank. During the performance assessment period, a series of panel discussions held throughout the organisation ensure the consistency of the evaluations between the management levels and the individual divisions. Every employee in the Bank is given an assessment of their performance and an overview of their career opportunities.

Our career management system continues to operate, closely linked to the TÉR processes, with the main objectives of the system being for us to identify and retain our talented members of staff, for every employee to have the opportunity to carefully consider what career path he or she would like to follow within the CIB Bank Group, for managers to deliberately plan succession within their team, and to promote career mobility among the various divisions.

Process of monitoring relevant considerations

Ongoing compliance with and application of the protection of social and workers' rights are monitored by the Compliance, Human Resources and CSR departments, by way of the below procedures:

- At the level of the Intesa Sanpaolo Group, by way of the monitoring of compliance with the Group's Code of Ethics, including the assessment of third parties, in accordance with international corporate social responsibility related standard ISO 26000, and in particular the areas related to the topic of occupational safety rights.
- By way of the sustainability report that encompasses the inclusion of stakeholders and identifies development goals and the related metrics.
- Through regular and ad-hoc, official consultations between the Works Council, Human Resources, and the Chairman & CEO.
- We are monitoring changes in our corporate culture and our colleagues' opinion by conducting regular employee satisfaction surveys.

The Code of Ethics mailbox (etikaibejelentes@cib.hu), under the jurisdiction of the Ethics Committee, represents another guarantee for all stakeholders, which can be used by all to report any rights violations with the guarantee that any reports made will be treated confidentially and will not result in retaliation.

Main indicators as at 31 December 2018

- Number of employees of the CIB Group, per level of seniority (persons):

colleague	1,211	(2017: 1,253)
specialist	537	(2017: 548)
manager	196	(2017: 213)
Total	**1,944**	**(2017: 2,014)**

- Standard deviation of salaries from market median at CIB Bank broken down by gender and seniority category (%):

	male	**female**
colleague	99.1% (2017: 96.68%)	97.0% (2017: 95.65%)
specialist	90.5% (2017: 94.47%)	88.7% (2017: 91.40%)
manager	82.6% (2017: 90.39%)	83.8% (2017: 89.19%)

- Average number of training hours (hour/person) 56.57 (2017: 32.23)
- Ratio of part-time employees (%): 4.3% (2017: 3.1%)
- Percentage ratio of trade union member employees (%): 7.9% (2017: 9.2%)
- Number of workplace accidents (number): 10 (2 workplace accidents and 8 traffic accidents) (2017: 15, 4, 11)

Anti-corruption, conflict of interest

HIGHLIGHTS

- The Bank has approved the Code of Ethics and the Code of Conduct setting forth the standards of behaviour that are expected of our employees, which also has a section devoted to the prohibition of corruption.
- Our conflict of interest regulations are stricter than the national requirements.
- All employees of the CIB Group have received training in the prevention of money laundering, financing of terrorism, anticorruption and conflicts of interests, through the e-learning interface (MultiLearn) accessible via the internal network.

Relevant considerations and their detailed explanation

In terms of responsible banking operation, clearly defining responsibilities, and in certain cases – depending on the relative importance of the given function – creating a separate organisational unit, is of key importance. We regard legal compliance – especially with respect to the prevention of market fraud and money laundering – and the appropriate management of the risks arising from our operation as being of particular importance.

The functions supporting compliance with EU guidelines and legislative requirements ensure responsible operation, a key tenet of which is the effort towards corruption-free operation.

A separate team of specialists coordinates anti-money laundering activities and activities against financing of terrorism. They have the task of checking transactions that are relevant or risky from the perspective of money laundering and sanctions, authorising the opening of accounts for new customers and reviewing existing customer relationships, as well as providing training for employees in the prevention of money laundering, forwarding reports to the competent authorities, and ensuring the necessary flow of information.

The obligatory Code of Conduct, which was approved in 2008, and the Anti-corruption Regulations issued by Intesa Sanpaolo in 2017 include a set of rules on the prohibition of corruption. As a part of its efforts to mitigate the risk of corruptive behaviors – in keeping up with the relevant guiding principles of Intesa Sanpaolo –CIB Group does not, in any way, support politicians or political parties, or institutions with which they are associated. The "principle of zero tolerance" towards corruption applies to our employees, suppliers and other external parties.

Internal Audit is an independent and objective, corroborative and advisory function, the purpose of which is to improve the operations and effectiveness of the given organisation. In order to assist in achieving the organisation's stated objectives, the Internal Audit function methodically and systematically assesses and improves the effectiveness of the audited organisation's governance and control procedures.

Our internal policies set out stricter rules on conflicts of interest than the provisions of Act CXXXVII of 2013 (Credit Institutions Act), Act CXXXVIII of 2007 (Investment Firms Act) and Act I of 2012 (Labour Code).

The purpose of the risk management function is to identify the risks of the given organisational unit, to measure the identified risks and manage them to ensure that they do not jeopardise prudent operation or the fulfilment of business objectives. At CIB Group, e Risk Management department is responsible for these activities.

It is important for us to promote ethical behaviour within our industry by exhibiting fair market and competitive conduct, leading by example, and through participation. We adhere to the self-regulating approach adopted by the industry and apply this to our own operations, while acting ethically towards our competitors. Fair competitive market conduct serves as the basis for our pricing policy.

Process of monitoring relevant considerations

- Our corporate governance regulations, process requirements and internal training courses ensure that our employees do not fall victim to or become involved in corruption. Our staff receives training and information on this topic as part of our ethical training course, while our compliance systems ensure these anti-corruption rules are enforced in practice through various compliance checks.
- Our employees take part in distance learning courses and examinations on the prevention of money laundering, conflicts of interest and security awareness via the e-learning platform accessible via the intranet, as well as through in-person training courses.
- The controlling of conflicts of interest is performed by the independent Compliance unit.
- The Compliance unit also performs the controlling and recording of gifts accepted by employees. The main principles governing the acceptance of gifts are zero tolerance and exceptionality. The acceptance of gifts can, in certain cases, be classified as corruption.

The Code of Ethics mailbox (etikaibejelentes@cib.hu) and postal address, under the jurisdiction of the Ethics Committee, allowing the reporting of any reports, questions, comments represents another guarantee for all

stakeholders, which can be used by all to report any rights violations with the guarantee that any reports made will be treated confidentially and will not result in retaliation. As an additional guarantee the Compliance and Internal Audit departments are also available for this purpose at compliance@cib.hu and belsoellenorzes@cib.hu.

Main indicators as at 31 December 2018

- Percentage of employees that have attended and got certified through distance learning courses one prevention of money laundering topics (compared to total Group population): 91% (2017: 77%)
- Number of employees that attended in-person training courses on the prevention of money laundering: 97 persons (2017: 231)
- Number of ethics violation reports related to suspected corruption: 0 (2017: 0)

Enviromental protection

HIGHLIGHTS

- The ISO 50001 standard was introduced at the end of 2016 and was certified by an external audit company.
- We continue to perform the energy efficiency objectives (installing LED lights in the bank branches, UPS optimisation, server cooling setting, replacement of heaters and air conditioners).
- Riding a bike to work remained popular, and our bicycle storage facilities were used to their full capacity last year as well.
- When preparing and implementing the training programs we take special care to respect the values of our natural, economic and social environment, and make an effort to manage our resources responsibly and without waste. To this end we give preference to electronic communication (e.g. in the process of sending out invitations, information or training materials), and where paper-based documentation is absolutely necessary we produce this economically, with double-sided printing.
- In 2018 we achieved selective waste collection in our head offices. Every year, the volume of hazardous waste is reduced, and most of it is reused (restaurant fats are recycled).
- We plan to build chaging points for electric cars.
- We established a partnership with the e-car sharing provider GreenGo in order to decrease our environmental footprint originating from taxi services.
- CIB Group first joined Earth Hour, WWF's international climate protection initiative in 2010. In 2018 we again committed to turning off lights wherever it was technically feasible in our central buildings during Earth Hour, highlighting the importance of climate and environmental protection.

Relevant considerations and their detailed explanation

We aim to use all our resources sparingly. In this regard we promote conduct that is based on the best use of resources and on the avoidance of waste and ostentation. We give priority to solutions that have been designed with sustainability in mind.

In December of 2016, CIB Bank adopted its energy policy, in which it has declared the following:

- we are committed to complying with all the legal requirements and other commitments undertaken in relation to energy management;
- we are continuously working toward improving our performance indicators and our energy management system;
- we are committed to ensuring that all necessary information and resources are available so that we are able reach our energy management goals;
- as a key component, energy efficiency will be integrated into our procurements, renovation, and building plans;
- we strive towards preventing pollution, reducing our ecological footprint and energy consumption by raising our colleagues' environmental awareness.
- we encourage our colleagues to engage in creative cooperation aimed at the realisation of our corporate objectives and improving the effectiveness of processes.

In certain contracts we stipulate that in the course of fulfilling their obligations suppliers are obliged to use environmentally friendly technology, products and materials, and make efforts to recycle the waste that is generated. We have launched numerous initiatives aimed at reducing energy and water consumption, including the installation of solar panels on the roofs of our central office buildings, in order to cut down on the use of non-renewable energy sources. We continue to perform the energy efficiency objectives (installing LED lights in the bank branches, UPS optimisation, server cooling setting).

- ***Introduction of the ISO 50001 Standard***

In 2016, CIB began the introduction of the ISO 50001 energy management system standard. In addition to it being a legal requirement, the introduction of this standard is also a means to improving corporate energy efficiency through regulated and monitored energy management, therefore, it is justified by both management expectations and professional reasons.

The main goal is to reduce energy costs, green-house gas emissions, and other related detrimental environmental impacts. It is essentially a means of creating a systematic framework for energy management activities, while it is based on the cyclical review of the plan-do-check-act (PDCA) process.

The introduction and continuous operation of the standard is sponsored by a management representative (CFO), while the introduction is performed by the energy team, whose members comprise colleagues from Realty Services, Communication and CSR, Human Resources, Procurement, IT and Process Development. Colleagues appointed from Network Coordination and Realty Services support this team in their operational tasks. A dedicated bank employee monitors energy management compliance with the standard, as an internal auditor, while operational decision preparations are undertaken by the members of theEnergy Team.

Process of monitoring relevant considerations

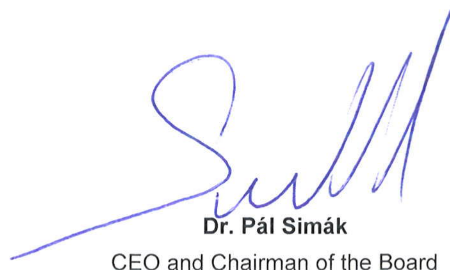
Ongoing compliance with environmental regulations and continuous application of commitments are monitored by the Realty Services, Human Resources and CSR departments, by way of the below procedures:

- by way of monitoring compliance with the Group-level Code of Ethics.
- compliance with international energy management system standard ISO 50001, audited by an independent third party;
- annual ISO 50001 certification in regards to every employee;
- by way of the sustainability report that encompasses the inclusion of stakeholders and identifies development goals and the related metrics.

Main indicators as at 31 December 2018

- Total energy used (GJ): 56,324 (2017: 50,980)
- Number of bicycle parking spots: 78 (2017: 78)
- Greenhouse gas emissions avoided through the use of solar collectors (tonnes, as carbon dioxide equivalent): 23 (2017: 23)
- CO_2 emissions from energy consumption per employee (t/person): 5,839 (2017: 4,527)
- Paper usage per employee - office A4, A3 - (kg/person): 108,739 kg / 1,980 persons =54.9 kg/person (2017: 95,422 kg/2034 persons =46.9 kg/person)
- Electricity usage (kWh): 10,008,122 (2017: 9,122,124)
- Other, renewable energy usage (kWh): 70,000 (2017: 70,000)
- CO_2 savings originating from e-car sharing service instead of taxi services since May 2018 app. 235 kg

18 February 2019



Dr. Pál Simák
CEO and Chairman of the Board

Dario Massimo Grassani
CFO

CIB Bank Ltd.